International Corporate Rescue – Special Issue

Transforming Capitalism from Within: A Relational Approach to Company Management and Operations

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4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

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ISSN: 1572-4638

Transforming Capitalism from Within: A Relational Approach to Company Management and Operations

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The corporate world is under pressure. It may be the repeat of the so-called 'shareholder spring' when shareholders in listed companies exercise their voting rights against the remuneration packages of executives. It may be zero hours contracts and low pay rates generally, long working hours and stress on employees. It may be the reality of companies consciously paying suppliers late in breach of contract terms with dire cash flow consequences for the suppliers. It may be payment of little or no tax in the UK by multinationals who generate significant taxable profits here. These are just some of the matters which exercise the minds of the Government, MPs, the media, academics and opinion formers on a daily basis.

It is not surprising that society as a whole has generally lost trust and confidence in the business world. Yet we all rely on companies for research and development, the manufacture of products, the sale of goods and services, jobs, including career progression and status, and, in many cases, our pensions. The cry frequently is that it is largely the fault of the short-term demands of investors in listed companies and their hunger for ever increasing dividend payments and capital growth. Many of us have investments in these companies through our pension funds and other monies yet we have no knowledge of the companies in which our funds are invested nor how they treat their employees, suppliers, customers and other stakeholders nor even how responsible they are to the society in which they operate.

Does the corporate world need to be like this, with society generally having to accept the status quo so long as good enough profits are earned no matter what impact company operations have on employees, suppliers and others? The current sticking plaster approach of more and more legislation and regulation imposed on companies to address particular aspects of corporate behaviour does little to bring effective and lasting change. This can often be put into practice by a formulaic box-ticking approach and it can stifle innovation and the entrepreneurial spirit of executives who want to develop companies. So perhaps the time is ripe to look at a different and refreshing approach which should benefit all stakeholders, as well as the company, and transform the view of society about the behaviour and standing of the corporate world.

In this Special Issue of *International Corporate Rescue*, Jonathan Rushworth, a retired City corporate lawyer, and Dr Arad Reisberg, reader in law at University College London, assess the current unsatisfactory nature of corporate behaviour and analyse some of the underlying causes. They suggest that the introduction in mid Victorian times of limited liability into company structures and the development of share trading markets, with no responsibility by shareholders for the company and its operations, is at least partly responsible for the current concerns.

They explain how the narrow shareholder focussed approach which company directors feel compelled to follow could be changed to embrace more directly the interests of all stakeholders, including shareholders, employees, suppliers, customers, regulators, lenders and the local community. This is not just a matter of improved corporate governance, through transparency by disclosure or ethical standards, they argue, but a plea for a complete change in culture from a largely financially-driven focus to a social capital approach. By putting the interests of stakeholders at the heart of company decision making and operations, they suggest that companies will become more competitive, stable and successful and generate greater returns for shareholders. Examples are given of the benefit of paying employees generously, ensuring they have time off to be with family, friends and the local community and recognising their contribution with bonus payments to reflect the success of the company. Engaged and incentivised employees are more likely to be more productive and loyal to the company and less likely to take time off for illness and other reasons. Similarly, if suppliers are treated fairly in negotiations of supply terms, and are paid on time or early, they would have greater commitment and loyalty.

Closer engagement and dialogue between shareholders and directors and other stakeholders, e.g. employees and suppliers, will, it is argued, lead to a sense of community so that all those involved with companies will respect the interests and concerns of others and help to generate more of a partnership approach within the corporate structure. This does not mean that difficult decisions will have to be avoided but they would be approached in a way which looks at the consequences on all stakeholders and not just on the financial driver.

The authors explain that the value of stakeholder relationships are increasingly recognised but there is a lack of an effective way to measure the quality of those relationships or how to introduce the relational ethos in a practical way into company decision-making and operations. After examining the Relational Proximity framework approach to understanding and analysing relationships between a company and its stakeholders, they suggest a number of ways in which this approach can be introduced into the corporate world. An assessment, based on information published by the company, could be carried out by an independent body which would show the extent to which a company has embraced a relational ethos in its operations and decision-making. Many companies might rate highly in such an assessment, but others would not in a number of respects. The exercise should encourage companies to recognise the benefits of, and adopt, the relational approach.

In addition, an investment fund could be established which would invest in companies which meet the criteria of a relational approach. Further, a group of investors, directors and others with an interest in company behaviour and performance could be established to develop an understanding of the relational approach and how it can be promoted in the business world.

If this approach is recognised as having a significant beneficial impact on how companies operate and their longer term competitiveness, stability and success, as the authors suggest, we could be on the threshold of introducing a different focus to company decision-making, management and operations. This could transform the way capitalism operates in the corporate sector, for the benefit of all those who rely on companies for their livelihood and wellbeing, and for society more generally.

Transforming Capitalism from Within: A Relational Approach to Company Management and Operations – Part One

Jonathan Rushworth, and Dr Arad Reisberg,[1] UCL Faculty of Laws, London, UK

Introduction

We have grown to expect much from the humble limited liability company. As an inanimate legal entity, it can be formed easily or bought ready made off the shelf for a few pounds.[2] Yet this entity, based on a simple but undeniably powerful concept conceived in the mid 19th Century, is expected to attract funding capital in the form of shares and loans, make products and provide services, provide employment, contribute to pensions, buy and sell assets, take on debts and other liabilities, sue and be sued and generate profits to pay shareholders. It may own other companies and may itself be owned by a company or individuals, or have its shares listed on a dealing exchange, domestically or overseas, with a widespread shareholder base. It has been called 'arguably the most important institution in the world'[3] and is the engine for economic growth and prosperity in numerous countries. It provides a vehicle for us to invest in, provides a livelihood for employees and a trading partner for suppliers and customers, pays tax to the Exchequer, and provides many other benefits to society. This is the capitalist model in a nutshell and it has over many years generally served society well.

However, something has gone wrong, in some respects fundamentally wrong. The corporate model has been tested and vigorously challenged by the recent financial crisis and continues to be challenged on a daily basis. Proposed remedies have been piecemeal, disjointed and largely inadequate, and imposed by new law and regulation. In particular, the remedies do not reflect an understanding of the underlying causes of the problems that have been identified.

Part One of this article considers some of the issues which are causing concern and suggests historical and structural reasons for this. It goes on to consider the effectiveness of attempts to address these issues. The article then suggests an alternative approach based on a recognition of the value and importance of relationships between a company and its stakeholders which is increasingly evolving and gaining momentum through academic research, with support from business leaders, Government and regulators.

Part Two develops the relational theme and how this is applied in a company context. It considers how a relational approach can change corporate culture so that companies could be run for the benefit of all stakeholders leading, in turn, to these companies becoming more competitive, flexible, stable and successful. The article outlines a method of assessment, through independent and objective means, to measure the extent to which a company has embraced the relational ethos in its operations and decision-making. Part Two concludes by suggesting ways in which the relational agenda, as explained in the article, can be pursued in a practical way.

Notes

1 Jonathan Rushworth practised as a solicitor at a major City law firm for over 30 years and was a partner in the firm for 26 years. He had a wide-ranging company and finance practice. Since retiring from practice he has been involved in charitable and historical projects. Amongst these he has helped to develop the concept of the relational company with Michael Schluter of Relational Research, based in Cambridge. For more information on relational companies refer to J. Rushworth and M. Schluter, 'Transforming Capitalism from Within: A Relational Approach to the Purpose, Performance and Assessment of Companies' found at <www.relationalresearch.org/Web/>.

