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THE ENLIGHTENED SHAREHOLDER VALUE PRINCIPLE AND CORPORATE SOCIAL RESPONSIBILITY

A THEORETICAL AND QUALITATIVE ANALYSIS

Taskin Iqbal

ROUTLEDGE

The Enlightened Shareholder Value Principle and Corporate Social Responsibility

The Enlightened Shareholder Value principle and Corporate Social Responsibility are areas of increasing academic and research interest. However, discussions on the ESV principle in relation to CSR are very limited. This book provides a critical analysis of the impact of the concept of ESV, embedded in the Companies Act 2006, on CSR and explores the scope for reform. Along with analysing existing empirical research, it presents the findings of an empirical study conducted to determine whether the concept of ESV is capable of promoting or assisting CSR.

The book also examines whether implementing an ESV approach has had any impact on the CSR practices of multinational corporations that originate in the UK and operate in developing nations, as in order to assess whether the ESV principle links to CSR both its domestic and international impact need to be considered. This analysis was undertaken through the lens of a case study on the ready-made garment industry in Bangladesh, with some focus on the Rana Plaza factory disaster. This study also assists in demonstrating the changes that need to be made to improve the current situation. Lastly, the book addresses the need for reform in the area and provides possible suggestions for reform.

This interdisciplinary book will be of great interest to students and scholars of corporate law, corporate governance and business studies in general as well as policymakers, NGOs and government departments in many countries around the world working in the fields of CSR, sustainability and global supply chains.

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For My Parents

Contents

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Abbreviations

Accord	Accord on Fire and Building Safety in Bangladesh
Alliance	Alliance for Bangladesh Worker Safety
BEIS	Department for Business, Energy and Industrial Strategy
BGMEA	Bangladesh Garment Manufacturers and Exporters Association
BIS	Department for Business, Innovation and Skills
CC	Corporate Citizenship
CLLS	The City of London Law Society
CLRSG	Company Law Review Steering Group
CSP	Corporate Social Performance
CSR	Corporate Social Responsibility
CR	Corporate Responsibility
ESV	Enlightened Shareholder Value
FRC	Financial Reporting Council
ILO	International Labour Organization
MNC	Multinational Company or Multinational Corporation
OFR	Operating and Financial Review
RMG	Ready-Made Garment
SOP	Standard Operating Procedure

1 Introduction and background

Background

All companies,[1] regardless of their size or type, have an enormous impact on our lives and play a crucial role in advancing economic growth. Public companies, in particular, possess extensive power in our society, and their actions are of significant importance to all of us. The businesses they carry out generate billions of pounds every year. In fact, the majority of the world's wealthiest entities are corporations.[2] A list compiled by Global Justice Now showed that 157 of top 200 economic entities, by revenue, are corporations, not countries.[3] However, companies are not only important for economic reasons; they have an influence on all facets of political and social life. They are the owners of major assets and substantial tracts of land, have millions of people working for them and enter into countless transactions. They have the potential to influence and are involved in the procedures of the government that determines what regulations will be implemented. They also play a fundamental part in interpreting and applying government policies in many areas because of their role as an employer. This leads to them having considerable leverage when interacting with the communities in which they function. This leverage can be used to gain concessions and other advantages.

Furthermore, the rate of development of certain areas of business is dependent on whether they choose to invest in those areas. They not only determine what products are produced but also the process through which they are produced, the amount in which they are produced and the times when they are produced. It has been asserted that the legal framework for the

1 The terms 'company' and 'corporation' will be used interchangeably.
2 B. Chapman, 'Majority of the world's richest entities are corporations, not governments, figures show' (*The Independent*, 17 October 2018) <https://www.independent.co.uk/news/business/news/companies-bigger-governments-un-human-rights-council-meeting-a8588676.html> accessed 9 November 2019.
3 Global Justice Now, '69 of the richest 100 entities on the planet are corporations, not governments, figures show' (2018) <https://www.globaljustice.org.uk/news/2018/oct/17/69-richest-100-entities-planet-are-corporations-not-governments-figures-show> accessed 9 November 2019.

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growth of resources and expansion of wealth in the private sector is provided by companies. Some companies are also involved in the supply of basic necessities such as water, gas, electricity and telecommunications. They have the capacity to have an impact on typical societal events, which consequently means that their power is social and political as well as economic. Thus, without a doubt, public companies have very strong bargaining positions in our society.[4]

Moreover, in this exceedingly globalised world the impact of companies also extends well beyond national borders.[5] For instance, the decisions made by large companies in the UK can affect stakeholders in various countries. When powerful multinational companies (MNCs) operate in developing nations, the governments of the host states might be very reluctant to confront these companies when they misuse their power and influence since their presence might be important for many reasons, such as investment and employment. In addition, since the industry regulations in those countries are sometimes not as strong as they are in a developed country, the stakeholders are left very vulnerable. The Bhopal disaster is probably the most tragic example of this vulnerability. In 1984 a gas leak at a Union Carbide facility in India killed thousands of people. The death toll was estimated to be as high as 25,000.[6] Campaigners claim that it left more than half a million people injured as well.[7] In 1987, Union Carbide eventually paid 282 million pounds to the Indian government in compensation, but some of those who were responsible were not brought to justice and a verdict was given many years after the incident. Eight former plant employees, including the chairman of the Indian arm of Union Carbide, the managing director, the vice-president, the works manager, the production manager, the plant superintendent and a production assistant, were sentenced to two years in prison after being convicted of causing death by negligence. They were also ordered to pay fines of around £1,467 apiece. It was claimed by NGOs working with the victims of the incident that the verdict was inadequate, setting a very bad precedent. Campaigners and victims wanted to see Warren Anderson, the former Union Carbide chairman, brought to justice.[8] The Indian government took almost

4 A. Keay, *The Corporate Objective* (Cheltenham, Edward Elgar Publishing Ltd., 2011) at 3–5.

5 N. C. Smith, D. Read and S. Lopez-Rodriguez, 'Consumer Perceptions Of Corporate Social Responsibility: The CSR Halo Effect' INSEAD The Business School for the World Working Paper 2010/16/ISIC <http://www.insead.edu/facultyresearch/research/doc.cfm?did=43990> accessed 4 April 2015.

6 BBC, 'Bhopal Trial: Eight Convicted Over India Gas Disaster' (2010) <http://news.bbc.co.uk/1/hi/world/south_asia/8725140.stm> accessed 1 February 2018.

7 E. Goddard, 'Bhopal Disaster Victims May Never Get Compensation Following Dow-Dupont Merger, Fears UN Official' (*The Independent*, 14 September 2017) <http://www.independent.co.uk/news/business/news/bhopal-disaster-victims-dow-dupont-merger-un-india-official-gas-leak-chemical-industrial-a7946346.html> accessed 1 February 2018.

8 BBC, 'Bhopal Trial: Eight Convicted Over India Gas Disaster' (n6)

nineteen years to make a formal request for his extradition, but it was rejected by the US.[9]

In a later case, in 2005 Unocal Corporation decided to settle a number of lawsuits filed in California due to its involvement with the Myanmar government in a number of horrific acts committed in association with a natural gas pipeline project. These acts included torture, rape, forced labour and the murder of Myanmar citizens.[10] Another noteworthy example is Royal Dutch Shell plc and its Nigerian subsidiary's involvement with the military government in torturing and executing Nigerian activists who protested against the destruction of local communities and the environment.[11] Lastly, it is worth mentioning the well-known case of *Adams v Cape Industries plc*,[12] in which the British parent company, Cape Industries plc, escaped all responsibilities for numerous deaths and injuries caused by its subsidiary operating in another country. Its subsidiaries were involved in mining asbestos in South Africa, which was then shipped to another subsidiary in the US. A number of employees of the American subsidiary suffered from injuries and illness caused by exposure to asbestos and sued Cape Industries plc and its subsidiaries. The company disposed of its assets in the US and Cape Industries plc and escaped all liabilities as the courts refused to lift the corporate veil. Such incidents reflect the power of public companies and show the vulnerable position of non-member stakeholders in corporate governance.

The incidents above reflect the extent of the impact of the decisions made by the individuals who are bestowed with the power to manage these companies. In today's world, generally the management powers regarding a company's affairs will be vested in its board of directors.[13] These boards make private decisions, which have public results. There is a need for them to be able to justify their actions as the capacity to make these decisions stems from this possession of immense power, which is the foundation for the argument that companies should be obliged to act in the public interest.[14] Large companies are eager to maintain their reputation as good corporate citizens by being perceived as considerate employers, contributing to the communities in which they function and caring about the environment. Whether this is done to maintain good public relations or not, directors have to make decisions that involve ethical and social-policy concerns. The justifications

9 T. Edwards, 'Bhopal verdict: A most convenient injustice' (*The Guardian*, 8 June 2010) <http://www.theguardian.com/commentisfree/libertycentral/2010/jun/08/bhopal-verdict> accessed 1 February 2018.

10 'Unocal Lawsuit (Re Myanmar)' (*Business-humanrights.org*) <https://business-humanrights.org/en/unocal-lawsuit-re-myanmar> accessed 1 February 2018.

11 See E. Pilkington, 'Shell Agrees To Pay Compensation For Execution Of Saro-Wiwa And Ogoni Protesters' (*The Guardian*, 9 June 2009) <https://www.theguardian.com/world/2009/jun/08/nigeria-usa> accessed 1 February 2018.

12 *Adams v Cape Industries plc* [1990] Ch. 433.

13 For a discussion on the functions of the board, see B. Tricker, *Corporate Governance: Principles, Policies and Practices* (4th edn, Oxford, Oxford University Press, 2019) at 179–204.

14 J. E. Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Oxford, Oxford University Press, 1995) at 10.

for the arguments that directors need to justify their actions and companies should act in the public interest will be discussed in detail later.

The objective of a company needs to be decided first, in order to correctly identify in whose interests the company should be managed. This means that before deciding in whose interests directors should run a company, the purpose of the company needs to be decided. Whether directors of public companies should make decisions based purely on considerations of profit, or whether they should take wider interests into account, has been debated for years. It is often believed that this debate regarding corporate objective commenced in the early 1930s with Adolph Berle and E. Merrick Dodd, two professors of law in the US.[15] Since that time the debate has become even more intense. Supporters of the two main theories of corporate governance, the shareholder value, or shareholder primacy, theory and stakeholder theory, often refer to the positions taken by one of these two professors.[16] Simply, Berle believed that the managers of the company should prioritise the interests of the shareholders and act accordingly to maximise shareholder wealth.[17] Dodd, on the other hand, held the view that managers are trustees for the company and should take broader interests into consideration.[18]

Even though Berle, like Dodd, actually favoured an approach similar to modern stakeholder theory, he did not perceive it as being workable. He believed that emphasis on shareholder wealth maximisation could not be discarded unless a clear and reasonably enforceable set of responsibilities could be offered to someone else. For him, the second-best solution to tackle the opportunism in which managers might engage was shareholder primacy. According to him, stakeholder theory was simply not practical,[19] although in the 1950s he actually admitted that Dodd had won the debate.[20] However, there has been no clear winner in resolving the debate between the proponents of shareholder primacy theory and stakeholder theory, and it continues today in different guises.

