October 2018

GC100 Guidance on directors' duties – Section 172 revisited

Earlier this week, against the background of the renewed focus on corporate governance and reporting, the GC100 Group published practical guidance[1] for boards on compliance with section 172 of the Companies Act 2006. Please see our recent briefings for further information on changes to the UK Corporate Governance Code and the Companies (Miscellaneous Reporting) Regulations 2018.

This guidance is timely as directors of large companies prepare to grapple with the new requirement to set out, in a separately identifiable statement in the strategic report, how they have complied with section 172 for financial years beginning on or after 1 January 2019 (see below).

Much ink has been spilled over the concept of "enlightened shareholder value" embodied in section 172. In particular, boards have struggled to reconcile the duty to promote the success of the company for the benefit of its members as a whole with the requirement to have regard to factors such as the interests of employees, other stakeholders and the environment. The guidance attempts to suggest concrete steps which directors can take in order to create a culture where wider interests are considered in the context of corporate decision-making and everyday business. It also includes an example of decision-making in accordance with section 172 in a specific business scenario.

Section 172 of the Companies Act 2006 states that a director must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;

1 Available to Practical Law subscribers only.

- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the company.

The guidance points out that the directors' job is "not to balance the interests of the company and those of other stakeholders" but to weigh up all the relevant factors and then to ask themselves which course of action they consider best leads to the success of the company, having regard to the long term. The GC100 goes on to say that although this may sometimes mean that stakeholders are adversely affected, "this does not call into question decisions made".

The guidance also states that the section 172 duty is not solely concerned with directors' decisions, but also their responsibility to bear in mind stakeholders and other relevant factors in setting strategy, developing policies and creating a corporate culture.

PRACTICAL STEPS

The focus of the guidance is on providing practical advice for day-to-day compliance in the areas of stakeholder engagement, strategy, training, information provided to the board, policies and process. As an over-arching theme, it emphasises the importance of developing a corporate culture which "in its pursuit of success for the benefit of shareholders as a whole, is consistent with the company's goals in relation to stakeholders, whether employees, customers, suppliers, local communities, the environment or others".

ENGAGEMENT

The guidance refers to an existing body of guidance on shareholder engagement and on engagement with other stakeholders[2]. It makes the following additional points:

- it is self-evident that consideration of stakeholder interests will be less effective without appropriate engagement;
- engagement will usually need to involve action on the part of managers and employees, not just directors;
- engagement may be considered in the context of how stakeholders experience the company through day-to-day business interactions, rather than just through channels established specifically for engagement;
- boards should consider the extent to which stakeholder feedback is communicated to the management, the board and the wider business; and
- boards should consider the balance between formal data collection (such as surveys) and senior management interactions with smaller groups of stakeholders.

STRATEGY

The guidance emphasises:

- the need to consider stakeholders (including considering which third parties are "stakeholders" and ways of engaging with them) and other factors which will contribute to the company's success or be affected by its activities;

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[2] See, for example, the ICSA and Investment Association guidance: The Stakeholder Voice in Corporate Decision-making

- the need to consider the relationship between the company's visions and goals, and stakeholder interests; and
- the need to allocate adequate time to considering the company's long-term vision and goals and impact, including the impact on the communities and environment in which it operates.

TRAINING

The guidance recommends that directors receive training and guidance on their duties, including section 172. It also recommends training for management and others in order to enhance their effectiveness in achieving the company's goals in line with the board's duties and the requirement to have regard to stakeholder interests.

INFORMATION

The guidance makes recommendations in relation to the information on the basis of which the board makes decisions. This should be sufficient to allow the board to make informed judgements, including decisions as to when others may be in a better position to make certain judgements. It gives advice as to matters to be considered in order to ensure the correct flow of information to the board.

POLICIES AND PROCESSES

The guidance considers the impact of section 172 in setting policies and processes at board level, management level and for subsidiary and joint venture companies. It emphasises that:

- at board level, directors should seek to ensure that relevant stakeholder factors are considered in setting policy. The guidance also sets out ways in which active consideration of directors' duties and, in particular, section 172 can be incorporated into board procedures;
- at management level, managers should be trained on writing effective board papers so that the impact of a decision is clear to the directors, and of implementing specific company policies on section 172 issues; and
- the directors of subsidiaries need to understand that they owe their duties to the subsidiary, and not the parent, but that the views of the parent company are "usually important and proper factors that should be taken into account".

REPORTING REQUIREMENT

The guidance does not make particular recommendations about the new section 172 reporting requirement which will apply to "large" public and private companies (as defined in the Companies Act 2006) for financial years beginning on or after 1 January 2019. However, the Financial Reporting Council (FRC) has updated its Guidance on the Strategic Report to address this new requirement.

The FRC states that what is included in the section 172 statement will depend on the circumstances of each company but should in most cases include:

- the issues, factors and stakeholders the directors consider relevant in complying with section 172 (1) (a) to (f) and how they have formed that opinion;
- the main methods the directors have used to engage with stakeholders and understand the issues to which they must have regard; and
- information on the effect of that regard on the company's decisions and strategies during the financial year.

THE FUTURE OF SECTION 172 COMPLIANCE

Although there has been no change to the duty under section 172, the new duty of large companies to report on their compliance has prompted a more practical interpretation of what the underlying section 172 duty actually requires. Maintaining a culture where wider interests are considered in the context of corporate decision-making is likely to be the best evidence of compliance.

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