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The authors would like to thank Eleanore Hickman for her excellent research assistance in the preparation of this article.

2 Companies are formed under the Companies Act 2006 by the adoption of Articles of Association, naming shareholders, appointing the first directors, a registered office and an accounting reference date and a name. Returns have to be filed at Companies House and that leads to registration. They can be bought ready made or 'off the shelf' from a number of businesses for less than GBP 50.

3 The quotation continues that the corporation is 'an institution that employs us and invests our savings, and is the source of economic growth and prosperity around the world. Yet the corporation has lost its purpose and become dominated by short-term financial concerns to the exclusion of all others and to the detriment of us as its customers, employees and communities.' Extract from C. Mayer, *Firm Commitment: Why the Corporation Is Failing Us and How to Restore Trust in It* (Oxford University Press, 2013); ibid. as reported in D. Wighton, 'Don't Let the "Quick Buck" Brigade Prosper' *The Times* (13 February 2013) <www.thetimes.co.uk/tto/opinion/columnists/davidwighton/article3686368.ece> accessed 23 June 2014.

A. What has gone wrong?

Hardly a day goes by without there being public criticism of some aspect of corporate behaviour. This may for instance be about levels of executive remuneration, stress levels of employees, late payment of suppliers or avoidance of tax payments on profits earned in the UK. These concerns may be raised by, for example, the press, regulators, Government, MPs, academics and other commentators. At times these concerns may be aired from inside companies, for example, by employees who serve in various managerial or other senior roles. They reflect the unease of society about aspects of the corporate world on which we rely in so many ways but which seems to reward itself generously whilst treating others badly. Companies and the directors running them seem to operate in a world remote from ordinary people and yet it is these people who invest in companies, and in some respects own them, through pension funds and other indirect investments. Some of the more significant concerns are considered below.

a. Short-termism

Many criticisms stem from the short-term demands of shareholders of listed companies. Quarterly reporting and pressure to maximise shareholder wealth drives the push for consistently increasing dividends and continued growth in capital value.[4] Many shareholders in listed companies view their investment as constituting a purely financial asset. This short-term approach can stifle long-term planning and funding of research and development and, ultimately, hinder progressive long-term, stable and steady growth.[5]

b. Lack of shareholder engagement

The powers to manage and operate companies are usually delegated, by virtue of the Articles of Association, from the shareholders to the directors. This can lead to the impression that the directors run the company as if they are owners but they do not have the responsibility of owners.[6] Directors have to comply with various laws and regulations but have limited obligations to refer matters to shareholders for their consent or approval.[7] Indeed, shareholders in listed companies rarely take much interest in the operations of the company, nor hold the directors to account. If problems arise in the company which affect the share price or dividend payments, the reaction of shareholders is often simply to sell their shares and thereby 'exit' the company, rather than use their voice to engage in dialogue with the directors and other shareholders to understand and address the issue.[8]

c. Excessive remuneration

Lack of engagement by shareholders has been one reason for the growth of the so-called 'bonus culture' and the excessive remuneration of directors loosely based on the financial success of the company. The argument has developed that, if the directors generate wealth for shareholders through dividend payments and capital growth, they should share in that wealth through the payment of bonuses: the so-called alignment of interests between the directors and shareholders. However, there have been increasing attempts by Government, the EU and shareholders to limit the scale of remuneration packages and particular concern over the differential between the highest and lowest remuneration levels in

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4 See J. Kay, *The Kay Review of UK Equity Markets and Long-Term Decision Making* (2012) 10-11 for findings of the causes of short-termism. The Government has accepted and endorsed much of this report (*Ensuring Equity Markets Support Long-Term Growth. The Government Response to the Kay Review* (Department for Business Innovation and Skills, 2012)). The European Commission has proposed a number of measures to stimulate long-term investment and thereby counteract short-termism (*Communication from the Commission to the European Parliament and the Council on Long-Term Financing of the European Economy* (European Commission, 2014)). See further A. Reisberg, 'The Role of Institutional Shareholders: Stewardship and the Long/Short term Debate', in *The Law on Corporate Governance in Banks* (Elgar Financial Law Series) (forthcoming).

5 The Kay Review made 17 recommendations aimed at encouraging long-term decision making, most of which have been or are being addressed (D. Oakley, 'Kay Review Chimes with Spirit of the Times' *The Financial Times* (23 July 2013) <www.ft.com/cms/s/0/a1461042-f09b-11e2-929c-00144feabdc0.html#axzz354UTNsfH> accessed 19 June 2014). For further discussion of short termism see S.G. Cox, *Overcoming Short-Termism within British Business. The Key to Sustained Economic Growth* (2013). See further A. Reisberg, 'Short Term v Long Term Dichotomy and the Elusiveness of the term Long-Term' (forthcoming).

6 This problem is commonly known as the separation of ownership and control and was first identified in 1932 by Adolf Berle and Gardiner Means. See A.A. Berle and G.C. Means, *The Modern Corporation and Private Property* (3rd edn, Macmillan, New York, 1932) 45.

7 Matters that require 75% shareholder approval include the alteration of articles of association (s21 Companies Act 2006) and reduction of share capital (s641 Companies Act 2006). Matters requiring a majority shareholder approval include the removal of a director (s 168 Companies Act 2006) and approval of transactions between connected persons (s190 Companies Act 2006).

8 This is very different to the approach in some other countries where there is often greater shareholder support. See D Green, 'In America, Pfizer Would Struggle to Launch a Hostile Takeover' *The Spectator* (21 May 2014) <blogs.spectator.co.uk/coffeehouse/2014/05/in-america-pfizer-would-struggle-to-launch-a-hostile-takeover/> accessed 11 June 2014.

companies.[9] There has been a considerable resurgence of the ‘shareholder spring’ of 2012. Investors have been protesting this year against the high remuneration packages of directors in a significant number of large corporations, including Barclays, AstraZeneca, HSBC, BP, Tesco and Royal Mail.[10]

Other investor and shareholder-based concerns include certain methods of share dealing. One of the most pertinent examples is short selling. This practice can have a damaging and sometimes destructive impact on listed companies.[11]

d. Employee treatment

Employees are often subject to demanding terms of employment, work long hours feeling under pressure and stress, paid the minimum wage (and not the living wage) and significant numbers are restricted in the hours they work by zero hours contracts.[12]

e. Suppliers and debt

There has been much criticism of the burgeoning practice of powerful companies delaying payment to suppliers for days or weeks beyond the contract date. Suppliers usually rely on payments being received from customers in a timely manner, and certainly by the contractually agreed date, in order to meet their own liabilities. Delays in payment mean that the supplier is involuntarily providing interest free credit and that can have critical cash-flow implications for the supplier.[13]

High levels of debt can cause concern for the stability of a company. The debt may have been incurred to help with cash flow, to expand the business, finance an