Corporate social responsibility

Discontent with the idea of profit maximisation within the constraints of law is also at the heart of the debate about corporate social responsibility (CSR),[21] which has become a very important phenomenon internationally for companies,

15 See A. A. Berle, 'For Whom Are Corporate Managers Trustees: A Note' (1932) 45 *Harvard Law Review* 1365 and E. M. Dodd Jr., 'For Whom are Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1145.
16 Keay, *The Corporate Objective* (n4) at 12.
17 Berle, 'For Whom Are Corporate Managers Trustees: A Note' (n15).
18 Dodd Jr., 'For Whom are Corporate Managers Trustees?' (n15).
19 Berle, 'For Whom Are Corporate Managers Trustees: A Note' (n15).
20 A. A. Berle, 'Control in Corporate Law' (1958) *Columbia Law Review* 1212.
21 Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (n14) at 42.

stakeholders, shareholders, governments, academics, etc. Nowadays, many will argue that businesses do not exist for the sole purpose of making money.[22] Companies do not operate in isolation. There is interaction with various groups of stakeholders such as employees, suppliers and the community.[23] There is a concern for non-economic issues, such as human rights, social and environmental issues. That is why, as discussed above, businesses have a major impact on our society and environment. Consequently, there is a growing concern for responsible business behaviour among various bodies including governments, NGOs, and businesses themselves. For example, on 1 April 2014 India became the first country in the world to mandate a form of CSR by requiring large companies to spend 2 per cent of their net profit on social development.[24] Another example of CSR being explicitly included in national legislation is Article 5 of the Company Law 2005 of the People's Republic of China, which states: "When engaging in business activities, a company shall abide by laws and administrative regulations, observe social morality and business ethics, act in good faith, accept supervision by the government and the public, and bear social responsibilities".[25]

Many academics and institutions at various points have highlighted the importance of, and attempted to define, CSR. For example, the World Business Council for Sustainable Development defined CSR as "the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large".[26] The United Nations stated that "the concept of CSR aims both to examine the role of business in society, and to maximise the positive societal outcomes of business activity".[27] The European

22 For example, see Smith, Read and Lopez-Rodriguez, 'Consumer Perceptions Of Corporate Social Responsibility: The CSR Halo Effect' (n5); D. Gelles and D. Yaffe-Bellany, 'Shareholder Value Is No Longer Everything, Top C.E.O.s Say' (*The New York Times*, 19 August 2019) <https://www.nytimes.com/2019/08/19/business/business-roundtable-ceos-corporations.html> accessed 1 December 2019.

23 R. Fenn, 'Benefits Of Corporate Social Responsibility' (*Sustainable Business Toolkit*, 2013) <http://www.sustainablebusinesstoolkit.com/benefits-of-corporate-social-responsibility/> accessed 1 February 2018.

24 Section 135 of India's Companies Act 2013. Also see: A. Prasad, 'India's New CSR Law Sparks Debate Among NGOs And Businesses' (*The Guardian*, 11 August 2014) <http://www.theguardian.com/sustainable-business/india-csr-law-debate-business-ngo> 25 February 2018.

25 Article 5 of the Company Law 2005 of the People's Republic of China.

26 The World Business Council for Sustainable Development, *Corporate Social Responsibility* <http://www.wbcsd.org/pages/edocument/edocumentdetails.aspx?id=82&nosearchcontextkey=true> accessed 3 November 2015. Also see L. Holmes and R. Watts 'Corporate Social Responsibility: Making Good Business Sense' (2000) World Business Council for Sustainable Development at 8; B. Michael, 'Corporate Social Responsibility in International Development: An Overview and Critique' (2003) 10 *Corporate Social Responsibility and Environmental Management* 115 at 115.

27 United Nations, 'CSR and Developing Countries: What scope for government action?' (Issue 1, February 2007) <https://sustainabledevelopment.un.org/content/documents/no1.pdf> accessed 25 February 2018.

Commission has defined CSR as "the responsibility of enterprises for their impact on society". The Commission has also mentioned that companies can become socially responsible by following the law and integrating social, environmental, ethical, consumer and human rights concerns into their business strategy and operations.[28] There is no single definition of CSR that is accepted by everyone. Due to the changing and complex demands and expectations of various stakeholder groups, agreement regarding the definition of CSR has not been reached yet.[29]

One of the most prominent scholars in the area, Archie B. Carroll, stated: "For a definition of social responsibility to fully address the entire range of obligations business has to society, it must embody the economic, legal, ethical, and discretionary categories of business performance".[30] This is arguably the most established and accepted model of CSR.[31] John Parkinson stated that CSR refers to behaviour that entails giving up profit willingly while believing that such actions will have results superior to those that follow from the pursuit of an ideology of pure profit maximisation.[32] If the voluntary sacrifice of profits for superior results other than those following from a pure policy of profit maximisation is truly better for our society, this has very important repercussions for the legal regulation of companies. If our society will be served better by such behaviour, then the law should be considered as a mechanism that is to be used to change the objectives of corporations so that in appropriate situations, the interests of stakeholders can be given more importance than profit maximisation.[33] This would involve relaxing the duty of the management to conduct the operations of the company in the interests of the shareholders. The desired result would be designing practical mechanisms that could be employed to make sure that the many constituencies that form the public interest are balanced properly while making corporate decisions.[34] Insisting that companies be socially responsible might require a demand that the company modify its objectives and carry on business in a way that promotes the welfare of non-member stakeholders instead of maximising profits for shareholders. Or, it might demand that the company pursue various goals, and the duties of the management of the company should be to use its discretion to balance the

28 European Commission, 'Corporate Social Responsibility (CSR)' <http://ec.europa.eu/growth/industry/corporate-social-responsibility/index_en.htm> accessed 3 November 2015.

29 J. Zhao, 'Promoting more socially responsible corporations through a corporate law regulatory framework' (2017) 37 *Legal Studies* 103 at 106.

30 A. B. Carroll, 'A three-dimensional conceptual model of corporate performance' (1979) 4 *Academy of Management Review* 497 at 499. This will be considered again in Chapter 2.

31 See A. Crane and D. Matten, *Business Ethics* (Oxford, Oxford University Press, 2016) at 50.

32 Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (n14) at 260–267.

33 Ibid.

34 Ibid.

interests of the different stakeholders. Lastly, it might only require that more rigorous constraints should be adopted by the company while following the long-established profit-maximisation policy.[35]

Genesis of the enlightened shareholder value principle

As the objective of a company is often argued as a choice between either economic responsibility to shareholders or social responsibility to society, there has been a search for a middle way with an integrated shareholder maximisation and stakeholder management approach. The enlightened shareholder value (ESV) approach is seen as an evolving viewpoint that embraces an integrated approach, focused on long-term value creation for shareholders but which potentially also benefits other stakeholders.[36] This approach appears to combine the elements of shareholder and stakeholder approaches.[37] Before the enactment of the Companies Act 2006 ("the Act"), in which the general duties of directors have been codified, there was no definitive legislation that defined the scope of company law and governance in the UK. In 1998 the Company Law Review Steering Group (CLRSG) was established by the Department of Trade and Industry for the purpose of reviewing corporate law in the UK. The CLRSG recommended that there should be a legislative statement regarding the corporate objective. The principle that it advocated in this regard was the ESV approach.[38] In July 2002, the Government published a White Paper based on the CLRSG reports in two volumes, and a draft Companies Bill was contained in the second volume. Based on the suggestions of the CLRSG's *Final Report*, one of the major proposals contained in the White Paper was that there should be an alteration in the formulation of directors' duties to incorporate other factors besides shareholder benefits. Thus, the so-called ESV approach was born.[39]

Clarifying what is expected of directors and defining in whose interests companies should be run was a significant aspect of the reform agenda leading up to the enactment of the Act.[40] It was recommended by the Company Law Review that the duty should be formulated in a manner that reminds directors

35 Ibid.

36 P. E. Queen, 'Enlightened Shareholder Maximization: Is this Strategy Achievable?' (2015) 127 *Journal of Business Ethics* 683 at 683–684.

37 C. A. Williams and J. M. Conley, 'An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct' (2005) 38 *Cornell International Law Journal* 493 at 495.

38 Company Law Review, *Modern Company Law for a Competitive Economy: Strategic Framework*, 1999, London, DTI.

39 A. Dignam and J. Lowry, *Company Law* (Oxford, Oxford University Press, 2010) at 405.

40 P. Loose, M. Griffiths and D. Impey, *The Company Director* (Bristol, Jordan Publishing Ltd., 2011) at 22. Note that it was stated in J. Lowry, 'The Duty of Loyalty of Company Directors: Bridging the Accountability Gap through Efficient Disclosure' (2009) *68 Cambridge Law Journal* 607 at 608 that "the Act had a particularly long gestation period, being conceived in March 1998 when the Labour Government announced what proved to be the most far-reaching review of company law

that shareholder value might be dependent on handling the company's relationships with other stakeholders properly and thinking about the impact of their decisions in the long term. A codification of the directors' duties developed around an emphasis on shareholders, but also obliged directors to take material factors into consideration. The final formulation of the obligation is contained in the duty to promote the success of the company under section 172 of the Act.[41] Section 172 (1), the heart of the ESV principle, reads as follows:

> (1) A director of a company 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—
>
> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment,
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
> (f) the need to act fairly as between members of the company.

The concept of ESV is incorporated in section 172 of the Act by obliging directors to consider a list of factors while promoting the success of the company for the benefit of its members as a whole. This approach is considered to be enlightened because the directors are required to take the factors enumerated in the provision into account, instead of just focusing on the interests of the shareholders alone. This section caused more debate in the UK Parliament than any other provision in the Act and is probably the most controversial duty that was introduced by the Act. Directors are required to have regard to stakeholder interests when they make corporate decisions, but all the listed factors can actually be overridden by the interests of the shareholders as the section states that a director must act in a way that would be most likely to promote the success of the company for the benefit of its members as a whole. It is argued by some that through this approach a balance is struck between the traditional shareholder value approach and the stakeholder approach.[42] Nevertheless, some still contend

since Gladstone's Joint Stock Companies Act 1844 and the introduction of limited liability in 1855".