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9 The EU has passed the Capital Requirement Directive 4, which limits bankers’ bonuses to a maximum of twice annual salary, subject to shareholder approval (a bonus of one times the annual salary would not require such approval). It is due to come into force in January 2015. The concern over levels of remuneration is supported by a report which concludes that basing executive levels of pay on financial performance has ‘a strong negative impact’ on R&D investment (Corporate Governance practices and companies’ R&D orientation: evidence from European countries, Second draft December 2010, found at <iri.jrc.ec.europa.eu/documents/10180/13501/Corporate%20governance%20practices%20and%20companies’%20R%26D%20orientation%20-%20Evidence%20from%20European%20countries>). For a discussion of concerns over pay structures which align the interests of management and shareholders, see A. Smithers, ‘Poor Productivity Is No Puzzle’ *The Financial Times* (26 June 2014) < blogs.ft.com/andrew-smithers/author/andrewsmithers/> accessed 30 June 2014. Further, Vince Cable recently wrote to the chairs of all FTSE remuneration committees reminding them to act responsibly and exercise proper discretion in setting boardroom pay (J. Rankin, ‘Vince Cable Warns 30 Biggest Firms over Executive Payouts’ *The Guardian* (26 March 2014) <www.theguardian.com/business/2014/mar/26/vince-cable-warns-biggest-firms-executive-payouts> accessed 11 June 2014). It has also been reported that the recent merger of the Association of British Insurers and the Investment Management Association will give them greater authority on behalf of institutional investors to influence matters including executive remuneration (E. Dunkley, ‘ABI Investment Arm to Merge with IMA’ *The Financial Times* (11 April 2014) <www.ft.com/intl/cms/s/0/a092875e-c15e-11e3-97b2-00144feabdc0.html#axzz34L3vGNJO> accessed 11 June 2014).

10 J. Moore, ‘“Shareholder Spring” Reawakened as Fidelity Vows Pay Crackdown’ *The Independent* (13 January 2014) <www.independent.co.uk/news/business/news/shareholder-spring-reawakened-as-fidelity-vows-pay-crackdown-9054837.html> accessed 11 June 2014. See also B. Groom, ‘Gap Widens between UK Executive Pay and Results’ *ibid.* (23 January 2014) <www.ft.com/intl/cms/s/0/92a3db66-835b-11e3-aa65-00144feab7de.html#axzz34L3vGNJO> accessed 26 June 2014. Proposals are underway to develop ways in which bonuses can be ‘clawed back’ in order to discourage undue risk taking (M. Carney, *Inclusive Capitalism: Creating a Sense of the Systematic* (2014) 7).

11 Shorting is the practice whereby a dealer sells shares on the market with a view to depressing the listed price and then buys the same number of shares at the lower price. See for example M. Clinch, ‘Bazaar Trade? Short-Sellers Target UK Retailers’ *CNBC* <www.cnbc.com/id/101340722> accessed 11 June 2014. Other problematic types of share dealing include day trading.

12 According to the Office of National Statistics, working hours in the UK were the third longest out of a selection of the largest economies in Europe (see *Hours Worked in the Labour Market, 2011* (Office for National Statistics, 2011) 5). Workers in the UK also suffer high stress levels, with over 40% of all work-related illnesses in 2011/12 being attributable to stress (‘Stress-Related and Psychological Disorders in Great Britain’ (*Health and Safety Executive*) <www.hse.gov.uk/statistics/causdis/stress/> accessed 13 June 2014). With the increasing number of controversial zero-hours contracts, many employees feel mistreated, on the basis that they are required to be available to work but their employer is not required to give them any and they are only paid on an hourly basis for the time actually worked. This has lead to European censure (T. Milevska, ‘UK Reprimanded over ‘Zero-Hour’ Contracts’ (*EurActiv.com*, 8 May 2014) <www.euractiv.com/sections/social-europe-jobs/uk-reprimanded-over-zero-hour-contracts-301994> accessed 13 June 2014).

13 The Institute of Chartered Accountants in England and Wales report that 17% of businesses cite late payment as being a ‘business challenge’ *UK Enterprise Survey Report 2013* (ICAEW, 2013). A recent survey reported that nearly two-thirds of businesses consulted had late payments of 90 or more days in the previous 6 months (*The Times* 13 Jan 2014). The Department of BIS recently announced that a total of GBP 30bn of late payments is outstanding to SMEs (see *Building a Responsible Payment Culture* (Department for Business, Innovation and Skills, 2013)). GlaxosmithKline is one example of a company adopting late payment practices, see J. Tozzi, ‘Glaxosmithkine’s Latest Formula: Pay Suppliers Later’ *Bloomberg Business Week* (24 January 2013) <www.businessweek.com/articles/2013-01-24/a-new-glaxosmithkline-formula-pay-suppliers-later> accessed 11 June 2014. Further, Debenhams gave their own brand suppliers 24 hours notice on 16 December 2013 that they would reduce outstanding amounts due to suppliers and accounts for work in progress, as well as for future work, by 2½% (see L. Saigol, D. Robinson and A. Felstead, ‘Debenhams Enrages Suppliers with Christmas Discount’ *The Financial Times* (17 December 2013) <www.ft.com/intl/cms/s/0/c1ac148c-66fa-11e3-a5f9-00144feabdc0.html#axzz34Wgeu4al> accessed 13 June 2014). Mars has recently been reported to be proposing to increase terms to its suppliers from 60 to 120 days, a move that many of its suppliers will be unable to refuse (see R. Gribben, ‘Mars Accused of Delaying Payments to Suppliers’ *Telegraph* (20 May 2014) <www.telegraph.co.uk/finance/businessclub/10842989/

acquisition or for other reasons, such as the funding of a share buy back or the payment of a dividend to shareholders. Whilst the company is making adequate profits its income should be sufficient to pay interest on its loans and debt instruments and it should be able to refinance the debt when it matures. However, if there is a downturn in the market in which it operates or there are problems in its business, its income may not be sufficient to service its debt and a refinancing may be required or formal insolvency proceedings commenced. The potential consequences include redundancies, 'zombie companies',[14] and debt for equity swaps significantly diluting the interests of shareholders[15] or, in the case of insolvency, no retained value in the shares.[16]

f. Tax

Multinational groups paying little or no tax on profits earned in a particular country, often by sheltering tax liability through other companies and in other countries, has generated widespread concern and condemnation from Government, the media and the public generally.[17]

All these issues, and the attendant publicity, have led to distrust and loss of confidence in the traditional corporate model and how it operates.[18] Companies seem to be operating for the benefit of shareholders and directors but not for the benefit of other stakeholders nor society generally. Yet shareholders, who take the financial reward of their holdings, take no responsibility for the actions of the directors and the impact of how the company is run on other stakeholders (e.g. suppliers and employees) who rely on the company for their livelihood. Because of this absence of engagement or responsibility, shareholders have frequently been referred to as 'absentee landlords' and companies as being 'ownerless'.[19] The impression is given that those dealing with a company are only interested in achieving the best commercial terms and the highest possible financial return. There is no feeling of those with an

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Mars-accused-of-delaying-payments-to-suppliers.html> accessed 13 June 2014). The current Prompt Payment Code seems to be largely ineffective but new proposals encouraging prompt supplier payment were included in the Queen's speech (B. Groom, 'Business Welcomes Focus on Enterprise in Queen's Speech' *The Financial Times* (4 June 2014) <www.ft.com/intl/cms/s/0/6643ea44-ebdd-11e3-ab1b-00144feabdc0.html#axzz34Wgeu4al> accessed 13 June 2014). Many companies are choosing to use their unpaid invoices as security for borrowing, known as supply chain financing (J. Hughes, 'Groups Embrace Supply Chain Financing' *ibid.* (26 May 2008) <www.ft.com/cms/s/0/26020d64-2b4d-11dd-a7fc-000077b07658.html#axzz354UTNsfH> accessed 19 June 2014).