41 Dignam and Lowry, *Company Law* (n39) at 324, 405.

42 S. Brammer, G. Jackson and D. Matten, 'Corporate Social Responsibility and Institutional Theory: New Perspectives on Private Governance' (2010) 10 *Socio-Economic Review* 3 at 11–12.

that the section does not provide adequate or sufficient protection of the interests of non-member stakeholders.[43]

What is of great interest, with the possibility of wide effects, is whether the concept of ESV provides any link to CSR. ESV is the notion that companies should aim for shareholder wealth with a long-run orientation that pursues sustainable growth and profits based on responsible consideration of all the relevant stakeholder interests. It resonates with the notion of CSR because its idea of value is based on long-term sustainability, and it acknowledges the importance of considering stakeholder interests in achieving that goal. A long-term perspective entails being attentive to the complete set of stakeholder concerns that might have the capacity to impact the business success of the corporation. Hence, values of sustainability seem to rely on acknowledgment of the importance of non-shareholder as well as shareholder interests. In this regard, a long-term orientation is dependent on recognising a corporation's responsibility to its diverse internal and external constituencies.[44]

Another issue of interest is the impact of section 172 on MNCs. In order to assess whether the ESV principle links to CSR, both its domestic and international impact need to be considered. As highlighted earlier, there is a growing concern for the lack of responsible business behaviour of MNCs operating in developing nations. Developing countries persistently compete for foreign investment capital because they are sometimes dependent on it to promote economic growth and prosperity. This acts as an incentive to provide hospitable legal environments for MNCs operating within their borders. Moreover, international law does not really provide a basis for holding MNCs accountable to non-member stakeholders, except in the most egregious cases.[45] This can sometimes lead to serious abuses of vulnerable stakeholders in those countries. This was demonstrated by the Rana Plaza factory disaster in Dhaka, Bangladesh. The Rana Plaza factory was an eight-storey building, housing five garment factories. It collapsed on 24 April 2013. According to authorities at the time, the death toll was around 1,021; about 2,500 people were injured and around 2,437 people were rescued. This was the worst industrial accident that has ever happened in Bangladesh, and arguably one of the worst industrial accidents in the world. Just a day before the accident, the building was briefly evacuated

43 For example, see S. Wen and J. Zhao, 'Exploring the Rationale of Enlightened Shareholder Value in the Realm of UK Company Law – The Path Dependence Perspective' (2011) 14 *International Trade and Business Law Review* 153; A. Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's "Enlightened Shareholder Value Approach"' (2007) 29 *Sydney Law Review* 577; J. L. Yap, 'Considering the enlightened shareholder value principle' (2010) 31 *Company Lawyer* 35 at 36.

44 D. Millon, 'Enlightened Shareholder Value, Social Responsibility and the Redefinition of Corporate Purpose Without Law' in P. M. Vasudev and S. Watson (eds), *Corporate Governance after the Financial Crisis* (Cheltenham, Edward Elgar, 2012). Washington & Lee Public Legal Studies Research Paper Series Paper No. 2010–11 at 19. Available at SSRN <https://dx.doi.org/10.2139/ssrn.1625750>.

45 Ibid at 2.

after cracks became visible in the walls. Even so, the factory owners allowed and even compelled the workers to re-enter the building later on.[46] These workers were producing garments for sale to well-known brands owned by companies in Britain, Ireland, the United States of America, France, Germany, Spain, Denmark and Canada.[47] Some of the retailers for whom garments were being made by the factory included Primark, Matalan, Bonmarche and Benetton.[48] After the accident, certain companies whose brands were involved with the factories, which were owned by local companies, failed to provide any form of support for the workers. First, these companies had failed to ensure that they were sourcing garments from factories that met basic safety standards. Then, they failed to make any attempts to aid the victims of the tragedy and their families.[49] Some companies that came forward and took responsibility, such as Primark, did so willingly. However, the companies that failed to come forward could not be obligated to take any responsibility or be held accountable for anything.[50]

Even though it could be argued that these companies had no responsibility, as the workers were not directly employed by them, a broader view would entail considering these workers as de facto employees. Under section 172, the list of factors directors need to have regard to includes the need to foster the company's business relationships with suppliers, customers and others, the impact of the company's operations on the community and the environment, and the desirability of the company maintaining a reputation for high standards of business conduct. Thus, companies that had given contracts to or were involved with the factories in the Rana Plaza arguably did not have regard for the need to foster their business relationships with suppliers, the need to consider customers and others or the need to consider the impact of their operations on the community and environment. Furthermore, considering the tremendous amount of bad publicity that comes from such reprehensible conduct, they certainly failed to maintain their reputation for high standards of business conduct.

46 BBC, 'Bangladesh factory collapse toll passes 1,000' (2013) <http://www.bbc.co.uk/news/world-asia-22476774> accessed 01 February 2018.

47 BBC, 'Dhaka building collapse: Factories and buyers' (2013) <http://www.bbc.co.uk/news/world-asia-22474601> accessed 01 February 2018.

48 Clean Clothes Campaign, 'Who has paid up and who is dragging their heels' (no date) <http://www.cleanclothes.org/ranaplaza/who-needs-to-pay-up> accessed 10 May 2015.

49 *The Guardian*, 'Rana Plaza factory disaster anniversary marked by protests' (2014) <http://www.theguardian.com/world/2014/apr/24/rana-plaza-factory-disaster-anniversary-protests> accessed 01 February 2018.

50 Clean Clothes Campaign Ireland, '20 Brands completely ignore victims of Bangladesh factory disasters and refuse to compensate for their negligence' (no date) <http://cleanclothescampaignireland.org/2013/09/20-brands-completely-ignore-victims-of-bangladesh-factory-disasters-and-refuse-to-compensate-for-their-negligence/> accessed 10 May 2015.

It is suggested that exploring whether section 172 has any impact when MNCs, based in the UK and subject to UK law, operate in developing countries assists in understanding whether the ESV principle can promote CSR. Assessing whether section 172 has had an impact on CSR practices among MNCs that originate in the UK and are also operating in other countries might be able to show whether the section has the capacity to protect all stakeholder groups. This issue also ties in with long-term sustainability, as companies that are found to be involved in abuses of human rights and the exploitation of vulnerable individuals might suffer huge losses due to bad publicity, enraged customers, dissatisfaction of employees, actions being taken by NGOs, etc. Labour policies that reduce costs in the short term might lead to losses in the long term as consumers might stop buying, employee morale may be affected, investors might move their money to other companies that are more attentive to the potential costs of human rights violations and so on.[51]

In addition to providing insight on whether the ESV principle has had an impact on the CSR practices of MNCs that are based in the UK and operate in developing countries, extensive examination of this situation as a recent example of irresponsible business behaviour can also assist in demonstrating the changes that need to be or can be made to improve the current situation. It is contended that analysing this situation contributes to demonstrating how the concept of ESV can promote CSR in a better way, or how it might be reformed to promote CSR.

Aims and objectives

The overall objective of this book is to assess whether the concept of ESV is capable of promoting or assisting CSR, in both domestic and international contexts. As far as the international aspect is concerned, the book examines the impact on multinational enterprises in developing nations. The analysis presented in this book will also help to answer the secondary research questions: if the concept of ESV is capable of promoting or assisting CSR, can it or should it do so in a better way; and if the concept of ESV is not capable of doing so, how could it be reformed in order to do so? This book aims to contribute to the aforementioned questions by explaining the origin and theories of corporate governance that have an impact on companies, along with considering what CSR is and how it operates. It explains and examines the genesis of the ESV principle by discussing the institutional developments that led to the concept of ESV becoming part of the corporate governance regime in the UK. It also critically evaluates the concept of ESV and examines the effectiveness of the ESV principle in protecting stakeholder interests. Following this, this work seeks to examine whether the ESV principle is capable of promoting or assisting CSR in relation to companies in the UK and to

51 Millon, 'Enlightened Shareholder Value, Social Responsibility and the Redefinition of Corporate Purpose Without Law' (n44) at 3.

assess whether implementing an ESV approach has had any impact on the CSR practices of MNCs in developing nations. Lastly, based on the examination of the above, it provides reflections on whether the ESV concept can promote or assist CSR in a better way, or how it could be reformed to do so.

The ESV principle and CSR are both areas of increasing academic and research interest. Consequently, scholars have discussed the concept of ESV and stakeholder interests at great lengths. However, discussions on the ESV principle in relation to CSR are very limited. There are still many questions left to be answered. Furthermore, its potential to have an impact on CSR in an international context has not been explored in depth, if at all. The original contribution of the book is the examination of the link between the two concepts and the findings presented of empirical studies conducted specifically to assess this link, both in a domestic context and an international context. It is respectfully suggested that the book broadens the research literature and offers original insight. It also adds to wider discussions on the role and responsibility of MNCs, the significance of CSR in global supply chains and business ethics. Finally, the empirical analysis also adds an often-overlooked dimension to company law as a field of social scientific inquiry.

Methodology

The research presented in the book relies on a combination of doctrinal, theoretical and qualitative empirical methods. The initial research was doctrinal and involved a thorough review of the published literature, case law, government commissioned reports, guidance provided by the government and media. Predominantly, library and internet-based resources and legal databases were used. This included analysing journal articles and books across several disciplines, cases and annual reports of companies. There was theoretical research in addressing what CSR is as well as considering how it operates, and in explaining and analysing the concept of ESV.

In order to analyse whether the ESV principle promotes or assists CSR, an examination of how companies have reacted to section 172 was undertaken. This involved analysing existing empirical research. Then, an empirical study was conducted to determine whether the concept of ESV is capable of promoting or assisting CSR. This entailed analysing what is sometimes referred to as corporate rhetoric embodied in various corporate documents and websites. The research was conducted through an examination of the public documents of all the retail companies listed on the FTSE 100 Index of the London Stock Exchange. The study was focused on retailers as they tend to have long supply chains and cross-border contact. In addition, focusing on companies in the same sector made the comparison easier and more coherent.

An analysis was undertaken to look at whether implementing an ESV approach has had or could have any impact on the CSR practices of MNCs that originate in the UK and operate in developing countries, through the lens of a case study on the ready-made garment (RMG) industry in Bangladesh and also with some focus

on the Rana Plaza factory disaster. This qualitative method of research was considered to be useful to illustrate whether ESV can promote CSR in a better way, or if it could be reformed to promote CSR. The initial research on the case study involved the use of theoretical methods to explore how the operations of MNCs in developing nations are generally regulated. This involved considering any relevant treaties or codes applying to MNCs operating in developing countries. Then, secondary data, such as journal articles, theses and newspapers, as well as primary data in survey reports and annual reports published by the Bangladesh Garment Manufacturers and Exporters Association (BGMEA) and reports on industrial accidents, unfair trading methods and so on, was examined. Then, extensive fieldwork was undertaken in Bangladesh. Semi-structured interviews were conducted with individuals working for NGOs involved in the improvement of working conditions in the garment industry, company directors or owners of companies that employ workers and sell goods, human rights activists, trade union leaders and individuals who work with the BGMEA in Bangladesh. As a significant number of companies based in the UK source garments from suppliers in Bangladesh, this was an appropriate case study. It was also hoped that the situation of the suppliers in Bangladesh would be illustrative of the situation of suppliers in other developing countries from whom goods or services are sourced by MNCs based in the UK. A holistic approach to the case study enabled the author to gain deeper knowledge than what could be gained through relying solely on primary and secondary sources.

Structure of the book

This book is arranged in chapters. Chapter 1, the current chapter, discussed the background information in relation to main and subsidiary issues of the research and introduced the themes, aims, and significance of the book. It also addressed the methodology. Chapter 2 will provide a conceptual foundation for the book by giving an overview of the two major theories of corporate governance, which will be referred to frequently in later chapters. Shareholder and stakeholder theory are the two major theories that are employed around the globe for tackling the issue of what should be the ultimate objective of large public companies. An analysis of these theories is essential to provide a framework for understanding both the concept of ESV and CSR. The chapter will present a discussion of the main elements of the shareholder and stakeholder theory, including arguments for and against both the theories. Then, it will discuss the concepts and elements of CSR, which includes considering its definitions, theoretical foundation, implementation, justifications, criticisms and significance in a global context and in relation to supply chain management. Chapter 3 will provide a detailed analysis of the concept of ESV. Along with discussions on the institutional developments that led to the enactment of section 172 of the Companies Act, the chapter will include an analysis of the section, examination of its practical impact, and consideration of the effects of the Business Review and its successor, the Strategic Report. Chapter 4 will present a theoretical analysis

that aims to determine whether the concept of ESV is capable of promoting or assisting CSR, and then it will consider empirically whether this has occurred. There will be a discussion of studies carried out previously, followed by a description of the methodology and findings of the empirical study on corporate documents.

Chapter 5 will explore whether the concept of ESV is capable of promoting or assisting CSR in an international context and will present a case study, on the RMG industry in Bangladesh, that was conducted to address this aspect. The chapter will begin by addressing the reason for the study and then it will describe the methodology and present findings of the study. Chapter 6 will draw together the discussions in the previous chapters and provide concluding thoughts on the impact of ESV on CSR. It will summarise the book's general argument that there is a link between the concept of ESV and CSR. This link has been established by the doctrinal and theoretical research on the concept of CSR, the examination of the ESV principle, and the results from the study on the corporate documents. However, in light of the arguments presented in the previous chapters, it will be submitted that section 172 has had limited impact, if any at all, in practice. The research presented in the book will demonstrate that it has not made any significant difference in the position of the stakeholders. Hence, its ability to promote or assist CSR, both domestically and internationally, is also limited. However, considering the fact that there is a link between the two concepts, it will be suggested that the ESV principle could promote CSR if its impact could be improved. The chapter will conclude with some suggestions for reform in this area.

2 Theories of corporate governance and corporate social responsibility

Introduction

The various theories of corporate governance aim to facilitate the understanding of the mechanisms, processes and relations by which companies are directed and controlled. Corporate governance has been defined in many different ways and there is no single, widely-accepted definition.[1] In general terms, in comparative literature the world of corporate governance is usually divided into two models: the Anglo-American model (illustrated by the UK and USA) and the Continental model (illustrated by Japan and Germany). Companies based in the Anglo-American countries usually endorse the shareholder value principle, which considers the maximisation of shareholder wealth as the primary objective of companies. On the contrary, the Continental approach involves the consideration of the interests of all the relevant stakeholders, and thus promotes the stakeholder theory.[2] These are the two major theories that are employed around the globe for tackling the issue of what should be the ultimate corporate objective of large public companies.[3] This was also acknowledged by the CLRSG.[4]

This chapter seeks to provide a conceptual foundation for the book by giving an overview of these two contrasting theories of corporate governance, which will be referred to frequently in later chapters. The key issue regarding the objective of the company is consideration of in whose interests the directors

1 For example, Sir Adrian Cadbury considers corporate governance in its widest sense as encompassing "*the whole framework within which companies operate*" (A. Cadbury, 'Highlights of the Proposal of the Committee on Financial Aspects of Corporate Governance'). The OECD Principles of Corporate Governance state: "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined".

2 S. Wen, *Shareholder Primacy and Corporate Governance: Legal Aspects, Practices and Future Directions* (Abingdon, Oxon, Routledge, 2013) at 10–11.

3 A. Keay, *The Corporate Objective* (Cheltenham, Edward Elgar Publishing Ltd., 2011) at 40.

4 Company Law Review, *Modern Company Law for a Competitive Economy: Strategic Framework*, 1999, London, DTI at paras 5.1.12 to 5.1.33.

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of a company should operate the business. ESV is based on shareholder value while CSR is closely linked with stakeholder theory. Therefore, an analysis of these theories is essential to provide a framework for understanding both the concept of ESV and CSR. The chapter does not aim to cover everything that has been written on both the theories as it will be impossible to do so in one chapter of a book, but it will provide a discussion of the main elements of the shareholder theory and the stakeholder theory. It will then go on to provide a review of the various arguments for and against both theories. The chapter will also explore the concepts and elements of CSR, as it is what the balance of the book is focused on. The different definitions of CSR, its history and evolution and its theoretical foundations will be considered. This will be followed by a discussion of how CSR operates, the justification and motivation for CSR, the criticisms and concerns surrounding CSR and its significance in a global context. Again, this chapter only aims to provide an analytical outline of the key aspects of CSR which is crucial to understanding the arguments and findings presented in this book.

Shareholder theory

Liberal market economies, such as the UK and the US, have certain aspects such as large institutional investors, dispersed share ownership and more risk of hostile takeovers, and they tend to embrace shareholder theory. Even though it is not absolutely clear when shareholder theory became prominent, it definitely gained momentum as a result of the monumental work on the corporation, *The Modern Corporation and Private Property*[5] by Adolf Berle and Gardiner Means, and also due to the individual writings of Berle. Then there were some fluctuations between the two theories until the 1970s. After that, due to institutional investors advocating the implementation of shareholder theory, and the popularity of the law and economics movement which certainly endorsed this theory, the eminence of shareholder theory has been greater since the 1970s. Regardless of when it gained prominence, there is no doubt that it is one of the dominant theories in corporate law.[6]

Description

The theory provides that the primary purpose of the company is to maximise financial returns for shareholders.[7] Consequently, the directors of the company are required to manage the company in a manner that ensures the maximisation

5 A. A. Berle and G. C. Means, *The Modern Corporation and Private Property* (New York, Harcourt, Brace and World, 1967).
6 Keay, *The Corporate Objective* (n3) at 40–43.
7 For example, see M. Friedman, 'The Social Responsibility of Business Is To Increase Its Profits' *New York Times*, September 13, 1970, Section 6 (Magazine) 32 at 33; M. Friedman, *Capitalism and Freedom* (Chicago, IL, University of Chicago Press, 1962) at 133; C. Mayer, 'Corporate Governance, Competition and Performance' (1997) 24 *Journal of Law and Society* 152 at 155.

of shareholder wealth. Directors are only responsible for achieving this narrow purpose of making as much money as they can for the shareholders and are entitled to do anything to achieve that, as long as it is lawful. Hence, in the event of any conflict between shareholder and stakeholder interests, the directors should make decisions in favour of the former. However, this does not mean that stakeholder interests cannot be taken into account. It is well recognised that neglecting stakeholder interests completely can harm the company in the long run and might affect the maximisation of shareholder wealth. Hence, under most views of this theory, the directors should consider stakeholder interests as relevant only when they contribute to increasing shareholder wealth.[8]

Justification for and benefits of the shareholder theory

Contractarian theorists emphasise the contractual relationships that exist between the various parties involved in the affairs of a company. Consequently, they embrace the principle of the sanctity of the contract.[9] Contracts fix the terms under which the participants are to contribute to the company and how they are going to be compensated for their input or supply. Since these participants have the freedom to enter into a contract with the company, they can quite efficiently protect their pre-fixed returns as a result of their contracts with the company. This is not the case for shareholders as their equity investments involve a lot of risk and uncertainty. As the shareholders are only left with residual cash flows after all other company commitments have been fulfilled,

8 A. Keay, 'Getting to Grips With the Shareholder Value Theory in Corporate Law' (2010) 39 *Common Law World Review* 358 at 362–364. For some of the key discussions on shareholder value, see J. R. Macey, 'An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties' (1991) 21 *Stetson Law Review* 23; S. M. Bainbridge, 'In Defense of the Shareholder Maximization Norm: A Reply to Professor Green' (1993) 50 Washington and Lee Law Review 1423; B. Black and R. Kraakman, 'A Self-enforcing Model of Corporate Law' (1996) 109 *Harvard Law Review* 1911; D. Gordon Smith, 'The Shareholder Primacy Norm' (1998) 23 *Journal of Corporation Law* 277; R. Grantham, 'The Doctrinal Basis of the Rights of Company Shareholders' (1998) 57(3) *Cambridge Law Journal* 554; J. Fisch 'Measuring Efficiency in Corporate Law: The Role of Shareholder Primary' (2006) *Journal of Corporation Law* 637; C. O'Kelly, 'History Begins: Shareholder Value, Accountability and the Virtuous State' (2009) 60 *Northern Ireland Law Quarterly* 35.

9 Many contractarians adhere to the nexus of contracts approach to company law. The nexus of contracts theory aims to justify the pursuit of the ultimate objective of maximising shareholder wealth. Under this theory, a firm or company is considered to be a nexus made up of contracts which are entered into by a variety of participants (M. C. Jensen and W.H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305). It must be noted that some contractarians do not accept shareholder primacy, and not all theorists who advocate shareholder value would accept the nexus of contracts theory.

they are considered to be residual claimants.[10] Shareholders have to bear the risk of the company suffering a loss, and hence they are entitled to the excess profit made by the company.[11] Therefore, as the shareholders are the risk-bearers of the company, the interest of the company is aligned with the interests of the shareholders. "For most firms the expectation is that the residual risk bearers have contracted for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock".[12] Agency theory also tends to support shareholder primacy.[13] This theory is based on a number of sources, but its analysis has been particularly influenced by the works of Jensen and Meckling,[14] as well as Jensen and Fama.[15] Under this theory, the directors are regarded as the agents of the shareholders, and they are employed to manage the company for the shareholders. The managers are considered to be imperfect actors whose opportunistic behaviour or disloyal actions will result in the company suffering loss or incurring additional costs for monitoring their behaviour.[16] The costs incurred in monitoring or disciplining the managers are referred to as agency costs. Thus, shareholder primacy is justified because by tasking the managers with a clear goal it acts as an efficient method to decrease managerial shirking and to reduce agency costs.[17] The managers owe their duties to the shareholders and are accountable to the shareholders for their actions. Shareholders are entitled to take action against them via derivative proceedings if they fail to maximise shareholder wealth.[18]