14 'Zombie company' has become a term used for companies with very fragile balance sheets which would not withstand changes such as rising interest rates (R. Atkins, 'Low Default Rates Display Uneasy Calm' *ibid.* (15 April 2014) <www.ft.com/cms/s/0/8732864c-c3c0-11e3-a8e0-00144feabdc0.html#axzz354UTNsfH>).

15 Drastic measures for refinancing in times of financial crisis include debt for equity swaps. A well known example is Marconi when in 2002 shareholders were the biggest losers in a debt for equity swap as they lost virtually all the value of their shares (J. Gapper, 'The Winners and Losers of the Restructure' *ibid.* (2 November 2002) <www.ft.com/cms/s/0/a4e54fe6-2c74-11d9-8339-00000e2511c8.html#axzz354UTNsfH>).

16 Concern about the levels of corporate debt have been around for many years (B.S. Bernanke and others, 'Is There a Corporate Debt Crisis?' 1988 Brookings Papers on Economic Activity 83-139). Recent examples of high levels of corporate borrowing include the acquisition of Cadbury by Kraft. Kraft borrowed USD 9bn to finance the acquisition of Cadbury (R. Cheyne, 'Kraft to Sell $9.5 Billion Debt to Buy Cadbury: Report' *Reuters* (4 Feburary 2010) <www.reuters.com/article/2010/02/04/us-kraft-debtsale-idUSTRE61334R20100204> accessed 19 June 2014). The liability to pay interest and refinance this is likely to have fallen on the combined Kraft and Cadbury group, with consequences on business planning and the inherent risks of a down turn affecting income levels.

17 Companies that have been the subject of recent tax related press attention include Starbucks (see T. Bergin, 'Special Report: How Starbucks Avoids UK Taxes' *ibid.* (15 October 2012) <uk.reuters.com/article/2012/10/15/us-britain-starbucks-tax-idUSBRE89E0EX20121015> accessed 15 June 2014), Amazon (see J. Garside, 'Amazon UK Boycott Urged after Retailer Pays Just £4.2m in Tax' *The Guardian* (9 May 2014) <www.theguardian.com/business/2014/may/09/margaret-hodge-urges-boycott-amazon-uk-tax-starbucks> accessed 15 June 2014) and Google (see V. Houlder and J. Smyth, 'Google UK Paid £11.2m in Corporate Tax' *The Financial Times* (30 September 2013) <www.ft.com/intl/cms/s/0/c6ff0ebc-29c4-11e3-bbb8-00144feab7de.html#axzz34sbaDazJ> accessed 15 June 2014). The Treasury is seeking ways in which tax avoidance of this kind can be prevented (V. Houlder, 'Company Tax Avoidance Reform Plans Unveiled' *ibid.* (11 June 2014) <www.ft.com/cms/s/0/e56d2af6-a289-11e0-9760-00144feabdc0.html#axzz34L3vGNJO> accessed 11 June 2014). A report from the House of Lords indicates that corporations can lower their UK tax liability through arrangements which include taking on debt through a British subsidiary, the manipulation of prices paid for transfers of goods between subsidiaries in different jurisdictions and the manipulation of royalty fees paid between jurisdictions (*Tackling Corporate Tax Avoidance in a Global Economy: Is a New Approach Needed?* (House of Lords Select Committee on Economic Affairs, 2013) 8). Tax avoidance of this kind is being targeted at an international level. The Organisation for Economic Cooperation and Development (OECD) is developing a template under which multinational companies will need to report on their allocation of income and tax payments (*Discussion Draft on Transfer Pricing Documentation and Cbc Reporting* (OECD, 2014)).

18 John Cridland, Director-General of the Confederation of British Industry (CBI), reported that research carried out by YouGov for the CBI has revealed that only about half of people think business makes a positive contribution to society. Further, whilst small firms are at one end of the spectrum so far as trust is concerned, big business and multinational corporations are very poorly trusted. See, J. Cridland, 'Trust Me, Bosses Know They Must Work Harder to Put Customers First' *The Times* (19 June 2014) <www.thetimes.co.uk/tto/business/columnists/article4123188.ece> accessed 23 June 2014.

19 P. Myners, *Speech to the Association of Investment Companies* (2009). The relationship of the shareholders to the company reflects an ownership interest in certain respects. However, it is not ownership in other respects, for instance, the shareholder cannot simply require an asset of the company to be transferred to it.

interest in the company working as a community for the benefit of all stakeholders and society generally.

Having considered some of the symptoms of the problem, it is important to highlight next some of the underlying causes. Following this will be a consideration of suggested remedies.

B. What are the underlying causes?

The limited liability structure for companies was introduced into law some 150 years ago.[20] The consequence was that responsibility for debts and other liabilities of such companies became limited to the assets of the company. If the company fails shareholders may lose the value of their investment but usually have no personal liability for the company's debts or other liabilities. This structure allowed investors to provide finance for a manufacturing, trading or service business with a view to making a financial return, without requiring direct involvement in, or responsibility for, its day-to-day operations. As a consequence, those investing as shareholders, particularly in listed companies, are not generally concerned about the underlying operation of the company and its impact on other stakeholders, beyond its survival and its ability to generate a financial return.

The development of the investment markets through shareholders trading in their shares has exacerbated this issue. Investing and dealing in shares has become a sophisticated, often computer driven, financial exercise. There is usually no direct knowledge or interest in the detailed operations of the company whose shares are traded. Neither is there interest in how the employees and suppliers, for instance, are treated or the impact of the company on society generally. Not only are shares bought and sold through dealers but they may be the subject of arrangements for trading mainly indirectly or artificially in shares, for instance through equity derivatives, contracts for difference, synthetic structures, structured products and shorting.[21] Many of these rely purely on a share or index increase or decrease in value for their investment purpose.[22]

Capital providers, who may, for instance, be individuals with funds to invest or company employees whose pension funds are being invested through pension fund trustees, tend to be indirect investors in listed companies. There is a chain of investment, in that the individual may instruct an independent financial adviser[23] who will invest the monies in funds that have investment managers who, in turn, invest in specialist funds that have their own managers. These funds will invest on a short or long-term basis in individual company shares. The original capital provider will not know, or probably care, where their funds are invested. There is therefore no real connection between the underlying company and the capital provider.[24] Of course there are some direct holdings in listed companies, for instance, investments by individual investors and some institutional investors, such as sovereign wealth funds and hedge funds.[25] However, direct shareholders are frequently intermediaries representing, through an

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20 At its inception, and ever since, limited liability has been controversial. *The Times*, on the 24 May 1824, said of limited liability 'nothing can be so unjust as for a few persons abounding in wealth to offer a portion of their excess for the information of a company, to play with that excess – to lend the importance of their whole name and credit to the society, and then should the funds prove insufficient to answer all demands, to retire into the security of their un-hazarded fortune, and leave the bait to be devoured by the poor deceived fish'. In contrast, the *Economist* said, on 18 December 1926 'the economic historian of the future may assign to the nameless inventor of the principle of limited liability, as applied to trading corporations, a place of honour' (see further P. Halpern, M. Trebilcock and S. Turnbull, 'An Economic Analysis of Limited Liability in Corporation Law' (1980) *University of Toronto Law Journal* 117-150).