Next, an argument that is always put forward in support of shareholder primacy is that it is efficient.[19] Directors will work more efficiently if they can focus on one goal rather than trying to balance the interests of various constituencies. Also, the way that the managers conduct the affairs of the company can be monitored more efficiently in comparison to being obliged to take into account the interests of various constituencies. A fiduciary duty owed exclusively to the shareholders provides more certainty and is a lot easier to administer than a fiduciary duty

10 Wen, *Shareholder Primacy and Corporate Governance: Legal Aspects, Practices and Future Directions* (n2) at 59–62.
11 F. Easterbrook and D. Fischel, 'The Corporate Contract' (1989) 89 Columbia Review 1416.
12 F. Easterbrook and D. Fischel, *The Economic Structure of Company Law* (Cambridge, Massachusetts, Harvard University Press, 1991) at 36.
13 For the purposes of this book, the terms 'shareholder value' and 'shareholder primacy' have been used interchangeably.
14 Jensen and Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (n9)
15 E. F. Fama and M. C. Jensen, 'Separation of Ownership and Control' (1983) 26 *Journal of Law and Economics* 301; E. F. Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of Political Economy* 288.
16 Jensen and Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (n9) at 307–309.
17 Wen, *Shareholder Primacy and Corporate Governance: Legal Aspects, Practices and Future Directions* (n2) at 58–62.
18 Section 260 of the Companies Act 2006.
19 Keay, *The Corporate Objective* (n3) at 64.

owed to all stakeholders. It also allows the courts to review the actions of directors with some rationality. Shareholder primacy makes the directors more accountable for their actions than a multilateral fiduciary duty, which requires directors to act in the best interests of shareholders, creditors, employees, etc., and which might provide directors with a way to rationalise the most outrageous forms of self-dealing.[20] The property rights analysis also complements the agency analysis in supporting shareholder primacy.[21] If the shareholders are the owners of the assets of the company, the directors should manage the assets of the company in the owners' favour. As the owners of the assets, shareholders have control rights over the company.[22] Hence, they can expect the company to be managed exclusively for their benefit. However, it is also argued that the act of incorporation denies this justification.[23] A company is a separate personality and thus cannot be owned. Nonetheless, some still continue to propound the property rights approach.[24]

Furthermore, it is also asserted that a clear goal of maximising profits is essential for the efficient allocation of resources by the capital markets to maximise social welfare.[25] Various academics, particularly in the field of law and finance, have stated that managers should aim to maximise shareholder value and doing so will maximise social welfare.[26] For example, Hansmann and Kraakman have stated that

> the point is simply that now, as a consequence of both logic and experience, there is a consensus that the best means to this end (that is the pursuit of aggregate social welfare) is to make managers strongly accountable to shareholder interests.[27]

It is argued that the sacrifices made by the stakeholders in a shareholder value system will be compensated for out of the superior arrangement made for the shareholders. Benefits will be spread widely as a result of the shareholders'

20 M. van der Weide, 'Against Fiduciary Duties to Corporate Stakeholders' (1996) 21 *Delaware Journal of Corporate Law* 27 at 67–68.
21 Wen, *Shareholder Primacy and Corporate Governance: Legal Aspects, Practices and Future Directions* (n2) at 70–74.
22 Keay, *The Corporate Objective* (n3) at 66.
23 L. Roach, 'The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach' (2001) 22 *Company Lawyer* 9.
24 See Oliver Williamson's discussion on transaction cost analysis: O. E. Williamson, 'Transactional-Cost Economics: The Governance of Contractual Relations' (1994) 21 *Journal of Law and* Society 168; O. E. Williamson, *Markets and hierarchies: Analysis and antitrust implications: A study in the economics of internal organization* (New York, Free Press, 1975); O. E. Williamson, 'The Economics of Organization: The Transaction Cost Approach' (1981) 87 *The American Journal of Sociology 548*.
25 van der Weide, 'Against Fiduciary Duties to Corporate Stakeholders' (n20) at 69.
26 C. Loderer, L. Roth, U. Waelchli and P. Joerg, 'Shareholder Value: Principles, Declarations, and Actions' (2010) 39 *Financial Management* 5 at 6.
27 H. Hansmann and R. Kraakman, 'The End of History for Corporate Law' (2001) 89 *The Georgetown Law Journal* 439 at 441.

interests being maximised. For example, creditors will receive higher interest payments and employees will be rewarded with higher wages. Some also contend that society can benefit from the maximisation of share prices alone. It is argued that when directors take part in activities that improve the economic conditions of the company and consequently benefit the shareholders, such as lowering production costs and increasing sales, it also benefits society at large.[28]

Lastly, it is asserted that shareholders are in a more vulnerable position in comparison to the other constituencies. Non-member stakeholders have explicit contracts with the company and their interests are protected by contract law and by regulation. Shareholders, on the other hand, have an implicit contract which only stands for a claim on the company's residual cash flows. Contract law does not provide them with any recourse. It can be argued that shareholders are entitled to bring derivative claims, but even if such a claim is successful, damages will be ordered to be paid to the company. Any benefit they gain from a positive outcome is indirect, such as share prices increasing or changes in management behaviour.[29]

Problems and criticisms

One of the arguments usually put forward by proponents of shareholder theory is certainty. In comparison to stakeholder theory, shareholder theory is considered to be more realistic as it provides a clear standard for determining success and proper directions for directors on how they should manage the company. However, there are blatant uncertainties regarding the theory and how it should be implemented. The theory does not give a clear idea as to what directors should be doing. Also, shareholder value maximisation is a vague term. It simply fails to provide proper guidance to directors about what they should do. Should the directors promote shareholder interests at any cost, as long as it is lawful, even if it means polluting the environment and putting employees at risk? Does acting in the interests of the shareholders mean that directors should aim for immediate revenue, or should the directors think about profitability in the long term? Hence, the period in which the objective is to be achieved is also uncertain and unclear. Also, in an investigation of the meaning of shareholder primacy[30] in the context of the development of new financial products and the process of financial innovation, Hu came to the conclusion that shareholder value has never been certain. Furthermore, shareholder value maximisation can mean different things to different shareholders. It will vary depending on their expectations from the company, investment goals, attitude to risk-taking, resources, etc.[31]

28 Keay, *The Corporate Objective* (n3) at 65.

29 A. Sundaram and A. Inkpen, 'The Corporate Objective Revisited' (2004) 15 *Organization Science* 350 at 355–356. Derivative claims are discussed further in Chapter 3.

30 H. Hu, 'New Financial Products, the Modern Process of Financial Innovation and the Puzzle of Shareholder Welfare' (1991) 69 *Texas Law Review* 1273 at 1317.

31 Keay, 'Getting to Grips With the Shareholder Value Theory in Corporate Law' (n8) at 375–376.

As mentioned above, another argument that is usually put forward in support of shareholder primacy is that it is efficient. It is claimed that shareholders have the greatest incentive to monitor the actions of managers to make sure that their wealth is maximised. This will be the most productive outcome for all the parties and ensure the greatest social wealth. Worthington notes that this argument makes a number of assumptions.[32] It assumes that the shareholders have an incentive to monitor the management, such monitoring will result in increasing social wealth and the desired end goal is to increase social wealth. It also assumes that the objective of increase in social wealth is so significant that the shareholder's incentive to monitor the management should be transformed into a legal duty that obliges directors to act in agreement with the shareholders' wishes for maximising their wealth. She states that there are problems with these assumptions.[33] It is true that the shareholders do have an incentive to monitor the directors because if the company is making more profits, it will also result in higher dividends.[34] Shareholders might also be encouraged by this incentive to demand more control rights. However, this does not necessarily mean that shareholders having these control rights will make the directors act more efficiently to maximise social wealth. They may also act inefficiently to maximise shareholder wealth. The law should also aim for goals other than efficiency, but the argument presupposes that efficiency is the most desirable outcome. Even if it is accepted that efficiency is the desired outcome, the argument seems to translate the incentive of the shareholders to have their wealth maximised into their right to have their wealth maximised. The law might support efficiency, but it usually does not oblige it.[35] Finally, it is also asserted that the theory often leads to negative externalities and unchecked social costs; that is, the shareholders are benefitted by the company causing harm to innocent third parties, producing poor products and providing poor working conditions.[36]

It is argued that since the shareholders are residual claimants, it is their right to have the assets of the company managed for their benefit. This assertion relies on the fact that shareholders have residual rights, which is the right to dividends and capital, and this ownership entitles them to control the management of the assets of the company to maximise shareholder wealth. The critical issue concerns the residual rights that the shareholders have. This argument is only valid if their residual rights are to have the company's assets used for them alone. However, if their residual rights only entitle them to the residue after the assets of the company have been managed for other purposes and in other ways, then the residual rights argument will not be able to support the assertion that the company's assets should be managed for the benefit of the shareholders. Also, as mentioned above, the

32 S. Worthington, 'Shares and shareholders: property, power and entitlement: Part 1' (2001) 22 Company Lawyer 258 at 265.
33 Ibid at 265–266.
34 Ibid at 266.
35 Ibid.
36 Keay, *The Corporate Objective* (n3) at 80.

property rights analysis that shareholders are the owners of the company fails on the basis of the act of incorporation which leads to the advent of a separate legal entity. Supporters of shareholder theory try to counter this argument by claiming that even if the shareholders do not own the company or its assets, they have sufficient control over it to move towards practical ownership, and this entitles them to have the company's assets managed for their benefit. This is circular reasoning.[37] "It simply asserts that the shareholders control the company's assets, and from that it follows that they must own them, and because they own them they are therefore entitled to control them, and have them managed in their interests".[38] This argument overstates the control that shareholders have and underestimates the level of control possessed by other stakeholders. There is no correlation between the level of practical control that shareholders have and the idea that directors are legally compelled to act in a way that maximises shareholder value.[39]

Shareholder theory fails to take into account that different shareholders might have different interests. Some might be seeking short-term interests while others are more concerned about long-term interests. Also, shareholder theory has been criticised for promoting short-term managerial thinking. Managers fail to manage for the long term because they feel that shareholder primacy prevents them from doing so; they focus primarily on quarterly earnings figures. They manage the company in a way that hampers the prospect of success in the long term because they believe that the value of the company's share price in the present represents its outlook in the future, and they might be removed by shareholders if they fail to show immediate results. Short-term focus also leads to short-term earnings alone, which outshine everything else and fail to ensure social wealth as claimed by proponents of shareholder theory.[40]

Lastly, it is asserted that shareholder primacy downplays the language of morality and uses the rights claims of shareholders to excuse the violation of the rights of others. It removes moral complexity for directors and managers making corporate decisions. It distorts reality for managers, and promotes an outlook in which the managers do not consider themselves as moral agents who are accountable to a wide group of people for their actions. If their primary duty is to make money for shareholders, it becomes very convenient for them to justify questionable behaviour and practice that harms stakeholders, such as employees, suppliers and the environment, in the name of maximising shareholder value.[41]

37 Worthington, 'Shares and shareholders: property, power and entitlement: Part 1' (n32) at 265.

38 M. Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Washington DC, Brookings Institution, 1995) at 223–225.

39 Worthington, 'Shares and shareholders: property, power and entitlement: Part 1' (n32) at 265.

40 Keay, *The Corporate Objective* (n3) at 82–84, 94.

41 R. E. Freeman, A. C. Wicks and B. Parmar, 'Stakeholder Theory and "The Corporate Objective Revisited"' (2004) 15 *Organization Science* 364 at 367. Also see D. Attenborough, 'The Neoliberal (Il)Legitimacy of the Duty of Loyalty' (2014) 65 *Northern Ireland Legal Quarterly* 405 at 414–415.