21 With the exception of shorting, discussed at note 11, each of these investments creates an indirect link between the investment holder and the underlying company. This discourages investor engagement and encourages the view that investing in companies is purely about quick financial reward.

22 High frequency trading has been the subject of growing media scrutiny, see for instance C Flood, 'High Frequency Trading Is "a Growing Cancer"' *The Financial Times* <www.ft.com/cms/s/0/e579ec78-bf50-11e3-b924-00144feabdc0.html#axzz354UTNsfH> accessed 19 June 2014 and J. Fullerton, 'High-Frequency Trading Is a Blight on Markets That the Tobin Tax Can Cure' *The Guardian* (4 April 2014) <www.theguardian.com/business/economics-blog/2014/apr/04/high-frequency-trading-markets-tobin-tax-financial-transactions-algorithms> accessed 19 June 2014. Michael Lewis explains that the practice can involve trading platforms buying shares in the US market just before investors buy. This pushes up the share price marginally after which the software sells to the buyer at the inflated price (M. Lewis, *Flash Boys: Cracking the Money Code* (Penguin 2014)).

23 Independent financial advisers may be individuals, firms or companies who are qualified to provide such advice and are authorised by, and registered with, the Financial Conduct Authority.

24 Even this description of the indirect nature of shareholdings is slightly misleading in that shares are purchased through market dealing from a selling shareholder and the purchaser's funds are therefore paid to the selling shareholder and not to the company. Investment monies are paid directly to the company issuing shares in certain situations, in particular an offer to the market (an Initial Public Offering or flotation and a rights issue).

25 The proportion of listed company shares owned by individuals who are UK investors has fallen from 54% in 1963 to 10.7% in 2010. Foreign ownership of shares has increased from 40% in 2008 to over 50% in 2012 (*Ownership of UK Quoted Shares, 2012* (Office for National Statistics, 2012)). Sovereign wealth funds are investment funds managed by governments for profit. There are many unknowns about sovereign wealth funds but it is thought that they pursue long-term investment strategies only (S. Johnson, 'The Rise of Sovereign Wealth Funds' (2007) 44 *Finance and Development* 56). By contrast, as a result of their investment terms, hedge funds take both long and short positions (V. Agarwal

investment chain, the original capital providers who take no interest in or responsibility for the actions of the directors who run the company.[26]

The absence of direct shareholder interest has been the main cause of the 'absentee landlord' symptom, the result of which has been the creation of a lacuna or gap in the monitoring and accountability of directors that Government and regulatory authorities have tried to fill with ever more detailed and complex rules governing and controlling the directors' actions. Hence successive Companies Acts (culminating in the Companies Act 2006), the UK Corporate Governance Code and the Stewardship Code, as well as other legal and regulatory requirements have been introduced.[27] Some third party institutions do have standards they expect of corporate behaviour but this does not necessarily go to the heart of how companies make decisions, their ethos in dealing with stakeholders nor their impact on society.[28]

C. A relational approach

One of the main difficulties in developing remedies for the above issues of concern is that listed companies operate in the private sector, and therefore Governmental or other public sector or regulatory involvement could be argued to be an illegitimate interference. Clearly there are areas where interference is necessary, for example in relation to environmental concerns, money laundering or national security. However, if shareholders were to take more responsibility for the actions of the directors, and directors and management were to address other aspects in the interests of stakeholders, such as employees and suppliers, the requirement for so many rules and regulations could over time be reduced.[29] For example, shareholders could insist that their company have a greater respect for limiting pay differentials, pay its suppliers on time and promote the welfare and encouragement of employees (e.g. time off at weekends and John Lewis type incentive bonuses).[30] Such actions should form part of a broader approach to understanding and recognising the value of relationships between companies and their stakeholders leading to stability, competitive advantage and increased profits. It would mean a focus in all decision-making and planning by directors on the interests of stakeholders and not just on narrow commercial and financial advantage. Maintaining strong relationships with suppliers, customers, employees and the local and wider community should *not* be a burden for companies resulting in cost or a loss of value for shareholders. Rather, when carried out constructively and effectively, as explained in Part Two, such an approach would have far-reaching benefits for the business and shareholders alike, including the generation of higher shareholder returns.

The value of stakeholder relationships is increasingly recognised and appreciated. Take, for example, Dominic Barton, Global Managing Director, McKinsey & Company who was quoted in a speech recently: 'executives must understand that capitalism is not a zero sum game. They need to recognise that serving the interests of all major stakeholders – employees, suppliers, customers, creditors, communities and the environment – is essential to maximising corporate value. There are real risks in the narrower approach which focuses on the interests of shareholders above

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and N.Y. Naik, 'Risks and Portfolio Decisions Involving Hedge Funds' (2004) 17 *Review of Financial Studies* 63-98) but they are often criticised for their short-term nature (A. Hughes, *Short-Termism, Impatient Capital and Finance for Manufacturing Innovation in the UK* (Foresight, Government Office for Science, 2013) 81).

26 The Law Commission is considering responses to a consultation on fiduciary duties for investment intermediaries. At the time of writing their report had not yet been published. When published it will be available on the Law Commission's website.

27 The Codes focus on internal governance requirements for companies and their relationship with shareholders but not with other stakeholders. For a commentary on the Stewardship Code see A. Reisberg, 'The Notion of Stewardship from a Company Law Perspective: Re-Defined and Re-Assessed in Light of the Recent Financial Crisis?' (2011) 18 *Journal of Financial Crime* 126-147 and 'The UK Stewardship Code (Four Years On): On the Road to Nowhere?' (forthcoming).

28 For example, the Institute of Business Ethics was established to promote high standards of business practice based on ethical values. Amongst other things, it helps companies to develop corporate ethics and responsibility policies and proposals. Hermes, one of the UK's largest pension fund managers, has adopted ethical principles as to what owners should expect of listed companies and what they should expect from their owners. One of the principles is that 'Companies should manage effectively relationships with their employees, suppliers and customers and others who have a legitimate interest in their activities with a view to maximising long-term shareholder value' 'The Hermes Responsible Ownership Principles' (*Hermes*) <www.hermes.co.uk/Portals/8/The_Hermes_Ownership_Principles_UK.pdf> accessed 17 June 2014.

29 HM Treasury, the 81% majority shareholder in RBS, recently told the bank that it would exercise its voting right to refuse the company's request to permit an increase in the level of bonuses that could be paid to employees (J. Pickard, E. Rigby and S. Goff, 'RBS Forced to Scrap Plans to Pay Bonuses at up to 200% of Salary' *The Financial Times* (25 April 2014) <www.ft.com/cms/s/0/e42bcbc8-cc40-11e3-bd33-00144feabdc0.html#axzz34sbaDazJ> accessed 17 June 2014). Similarly, shareholders should be allowed to show their concern for the environment and require retail companies to charge for supplying plastic bags without the Government having to legislate for this. See P. Wintour, 'Queen's Speech: The Humble Plastic Bag Takes the Spotlight' *The Guardian* (4 June 2014) <www.theguardian.com/politics/2014/jun/04/queens-speech-humble-plastic-bag-spotlight> accessed 23 June 2014.

30 John Lewis pays a percentage bonus to all staff based on the results for the year. The amount paid will of course be different depending on pay levels but the payment reflects the appreciation of the company (which is owned by its employees through a trust arrangement) for the commitment of employees and the success of the company.

everything else'.[31] Sir Richard Lambert, former Director General of the Confederation of British Industry, echoed this thinking when he said last year: 'Too preoccupied with their own interests and that of their shareholders, executives can't be trusted to do the right thing for their customers or for the community more broadly. That's the popular perception, at any rate'.[32]

The International Integrated Reporting Council's framework for company reporting states 'Value is not created by or within an organisation alone. It is influenced by the external environment, created through relationships with stakeholders, dependant on various resources'.[33] The UK Companies Act 2006 requires directors, when carrying out their duty to promote the success of the company for the benefit of its members as a whole, to have regard, amongst others matters, to the interests of the company's employees and the need to foster business relationships with suppliers, customers and others.[34]

Part Two of this article will further explain the relational approach and its benefits in the context of a company and its stakeholders. It will set out a series of principles which illustrate whether a company has adopted this ethos and describe how the level of adoption can be measured and reported on by objective means. It will conclude by explaining how the relational agenda can be implemented in practice.

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31 D. Barton, *The City and Capitalism for the Long Term* (The Tomorrow's Value Lecture Series, 2013).

32 Speech given by Sir R. Lambert at The World Traders' Tacitus Lecture at the Guildhall in London on 28 February 2013.

33 *The International IR Framework* (The International Integrated Reporting Council, 2013).

34 s172, Companies Act 2006. See further A. Keay, 'Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado About Little?' (2011) 22 *European Business Law Review* 1-49; A. Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach' (2007) 29 *Sydney L. Rev.* 577. Another example is South Africa's Code of Governance Principles of South Africa 2009, which incorporates a so-called 'stakeholder inclusive' approach for corporate governance and includes requirements concerning stakeholder relationships and a recognition of their importance.

Transforming Capitalism from Within: A Relational Approach to Company Management and Operations – Part Two

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Introduction

Part One of this article outlined some of the issues that have led to society's loss of confidence and trust in the corporate world. It suggested that the causes of this loss in confidence, and not just the symptoms, need to be understood and addressed. The structure of limited liability companies and the nature of shareholding and trading were examined as at least part of the reason for these difficulties. The article suggested a comprehensive approach that puts relationships between the company and its stakeholders at the heart of company decision-making and operations. This would lead to greater stability, competitiveness and success for companies and would benefit all stakeholders and society generally. It would result in Government and regulatory authorities having to impose fewer new laws and regulations on companies. Furthermore, as the approach to decision-making changed, many such outside requirements would become unnecessary.

There is a growing recognition that major aspects of corporate behaviour need to be addressed. The current piecemeal regulatory approach to addressing specific matters of concern tends to be reluctantly accepted by companies and their directors. Regulation is often seen as a burden on the flexible and entrepreneurial operation of companies and something to be avoided if possible (e.g. the banks working round restrictions on cash bonuses). The question is whether there is another way? In other words, is there a way to introduce change, in a more comprehensive manner, through a relational approach that stakeholders would recognise as being for the benefit of all? Understanding what a relational approach means in practice and how it can be applied in the management and operation of companies and their interaction with stakeholders would lead to a change in culture. This in turn would lead to more responsible, stable, competitive and successful companies. Further, they would become more fulfilling and rewarding places to work, more attractive to contract with as a supplier and customer and more satisfying from a shareholder's perspective. It would have an added bonus of helping to restore society's faith in corporate behaviour.

Part Two explains the relational approach in greater detail, how it can be applied in a company context and the attendant benefits. It outlines a method of assessment, through independent means, to measure the extent to which a company has embraced the relational ethos in its operations and decision-making. It concludes by considering how the relational agenda can be pursued in a practical way.

A. Understanding the relational approach

Before considering how to apply a relational approach to the way in which companies operate, it is necessary to understand what the concept actually means. The concept of Relational Proximity[2] explains various aspects or drivers of relationships that can be applied to many aspects of society. The premise is that interaction

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The authors would like to thank Eleanore Hickman for her excellent research assistance in the preparation of this article.

2 Relational Proximity is a trademark owned by Relational Research Limited, see <www.relationalresearch.org/Web/>. It is registered as a trademark in certain countries. The concept, which is explained in this article, is part of a wider approach called Relational Thinking, which explains our lives in the context of our relationship with others. For details and analysis see Michael Schluter and David Lee, *The R Factor* (Holder and Stoughton, 1993), *The R Option* (The Relationships Foundation, 2003) and *The Relational Manager* (Lion Hudson, 2009). Relational Research Limited licences the use of the Relational Proximity framework through its subsidiary Relational-Analytics Limited to consulting firms, in particular in the UK, South Africa and Australia, to measure the quality of relationships between a company and different stakeholder groups, and to explore ways to improve them.

and relationships with others form the cornerstone of society in a personal, family, Government and business context. The concept can be applied to companies i.e. relationships within the organisation and with other stakeholders who rely on and deal with the company, in particular employees, suppliers, customers, lenders, regulators, shareholders, the local community and society generally. Relational Proximity can be defined as a measure of the distance in the relationship between two people, groups or organisations which determines how well each engages with the thinking, emotions and behaviour of the other. If these relationships are positive and constructive this leads to greater trust, understanding, co-operation and support. The opposite is Relational Distance.

Applying this concept, an analysis of relationships among stakeholders takes place in terms of 5 domains of relationship. These can be summarised in a corporate context as:

a) Communication, i.e. direct dealings and dialogue between a company and its stakeholders, the avoidance of intermediaries, and face to face meetings where possible. This would lead to greater trust and minimise risk of misunderstandings;

b) Story, i.e. continuity of dealings and the building of relationships over time through regular contact and dialogue;

c) Breadth of knowledge about the other party, e.g. background of an employee and his family, health issues and interests. This would lead to greater commitment, understanding and trust;

d) Power over the other party, whether financial, commercial, reputational or executive, with the goal being parity, mutual respect, openness and fair treatment in the approach to dealings between the company and stakeholders; and

e) Purpose or commonality. This would lead to alignment of purpose, goals and values between the company and stakeholders so they work together, in the same direction, and for the benefit of their own and others' interests.

Practical ways in which companies could implement these changes are many and varied. In relation to shareholders, for example, there would be greater direct dealings and dialogue with directors and meetings with other stakeholders in order to understand and address issues of concern. Companies would hold regular meetings with stakeholders, possibly in different parts of the country and at convenient times of day, to encourage attendance, and invite not only shareholders but employees and perhaps some suppliers and customers.[3]

In relation to employees, their contribution and commitment would be recognised by, for instance, closer communication, an interest in their families and wellbeing, and openness to their ideas to improve the business. There could be rewards (by cash or shares in the company) to recognise the success of the business and reduced working hours for the benefit of employees and their families. Greater engagement by employees would lead to lower absence for illness and strikes and fewer employees leaving.