Stakeholder theory

The commencement of the use of the term 'stakeholder' is usually credited to the Stanford Research Institute (SRI), as they first used the term in a report called 'The Strategic Plan'. They used the term in the 1960s to describe "those groups without whose support the organisation would cease to exist".[42] Stakeholder concepts as we perceive them now can perhaps be traced back to J. Maurice Clark in an article from 1916.[43] It is possible to see modern stakeholder theory at a rudimentary stage in the work of Professor E. Merrick Dodd in the early 1930s. Then, in 1984 the publication of the landmark book *Strategic Management: A Stakeholder Approach*[44] by R. Edward Freeman sparked serious academic interest in stakeholder theory. This is usually considered as the origin of the theory in its organised modern form.[45] As time went by, stakeholder theory received greater importance due to public interest, greater coverage by the media, concerns about corporative governance etc.

Description

Stakeholder theory provides that those who are involved in or affected by the actions of the company, as groups and individuals, should be considered by the board, and stakeholders should be involved in corporate decision making because they have a stake in it. This membership consigns responsibilities on those who are involved, along with providing them with rights associated with belonging to the company. The stakeholder philosophy begins from the principle that inclusion is an important concept, and this involves the social, political and economic. It is asserted that the mutually receptive association of people in social, economic and political systems produces better outcomes for everyone. The idea is that all the constituents work together for a shared objective and gain mutual benefits for participating in the business's project. It is asserted that the real strength of the idea is that it goes on from a descriptive analysis of the ways companies function to the normative, and to a recommendation of how they can operate better based on a principle of fairness and inclusivity.[46]

Stakeholder theory cannot be seen as a single theory. Instead, it should be seen as a set of theories for the management of stakeholders.[47] Dean states that the

42 This was quoted in R. E. Freeman, *Strategic Management: A Stakeholder Approach* (Boston, Pitman, 1984).

43 See J. M. Clark, 'The Changing Basis of Economic Responsibility' (1916) 24 *Journal of Political Economy* 209.

44 Freeman, *Strategic Management: A Stakeholder Approach* (n42).

45 See Keay, 'Getting to Grips With the Shareholder Value Theory in Corporate Law' (n8) at 361; Keay, *The Corporate Objective* (n3) at 22, 122–123.

46 J. Dean, *Directing Public Companies: Company law and the stakeholder society* (London, Cavendish Publishing Limited., 2001) at 93–97.

47 See T. Donaldson and L. E. Preston, 'The stakeholder theory of the corporation: concepts, evidence and implications' (1995) 20 *Academy of Management Review* 65.

> theoretical writings about stakeholding have fallen into the following categories: (a) Descriptive observations – 'the way things are', interdependence of corporate participants. (b) Instrumental procedures – focus on business objectives, analysis to aid profitability. (c) Normative statements – pronouncements on ethics, principles of participation in business.[48]

The normative aspect is an explanation on a moral basis of how stakeholders should be treated, and it provides that they should be treated as ends and not means. This is unlike the shareholder value approach, where stakeholders are treated as means. The descriptive aspect is used to explain specific corporate behaviour. The instrumental aspect gives a framework for assessing the correlation between using this form of management and how a company performs. It examines how stakeholder theory can improve a company's efficiency and profitability.[49]

In this theory it is important to determine who the stakeholders are, and a number of different approaches are taken to define stakeholders. Freeman defined stakeholders as "any group or individual who can affect or is affected by the achievement of the organization's objectives".[50] This is how the term stakeholder is classically defined. Another popular definition is given by Clarkson, who differentiates between primary and secondary stakeholders. According to Clarkson, "A primary stakeholder group is one without whose continuing participation the corporation cannot survive as a going concern".[51] This would typically include shareholders, investors, employees, suppliers and public stakeholder groups. Public stakeholder groups are the governments and communities that provide infrastructures and markets, whose laws should be adhered to, and to whom certain obligations such as taxes are due. So, primary stakeholders and the company are highly dependent on one another. Secondary stakeholder groups are "those who influence or affect, or are influenced or affected by, the corporation, but they are not engaged in transactions with the corporation and are not essential for its survival".[52] This would include the media and a wide range of special interest groups. They have the power to affect public opinion about the company.[53]

Justification and arguments in support of the theory

Stakeholder theory holds that economic value is created by people who voluntarily unite and collaborate to make everyone's situation better. This is

48 Dean, *Directing Public Companies: Company law and the stakeholder society* (n46) at 97.
49 See Donaldson and Preston, 'The stakeholder theory of the corporation: Concepts, evidence and implications' (n47).
50 Freeman, *Strategic Management: A Stakeholder Approach* (n42) at 46.
51 M. E. Clarkson, 'A stakeholder framework for analyzing and evaluating corporate social performance' (1995) 20 *Academy of Management Review* 92 at 106.
52 Ibid at 107.
53 Ibid.

highlighted by today's economic realities. Managers of companies have to cultivate relationships, motivate their stakeholders and build an environment where all the constituencies endeavour to do their utmost to deliver the value that the company assures. Shareholders are, without a doubt, a very significant group and making profits is a crucial part of this. However, making profits should not be the ultimate outcome of the process of value creation. There are many companies that operate their businesses in ways conforming to the ideals of stakeholder theory. Even though these companies give a lot of importance to their shareholders and value their profitability, it is not what drives them. Maintaining good relationships with stakeholders is a crucial part of their success. Shareholder theory's focus on a single goal separates the economic from the ethical aspects and values. This is a very narrow outlook that simply cannot do justice to the amalgamation of human activity that is business. On the other hand, stakeholder theory is a better approach to explain and direct the behaviour of managers, as it is natural that creating value for stakeholders is strongly correlated to the idea of value creation and trade. Business is about constructing a deal so that all the suppliers, employees, customers, communities, shareholders and managers continue to succeed over time. If the stakeholder interests are not united and they travel in different directions, some parties are bound to leave and form a new association.[54] In order to be successful, a company must produce returns for shareholders, employ and inspire outstanding employees, ensure customers are satisfied and cultivate good relationships with suppliers.[55] It is better for everyone that the managers seek to generate as much value for stakeholders as they can. It will also produce greater social wealth. Even though the shareholders might not make as much in the short term, they will be better off in the long term.

As discussed above, proponents of shareholder theory claim shareholder primacy is based on a property rights analysis. It has even been argued that stakeholders have property rights:

> Consumers have the property right to their wealth. Suppliers have the property right to the supplies that they sell to the corporation. Employees have a property right to their labour. Communities have a property right to public goods. In order to respect these property rights, managers must pay attention to stakeholders.[56]

The idea is that since the stakeholders have contributed to the capital of the company, they have a claim on the company's property and profits. They have

54 R. E. Freeman, A. C. Wicks and B. Parmar, 'Stakeholder Theory and the Corporate Objective Revisited' (2004) 12 *Organization Science* 364 at 365.

55 Dean, *Directing Public Companies: Company law and the stakeholder society* (n46) at 251.

56 R. E. Freeman and R. Phillips, 'Stakeholder Theory: A Libertarian Defense' (2002) 12 *Business Ethics Quarterly* 331 at 338.

also risked their investments in the company like shareholders have.[57] It is also argued that considering the interests of all the stakeholders is important for the long-term sustainability of the company. It is important that the stakeholders are treated fairly, and one group is not favoured at the expense of others. The increased wealth and value created by the company should be distributed fairly among stakeholders groups to ensure that these groups continue to participate in the company's stakeholder system.[58] If one group feels, over the course of time, that is it being treated unfairly or inadequately, it may look for other alternatives and eventually decide to leave the company's stakeholder system. The company's survival will be at risk if withdrawals occur.[59] Lastly, it is contended that all stakeholders have intrinsic value and are morally entitled to be considered in corporate decision making. They have the right to take part in decisions that can considerably affect their welfare. A duty is imposed on all organisations regarding the individuals who are involved with them. This is found on a moral basis, and not doing so would amount to a breach of human rights.[60]

Problems and criticisms

The main criticisms of stakeholder theory centre around its lack of solid normative foundations, its lack of clarity, especially in the balancing of interests by directors and issues regarding implementation. It has been argued that stakeholder theory has been unable to give any normative foundations for its justification. In particular, it does not provide a normative basis for determining who is a stakeholder and for deciding how much weight should be given to the interests of each stakeholder. As a result, managers do not have a basis to prefer stakeholderism in comparison to other moral approaches. Defining stakeholders is extremely important as it is the first crucial step in applying stakeholder theory. In spite of the volume of literature on this theory, however, the term is considered to be vague and ambiguous.[61] Hence, the discernment of which groups are stakeholders is a very significant shortcoming of stakeholder theory. The idea that a stakeholder is anyone or any group which is the legitimate object of managerial or organisational attention is probably common to almost all the definitions of a stakeholder. The idea of legitimacy, that is that some constituencies are worthy of attention and some are not, is a very important aspect of this common understanding. However, this concept of legitimacy also remains vague within the literature regarding stakeholder theory, and is inconsistent with other literature which are significant to

57 Keay, *The Corporate Objective* (n3) at 132.
58 See M. M. Blair and L. A. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247.
59 Clarkson, 'A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance' (n51) at 112.
60 Keay, *The Corporate Objective* (n3) at 134.
61 A. Keay, 'Stakeholder Theory in Corporate Law: Has It Got What It Takes?' (2010) 9 *Richmond Journal of Global Law & Business* 249 at 273.

the study of organisations. This vagueness of the idea of stakeholder legitimacy is also apparent in the debate between those that advocate a broad definition and those who advocate a narrow definition of stakeholder. An excessively broad definition of stakeholder is detrimental to the meaningfulness of the term because if everyone is considered a stakeholder, the theory will fail to add any value.[62]

It is asserted that there is a lack of guidance on how managers should handle conflicting interests, and a failure to provide clear management objectives.[63] There might be different views on what constitutes a benefit within a particular stakeholder group, and this creates more difficulties for directors.[64] The problems with implementation also centre around the range and diversity of stakeholders. There is a lack of guidance on how directors can balance so many different and competing interests which include the shareholders' desire for higher dividends, the employees' wish for higher wages and the customers' yearning for lower prices. On what basis is the balance to be struck? It is argued that the need to strike such a complex balance makes the set of objectives impossible to achieve, and this diffusion of aims might also impair efficiency. There are also concerns about making directors accountable to such a wide variety of stakeholders. It is claimed that this gives directors a way to justify any decision, which might lead to them engaging in opportunistic behaviour. Being accountable to just about everyone might mean being accountable to no one, in that accountability is not only diluted by being distributed between different groupings, but also what allocation each grouping has can be cancelled out by managers playing off one set of interests against another.[65] This is why the theory is criticised for being unworkable.