Suppliers would receive greater support with respect and understanding for their businesses and they would be paid on time. Customers' concerns would be listened to in a more sympathetic and structured manner with a more personal service. Dealings with regulators would be approached more constructively so that both parties' views are respected.

Those investors in the company who are the capital providers would be encouraged to hold shares directly in the company and to attend meetings with the company and other stakeholders. They would be rewarded for long-term investment by receiving additional shares and other benefits. Irresponsible borrowing[4] would be discouraged, as there would be a recognition of the risk to the business and employment inherent in taking on such a debt burden and in effect handing ownership to the lenders; in financial difficulty there is likely to be a debt for equity swap diluting the interests of shareholders. Companies would support the society they operate in and rely on, by encouraging employees to take time to work for the local community, and they would pay corporation tax in the country where profits are earned.

All these suggestions are consistent with the domains of relationship in the Relational Proximity framework described above. Overall the company would encourage an understanding of its purpose and direction with stakeholders to engender a common interest to develop the business for the benefit of all.

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3 After the formal part of meetings there could be separate discussions between stakeholders and particular executives to discuss different aspects of the business in detail.

4 Appropriate levels of borrowing would vary depending on, amongst other things, the sector and nature of the business involved, for instance property development companies might have greater funding requirements than some other businesses. Banks have specific requirements for capital protection in respect of their borrowings. A responsible approach would be required to assess what a proper maximum level of borrowing might be, taking into account no doubt factors such as the strength of the company's balance sheet and its expected cashflow to service interest payments, as well as risks of increased costs of borrowing and any concerns about the strength of the business, its sector and the economy generally.

B. Implementation of the relational approach

One way to implement the relational approach would be to establish an organisation to measure the extent to which listed companies are relational in how they operate. This would be an independent body, not funded by the companies it assesses. It would review published annual reports and accounts as well as other material published by companies, e.g. CSR reports. It would give the company an opportunity to comment on initial conclusions and the final assessment would be published on a relational assessment website. Companies in particular sectors could thus be compared as to how relational they are in their dealings and treatment of employees, customers, suppliers etc. Many companies might rate quite highly in such an assessment but many others would not in a number of respects. It is important to emphasise that this approach does not introduce another regulatory requirement. It is for companies to decide whether they should change their approach to business operation and for shareholders and other stakeholders to encourage them to do so if they see merits in the approach on a short and long-term basis.

The measure of how relational a company is would be assessed against the extent of compliance with the Relational Business Charter (the 'RB Charter'), which comprises 10 principles. They reflect the hallmark of a company that operates with a relational approach in its ethos, operations and management, as explained earlier in the article. The RB Charter principles are set out in the following paragraphs:

1) *Companies have relational goals in their constitution and in directors' statements*. They adopt a relational ethos by a focus on the interests of stakeholders at the heart of decision-making and dealings with stakeholders. In addition, they would provide appropriate training to investors, directors and employees.
2) *Dialogue is encouraged with all significant stakeholder groups*. This would be by, for instance, regular face-to-face meetings with shareholders to which employees and other stakeholders would be invited and, where this is not practicable, there would be regular online communication.
3) *Companies expect to have a significant proportion of their shares held directly by named individuals or family trusts*. This would give a direct relationship between the ultimate capital providers and the company in which they have an ownership interest.
4) *Shareholders are encouraged to take a long-term view of their holdings*. Additional shares might be issued to long-term holders, who would be invited to meet the directors and would be named in the annual report and accounts.
5) *The interests of employees are recognised*. This could be effected by, for instance, encouraging shorter working hours (including more limited weekend work), encouragement to contribute to business ideas and rewards for all employees (in the form of cash bonuses and shares) to reflect the success of the company.
6) *The differential between the highest and lowest remuneration in the business is reduced.* The suggested target would be for a maximum pay differential of 20:1.[5] This would show respect for the dignity of employees and their contribution to the business.
7) *Suppliers are treated fairly and with respect and understanding, paid promptly and given support to develop their business*.
8) *Customers and the local community are treated fairly and their interests respected.* This would be reflected in a personal, efficient and speedy level of service (including complaint procedures) and appropriate payment terms, and employees would be encouraged to be involved in community activities.
9) *The risk of financial stability is minimised to protect the interests of stakeholders.* This would involve, for most companies, moving towards a low debt to equity ratio and high level of profit to interest cost cover. In addition, shareholders have to approve any increase in borrowing by the company and be informed of the reasoning and risks.
10) *The company fulfils its obligations to wider society*. It pays an appropriate amount of tax where profits are earned and generally is regarded as a good corporate citizen.

C. The benefits of the relational approach

Many listed companies follow high standards of business practice, with an ethical and caring approach to employees and in their dealings with stakeholders. However, their directors are likely to be driven by the

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5 It was suggested by David Cameron, in May 2010, that the maximum pay differential for workers in the public sector should be 20:1 in their organisation (A. Sparrow, 'General Election 2010 Live Blog' (*The Guardian*, 8 April 2010) <www.theguardian.com/politics/blog/2010/apr/08/general-election-2010-live-blog> accessed 30 June 2014). John Pierpont Morgan, founder of JP Morgan, had similar pay differential views but in relation to the private sector. His concern was that a differential greater than 20:1 would be detrimental to morale and productivity (Rushworth and Schluter note 1 above).

imperative of the short-term financial approach, believed to be demanded by the market and investors. They may recognise the value of relationships with stakeholders, but do not put social capital and a relational approach at the heart of their decision-making and do not necessarily see the benefits of doing so.[6]

The relational approach can be seen as a comprehensive way to encourage a radical change in business practice. Through the establishment of a discussion forum, the plan is to introduce companies, their directors, employees and shareholders to the relational concept and explain how the approach would benefit the company and stakeholders. This should mean not only greater stability and competitiveness but also an enhanced reputation for the company, as it will be seen as more responsible in its behaviour. Other stakeholders including regulatory authorities and Government would be involved in the debate. What follows is a consideration of the benefits of this approach to each of the various stakeholder groups.

Shareholders would feel more welcome and engaged with the company and appreciate the opportunity to meet employees and others involved with the company. They would appreciate having the opportunity to meet individual directors to discuss with them directly the company's practices and ask direct questions. They would like to invest in and feel part of a company that was generous to employees who are appreciated and rewarded financially (all of whom are paid more than the minimum wage) and are paid bonuses for their commitment and hard work for the company. They would also recognise the value of investing in a company that paid its taxes in the country where profits were earned and that looks after its suppliers, in particular which pays their accounts by the due date. Overall, their company would be supporting and working for the benefit of its stakeholders and supporting society. They will have confidence that a company that works with stakeholders to focus on mutual beneficial relationships will be more ethical,[7] stable and competitive, and generate higher long-term shareholder returns than one which has a focus on short-term financial interests.[8]

In terms of employees, there would be increased desire to work for a company with a relational ethos as they would know that their views on the business and its improvement will be listened to, they would have attractive work practices and working hours culture. They would be encouraged by bonus schemes and incentive schemes offering shares in the company. The ethos would be to demonstrate proper recognition for the commitment of employees and their value to the business, which would, in turn, increase loyalty and long-term commitment from employees to their companies.

Suppliers of goods and services would be encouraged to know that their customer or client would be interested in their welfare and would pay their invoices on or before the agreed date with a policy in place if their finances were to become difficult. Trade suppliers would have greater commitment if business practices were shared, for instance they were given help with their IT system to make it compatible with that of the company to which they supply goods.

Customers would be attracted to buy goods and services from such companies, knowing that efforts would be made to provide a personal service, with complaints handled in a transparent, efficient and swift manner, and loyalty would be rewarded.

The local community environment would be strengthened, as company employees would have time to be involved in local activities and charity work. Furthermore, a portion of the company's profits would be committed to CSR projects. An ethos of being engaged in the community would be adopted. Regulators would feel they were being dealt with openly by the company and positive personal relationships developed. Compliance issues would be discussed so that any difficulties could be mutually understood and agreed. Banks lending to the company would have more confidence in the stability of the business and would be encouraged to develop long-term personal contact with the company.

Directors would recognise the benefit of the relational approach to stakeholder dealings and have greater confidence in the support and understanding

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6 According to the Governor of the Bank of England, 'we simply cannot take the capitalist system, which produces such plenty and so many solutions, for granted. Prosperity requires not just investment in economic capital, but investment in social capital. It is necessary to rebuild social capital to make markets work' (M. Carney, *Inclusive Capitalism: Creating a Sense of the Systematic* (2014)).

7 Paul Polman, CEO of Unilever, asked 'Why would you invest in a company which is out of sync with the needs of society, that does not take its social compliance in its supply chain seriously, that does nothing about the costs of externalities, or of its negative impacts on society?' (J. Confino, 'Unilever's Paul Polman: Challenging the Corporate Status Quo' *The Guardian* (24 April 2012) <www.theguardian.com/sustainable-business/paul-polman-unilever-sustainable-living-plan> accessed 18 June 2014). However, society does invest in such companies through pension funds and other investments.

8 Empirical research has found that the way in which a firm handles various aspects of stakeholder relationships – its treatment of employees, the natural environment, diversity, customer/product issues, and community relations – will affect its financial performance (S.L. Berman and others, 'Does Stakeholder Orientation Matter? The Relationship between Stakeholder Management Models and Firm Financial Performance' (1999) 42 *Academy of Management Journal* 488-506, 494). Similarly, research has demonstrated a link (albeit a cautious one) between improvement in social performance and improvements in financial performance (B.M. Ruf and others, 'An Empirical Investigation of the Relationship between Change in Corporate Social Performance and Financial Performance: A Stakeholder Theory Perspective' (2001) 32 *Journal of Business Ethics* 143-156, 153).

of shareholders. They would understand that shareholders would take a greater interest in the company's business standards and would hold them directly to account for divergences. They will recognise that shareholder value will be enhanced by a relational approach to all stakeholders and will be gradually freed from box-ticking regulatory requirements as the process of addressing the interests of stakeholders will mean that other requirements are complied with as part of the general approach. Further, directors will feel empowered and freer to exercise their entrepreneurial flair in conjunction with supportive shareholders investing for the long term.

Finally, Government would see the benefits as the public would have greater trust in business and there would be less need for new laws and regulations to control details and excesses of corporate behaviour. This should benefit all parties involved.

D. The way forward

The relational approach to company management and operations has been a developing concept for several years, in conjunction with academics, the professions and the business world. There is increasing recognition of the value of stakeholder relationships in building long term, stable and successful businesses. It is hoped the proposals for the relational company concept and recognition of the approach of the RB Charter will encourage changes in corporate behaviour and, as such, it deserves to receive support and funding. In addition, as explained above, a body to assess the strength of the relational approach adopted by companies should be set up and a group of interested company directors, employees and shareholders should meet to consider adopting a coherent and comprehensive relational approach as the framework within which their companies should operate. Seeing the benefits to all parties and the recognition by society of a comprehensive and responsible approach would be a major step forward in putting the relational agenda into practice in the business world.

One way to attract investment for companies that are recognised as reflecting the relational ethos in their approach to business would be to establish a relational investment fund. Such a fund would, in a way similar to ethical funds which attract investors who want an investment focus based on environmental or other specific interests, invest funds subscribed only in companies which rate highly in their compliance with the requirements of the RB Charter. Such investors would meet company directors and other stakeholders, in order to understand, discuss and encourage the relational approach.

A change to the UK Corporate Governance Code is also proposed in order to ensure that companies analyse and report on the strength of their relationships with stakeholders. This would import the provisions of s172 Companies Act 2006 into the Code as a reporting requirement. This would help to oblige directors to have regard to the interests of suppliers, customers and others in fulfilling their statutory duties.[9]

One particular intended attraction of the RB Charter, and its encouragement for companies to adopt a relational approach, is that it does not require any change in legislation. The approach is considered to be consistent with the duties of directors, particularly if shareholders resolve to incorporate into the company's constitution the relational ethos. The approach required under s172 is the so-called 'enlightened shareholder' approach, in that directors have regard to the interests of certain stakeholders in carrying out their duty to promote the success of the company for the benefit of members as a whole. It would be interesting to see if such duty could be aligned more closely with South Africa's Code of Governance Principles, which adopts the 'stakeholder inclusive' approach.[10]

Conclusions

In many respects there is, at present, a mismatch between what various stakeholder groups understand as being required of them whilst, in reality, each is operating in its own financial interests. For example, shareholders expect a constantly increasing short-term return with no recognition that they have ownership responsibilities. Directors with little ownership responsibility are under pressure from shareholders and incentive alignment schemes to operate the company on a financial return basis which, if successful, leads directly to significant financial return for themselves (salary and bonus, and an interest in the company's shares). At the same time, employees feel their voice is not heard and watch their salaries stagnate whilst the executives are over rewarded. Similarly, suppliers feel under threat that contracts will not be renewed or their bills not paid on time, and customers are resigned to making worthless complaints, which is particularly

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9 Prior to 30 September 2013, companies were required to provide a business review informing members of the company how the directors have performed their duty in relation to s172. This requirement has now been repealed by s5 Companies Act 2006 (Strategic Report and Directors Report) Regulations 2013.

10 See Part One, note 34.

apparent with utility companies.[11] At the same time, regulators feel resented and sometimes disregarded.

If all these interests could be brought together, through increased dialogue, understanding and respect in discussions by all parties and permeated by an underlying intention to work in stakeholders' interests, and for the common good, this should lead to greater stability, sustainability and productivity. Although there is an increasing recognition of the so far hidden and unrecognised value of good relationships with stakeholders, there is a lack of an effective way to measure and improve the quality of such relationships and to apply the concept to the ethos and very heart of company decision-making and operation. The relational concept and the principles of the RB Charter provide an overarching and comprehensive approach that could fill this need. Ultimately, adoption of the relational approach in the way companies are managed and operated could indeed, as the title of this article suggests, lead to the transformation of capitalism from within the capitalist structure, for the benefit of all.

To contribute to the debate on this topic, contact Jonathan Rushworth on submissions@chasecambria.com.

Notes

11 See for example, T. Macalister, 'Energy Firms Accused of Treating Clients with Contempt as Complaints Leap' *The Guardian* (9 December 2011) <www.theguardian.com/business/2011/dec/09/energy-suppliers-complaints-consumer-focus> accessed 19 June 2014 and R. Smithers, 'Utility Call Centres under Fire over Poor Customer Service' *ibid.* (5 February 2008) <www.theguardian.com/money/2008/feb/05/consumeraffairs>.

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