Lastly, the stakeholder theory has major shortcomings when it comes to implementation and enforcement. As discussed above, the theory fails to provide directors with guidance on how to balance the interests of divergent stakeholder groups, and this causes a problem of enforcement. As mentioned in the last chapter, Berle favoured an approach similar to stakeholder theory, but he simply could not see how it could be done.[66] Another issue that correlates with enforcement is: what should be done in the event of any breach of the stakeholder approach by directors? Should all stakeholders be given the power to bring legal proceedings when there is a breach? Another problem that flows from this is that it will probably be one or more of the directors who will be responsible for the breach, and the breach will harm the company's interests. Only the company can enforce harm done to it and the directors will decide whether or not proceedings should be

62 R. Phillips, 'Stakeholder Legitimacy' (2003) 13 *Business Ethics Quarterly* 25 at 28.
63 E.W. Mainardes, H. Alves and M. Rapose, 'Stakeholder theory: Issues to resolve' (2011) 49 *Management Decision* 226 at 241.
64 S. Letza, X. Sun and J. Kirkbride, 'Shareholding versus Stakeholding: A Critical Review of Corporate Governance' (2004) 12 *Corporate Governance: An International Review* 242 at 255.
65 J. Kaler, 'Evaluating Stakeholder Theory' (2006) 69 *Journal of Business Ethics* 249 at 254.
66 E. M. Dodd Jr., 'For Whom are Corporate Managers Trustees?' (1932) *Harvard Law Review* 1145.

brought on behalf of the company, and they are unlikely to bring proceedings against themselves.[67] Furthermore, under section 260 of the Companies Act 2006 it is only the shareholders of the company who have the power to bring statutory derivative proceedings on behalf of the company for a breach of duty by a director. Hence, this does not provide the stakeholders with any remedy in the event of a breach.

Corporate social responsibility

Arguments for a contemporary stakeholder approach have been paralleled by the rise of the worldwide CSR movement. Williams and Conley argue that there is a causal link between these parallel developments.[68] In particular, they contend that the CSR movement has been a driving force in shifting corporate governance theory more towards the stakeholder direction by requiring companies to act beyond the purpose of creating short-term wealth for shareholders and pursuing wider goals, which include sustainable growth, fair employment practices and long-term social and environmental well-being.[69] These objectives have been pursued by the CSR movement both directly, by demanding significant changes in corporate behaviour, and indirectly, by encouraging extensive disclosure of corporate social and environmental information in the hope that the shareholders will ultimately use their power and require the major changes that are desired.[70] In various countries the advocates of CSR have had the very challenging job of trying to convince the corporate and legal communities to shift their focus from the narrow goal of shareholders' immediate returns to the wider goal of corporate well-being, or what could be called stakeholder value.[71] These statements reflect the relationship between CSR and stakeholder theory.

Definitions

The field of CSR has grown immensely and contains an abundance of approaches and terminologies. Even though the concept of CSR is discussed extensively both in theory and practice,[72] there is no universally accepted definition of CSR[73]

67 Keay, 'Stakeholder Theory in Corporate Law: Has It Got What It Takes?' (n61) at 294.
68 C. A. Williams and J. M. Conley 'An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct' (2005) 38 *Cornell International Law Journal* 493 at 495.
69 Ibid.
70 Ibid.
71 D. M. Branson, 'Corporate Governance Reform and the "New" Corporate Social Responsibility' (2001) 61 *University of Pittsburgh Law Review* 605 at 611–15.
72 M. Weber, 'The Business Case for Corporate Social Responsibility: A Company-Level Measurement Approach for CSR' (2008) 26 *European Management Journal* 247 at 247.
73 D. Turker, 'Measuring Corporate Social Responsibility: A Scale Development Study' (2009) 85 *Journal of Business Ethics* 411 at 412.

because the demands and expectations of the many stakeholders in corporate practices are continuously modifying due to the rapid changes in the corporate world.[74] This lack of consensus regarding the definition of CSR is one of the reasons why there is a limited conceptual understanding of CSR.[75] This chapter now considers some of the main perspectives of CSR.

Davis took the view that CSR is "businessmen's decisions and actions taken for the reasons at least partly beyond the firm's direct economic or technical interest".[76] Carroll mentioned that to fully address the whole range of obligations business has to society, a definition of social responsibility must represent the economic, legal, ethical and discretionary categories of business performance.[77] He stated the definition of CSR as follows: "the social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time".[78] Carroll's framework has been utilised and built on by a number of scholars.[79] Roberts states that "prior research has defined corporate social responsibility activities as policies or actions which identify a company as being concerned with society-related issues".[80] Waddock defines corporate responsibility (CR) as "the degree of (ir)responsibility manifested in a company's strategies and operating practices as they impact stakeholders and the natural environment day to day". She then goes on to specify that CSR is "the subset of corporate responsibilities that deals with a company's voluntary/discretionary relationships with its societal and community stakeholders".[81] A widely-used definition of Corporate Social Performance (CSP) that was penned by Wood[82] also partly encapsulates what is considered by many to be CSR: "a business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programmes, and observable outcomes as they relate to the firm's societal relationships". These definitions also reflect that

74 J. Zhao, *Corporate Social Responsibility in Contemporary China* (Cheltenham, Edward Elgar Publishing Ltd., 2014) at 9.
75 A. Gulyas, 'Corporate Social Responsibility in the British Media Industries – Preliminary Findings' (2009) 31 *Media, Culture & Society* 657.
76 K. Davis, 'Can Business Afford to Ignore Social Responsibilities?' (1960) 2 *California Management Review* 70 at 70.
77 A. B. Carroll, 'A three-dimensional conceptual model of corporate performance' (1979) 4 *Academy of Management Review* 497 at 499.
78 Ibid at 499, 500.
79 For example, see D. J. Wood, 'Corporate Social Performance Revisited' (1991) 16 *Academy of Management Review* 691; M. Clarkson, 'A Stakeholder Framework for Analysing and Evaluating Corporate Social Performance' (1995) 20 *Academy of Management Review* 92.
80 R. W. Roberts, 'Determinants of CSR Disclosures: An Application of Stakeholder Theory' (1992) 17 *Accounting, Organizations and Society* 595 at 595.
81 S. Waddock, 'Parallel Universes: Companies, Academics, and the Progress of Corporate Citizenship' (2004) 109 *Business and Society Review* 5 at 10.
82 D. Wood, 'Corporate Social Performance Revisited' (1991) 16 *The Academy of Management Review* 691 at 693.

the term CSR is sometimes used almost interchangeably with the terms CR, CSP or Corporate Citizenship (CC).[83]

However, in spite of the various differences in the definitions of CSR, some common elements are present[84] and many academics have tried to summarise the core CSR characteristics.[85] The European Commission has also tried to summarise them in its 2002 Communication on CSR:

> Despite the wide spectrum of approaches to CSR, there is large consensus on its main features:
>
> – CSR is behaviour by businesses over and above legal requirements, voluntarily adopted because businesses deem it to be in their long-term interest;
> – CSR is intrinsically linked to the concept of sustainable development: businesses need to integrate the economic, social and environmental impact in their operations;
> – CSR is not an optional "add-on" to business core activities – but about the way in which businesses are managed.[86]

However, even among these features there is contradiction. Each of the elements set out above still creates its own arguments and has its own limitations. It only serves as a starting point for further exploring the concept of CSR for the twenty-first century.[87]

History and evolution

The concept of CSR has a very long and varied history in the literature. Carroll has provided a historical sequence of the major developments in CSR from the 1950s to the 1990s.[88] He states that even though CSR was referred to quite a few times before the 1950s, this was the decade that steered the way for what might be referred to as the modern era of CSR definitions. The landmark book *Social Responsibilities of the Businessman*[89] by Howard Bowen commemorates the beginnings of the modern period of literature on this subject. He provided an initial

83 J. Jonker and A. Marber, 'Corporate Social Responsibility Quo Vadis?: A Critical Inquiry into a Discursive Struggle' (2007) 27 *Journal of Corporate Citizenship* 107 at 109.
84 B. Horrigan, *Corporate Social Responsibility In The 21st Century* (Cheltenham, Edward Elgar Publishing Ltd., 2010) at 42.
85 L. Albareda, 'Corporate responsibility, governance and accountability: from self-regulation to co-regulation' (2008) 8 *Corporate Governance* 430 at 433; also see Zhao, *Corporate Social Responsibility in Contemporary China* (n74) at 9–12.
86 The European Commission, COM (2002) 347 at 5.
87 Horrigan, *Corporate Social Responsibility In The 21st Century* (n84) at 42.
88 A. B. Carroll, 'Corporate Social Responsibility: Evolution of a Definitional Construct' (1999) 38 *Business & Society* 268.
89 H. R. Bowen, *Social Responsibilities of the Businessman* (New York, Harper & Row, 1953).

definition of the social responsibilities of businessmen: "It refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society". Because of Bowen's early and influential work, he has been referred to as the Father of CSR by scholars such as Carroll[90] and Windsor.[91] Then in the 1960s there was considerable development in the literature on CSR that attempted to formalise what CSR means, and academics publicised most of this definitional literature. One of the most significant writers during this period was Keith Davis,[92] who was well known for his views on the link between social responsibility and business power. He laid out his well-known "Iron Law of Responsibility," which states that the "social responsibilities of Businessmen need to be commensurate with their social power".[93]

Then, in the 1970s the number of definitions of CSR began to increase and they also became more specific.[94] CSP and corporate social responsiveness were also increasingly being mentioned during this time. In the 1980s fewer original definitions of CSR were added, but there was more focus on conducting research on and trying to measure CSR. Lastly, Carroll mentions that in the 1990s the concept of CSR shifted considerably to related concepts and themes such as stakeholder theory, business ethics theory,[95] CSP and CC. However, writers did not reject the concept of CSR, but there were no new definitions formulated to add to the body of literature.

The CSP model set forth by Wood[96] was an important contribution to the treatment of CSR.[97] It should be noted that Carroll revisited his former four-part definition of CSR in 1991, referring to the discretionary component as philanthropic and suggesting that it should adopt CC.[98] Lastly, for the millennium

90 Carroll, 'Corporate Social Responsibility: Evolution of a Definitional Construct' (n88) at 270.

91 D. Windsor, 'The future of corporate social responsibility' (2001) 9 *International Journal of Organizational Analysis* 225 at 230.

92 For examples of his work see K. Davis, 'The Case For and Against Business Assumption of Social Responsibilities' (1973) 1 *Academy of Management Journal* 312; and Davis, 'Can Business Afford to Ignore Social Responsibilities?' (n76).

93 Carroll, 'Corporate Social Responsibility: Evolution of a Definitional Construct' (n88) at 271.

94 Ibid at 291.

95 Business ethics can be defined as "the study of business situations, activities, and decisions where issues of right and wrong are addressed". See A. Crane and D. Matten, *Business Ethics* (Oxford, Oxford University Press, 2016) at 5. It can also be considered a "subset of corporate responsibility offering a crucial analytical tool for understanding. Conceptualizing, and legitimizing whether the actions and behaviour of companies are morally right or wrong"; see M. Blowfield and A. Murray, *Corporate Responsibility* (Oxford, Oxford University Press, 2014) at 14–16.

96 Wood, 'Corporate Social Performance Revisited' (n79).

97 Carroll, 'Corporate Social Responsibility: Evolution of a Definitional Construct' (n88) at 291, 292.

98 See A. B. Carroll, 'The pyramid of corporate social responsibility: Toward the moral management of organizational stakeholders' (1991) 34 *Business Horizons* 39.

century he suggested that measurement initiatives and theoretical developments will receive increased attention and emphasised the importance of empirical research to reconcile theory with practice. He asserted that the concept of CSR will continue to be a necessary aspect of business language and practice as it is a very important foundation for many of the other theories, and is persistently consistent with the expectations of the public as far as the business community is concerned.[99]

Another well-known classification was made by Frederick,[100] who suggested that the history of CSR can be categorised into four phases: CSR1, CSR2, CSR3 and CSR4.

> Frederick outlined a classification based on a conceptual transition from the ethical-philosophical concept of CSR (what he calls CSR1), to the action-oriented managerial concept of social responsiveness (CSR2). He then included a normative element based on ethics and values (CSR3) and finally he introduced the cosmos as the basic normative reference for social issues in management and considered the role of science and religion in these issues (CS4).[101]

He stated that CSR1 developed in the 1960s and 1970s, and CSR2 began in the late 1970s to 1980s. CSR3 originated in the late 1980s, and CSR4 started in 1998.[102]

Theoretical foundation

There are a number of theories that explain CSR. For example, theories such as stakeholder theory, social contract theory and legitimacy theory provide explanations for how and why businesses might undertake CSR.[103] Garriga and Melé[104] have provided a good classification of CSR theories. They have stated that most of the current CSR theories are focused on four main aspects: meeting objectives that produce long-term profits, using business power in a responsible way, integrating social demands and contributing to a good society by doing what is

99 Carroll, 'Corporate Social Responsibility: Evolution of a Definitional Construct' (n88) at 292.

100 See W. C. Frederick, 'Theories of Corporate Social Performance' in S. P. Sethi and C. M. Falbe, *Business and Society. Dimensions of Conflict and Cooperation* (Toronto, Lexington Books, 1987) at 142–161. Also, see W. C. Frederick, 'Moving to CSR4: What to pack for the trip' (1998) 37 *Business and Society* 40.

101 E. Garriga and D. Melé, 'Corporate Social Responsibility Theories: Mapping the Territory' (2004) 53 *Journal of Business Ethics* 51 at 52.

102 Jonker and Marber, 'Corporate Social Responsibility Quo Vadis?: A Critical Inquiry into a Discursive Struggle' (n83) at 110–111.

103 L. Moir, 'What do we mean by corporate social responsibility?'(2001) 1 *Corporate Governance* 16 at 19–20.

104 Garriga and Melé, 'Corporate Social Responsibility Theories: Mapping the Territory' (n101).

ethically correct. They used these aspects to categorise the most relevant theories on CSR and related concepts into four groups: instrumental, political, integrative and value theories. According to them, instrumental theories focus on achieving objectives through social activities and understand CSR as a mere means to the ends of profits. Some of the approaches include shareholder profit maximisation,[105] strategies for creating competitive advantages[106] and using socially recognised altruistic activities as marketing instruments.[107] Political theories focus on the social power of businesses and the responsible use of that power in the political arena. Examples include integrative social contract theories, which state that there is a social contract between businesses and society.[108] Integrative theories focus on the integration of social demands in such a way that businesses function in line with social values.[109] Lastly, ethical theories understand that the relationship between business and society is embedded with ethical values. These focus on aspects such as universal rights,[110] sustainable development[111] and the common good of society.[112,113]

How does CSR operate?

The regulations governing CSR exist in a range of forms and are drawn up and put into place by regulatory bodies at various levels. Government regulations are at the most significant level. These regulations are usually formal and binding in law. They can also take the form of recommendations that are not binding in law, but which are meant to be a form of guidance. Public regulations are issued by local government bodies. These public regulations are regional, national or supra-national (for example, the European Union), depending on the designated state, government or international powers (for example, the United Nations) that are based on the membership of every nation.[114] Furthermore, the legal environment has been made more complex

105 For example, see Friedman, 'The Social Responsibility of Business Is To Increase Its Profits' (n7).
106 See M. E. Porter and M. R. Kramer, 'The Competitive Advantage of Corporate Philanthropy' (2002) 80 *Harvard Business Review* 56.
107 See C. K. Prahalad and A. Hammond, 'Serving the World's Poor, Profitably' (2002) 80 *Harvard Business Review* 48.
108 See T. Donaldson and T. W. Dunfee, 'Towards a Unified Conception of Business Ethics: Integrative Social Contracts Theory' (1994) 19 *Academy of Management* 252.
109 Garriga and Melé, 'Corporate Social Responsibility Theories: Mapping the Territory' (n101) at 57.
110 See UN Global Compact (2018) <https://www.unglobalcompact.org/> accessed 25 January 2015.
111 See T. N. Gladwin and J. J. Kennelly, 'Shifting Paradigms for Sustainable Development: Implications for Management Theory and Research' (1995) 20 *Academy of Management Review* 874.
112 See R. Kaku, 'The Path of Kyosei' (1997) 75 *Harvard Business Review* 55.
113 Garriga and Melé have provided a table summarising these theories and their related approaches in Garriga and Melé, 'Corporate Social Responsibility Theories: Mapping the Territory' (n101) at 57.
114 Zhao, *Corporate Social Responsibility in Contemporary China* (n74) at 14–15.

by globalisation, as it makes corporations vulnerable to international law as well as the laws of individual foreign countries. Supporters of CSR who are involved in encouraging companies to be more environmentally friendly, sustainable businesses and firms that emphasise the importance of human rights will also compel companies to implement ethical codes and guidelines for conduct that is more socially responsible, even though adopting such codes is mostly done voluntarily.[115]

International law plays a very important part in promoting CSR, because it plays such a significant role in determining its substance. It also acts as guidance for the self-regulation of CSR along with providing guidance for reporting, benchmarking and government regulation concerning CSR matters. International human rights law, international labour law and international environmental law and principles, in particular, are very important for ascertaining the substance of CSR, for its self-regulation and for CSR reporting. Even though CSR is usually seen as doing more than what the law requires, a lot of CSR claims that stakeholders make and various CSR activities that companies engage in seem to be founded on evaluation of conformity with international law, mainly labour and human rights law. The regulation of CSR by governments and efforts made to implement such regulation, particularly at the supranational and international levels, are consulted frequently and substantially in international law.[116]

In spite of the common perception that CSR is going beyond what the law requires, quite a few legislative plans or proposals are considered by many to be CSR legislation. Several countries have national legislation regarding the reporting of CSR matters. In Denmark, particular types of companies that cause pollution have been legally obliged to keep environmental accounts since 1995, as well as to make them known to the public. In the late 1990s Belgium, the Netherlands, Norway and Sweden sanctioned laws that compelled particular types of companies to report environmental information in their annual accounts.[117] In the UK, under section 414A of the Companies Act all companies that are not defined as small are required to prepare a Strategic Report, and certain companies must include a non-financial information statement in the Strategic Report.[118] This requirement will be discussed in depth in later chapters.

115 Ibid.

116 K. Buhmann, 'Corporate Social Responsibility: What Role for Law? Some Aspects of Law and CSR' (2006) *Corporate Governance* 188 at 189–193. For a multifaceted discussion on the relationship between CSR and law, see D. McBarnet 'Corporate social responsibility beyond law, through law, for law: the new corporate accountability' in D. McBarnet, A. Voiculescu and T. Campbell (eds) *The New Corporate Accountability: Corporate Social Responsibility and the Law* (Cambridge, Cambridge University Press, 2008).

117 "Green accounts", Act on Environmental Protection, § 35a as cited in Buhmann, 'Corporate Social Responsibility: What Role for Law? Some Aspects of Law and CSR' (n116).

118 414CA of the Companies Act 2006.

Companies themselves are introducing measures to become more socially responsible:

> Business leaders have used different mechanisms to spread new responsible business principles: voluntary instruments adopted individually in the market: self-regulation; voluntary instruments adopted collectively through inter-firm cooperation: business organizations; and voluntary instruments adopted collectively through cooperation with other actors: public-private and hybrid partnerships (NGOs, international organizations, trade unions, governments).[119]

In quite a few European countries, the tendency until now has been that companies are becoming socially responsible voluntarily, which means without being legally required to adopt that approach. A lot of such self-regulation is based on Codes of Conduct written and implemented by the companies themselves, or in certain situations by NGOs or consultancies, sometimes with wider applicability. In the European Commission's 2001 Green Book on CSR[120] and in the follow-up 2002 Communication,[121] it encouraged voluntariness. Even then, the Commission made quite particular assertions that companies should show that they are socially responsible to their employees in the European Union as well as in the developing world. Companies are clearly pushed to adopt the ILO (International Labour Organization) labour standards and the OECD's (Organisation for Economic Co-operation and Development's) Guidelines for Multinational Enterprises as minimum standards, which is an explicit indication to international law and standards, for their operations.[122]

The concept of CSR is very closely related to information disclosure. It can be voluntary or legally required to report on CSR issues. There has been growth in the development of legal requirements imposed on particular kinds of companies to provide information on social and environmental responsibility as well as ethics. There is also a lot of variation in voluntary reporting. To facilitate the reporting of CSR issues, many methods and instruments have been developed. NGOs have been working towards this and governments have also encouraged such proposals. It is also of interest that a number of these refer to national and international law as a starting point for the development of indicators and benchmarks. A growing number of companies produced non-financial reports even when

119 Albareda, 'Corporate responsibility, governance and accountability: From self-regulation to co-regulation' (n85) at 434.

120 Commission (2001), *Promoting a European Framework for Corporate Social Responsibility*, COM (2001) 366, European Commission, Luxembourg.

121 Commission (2002), *Corporate Social Responsibility: A Business Contribution to Sustainable Development*, European Commission, Office for Official Publications of the European Communities. Luxembourg.

122 Ibid.

they were not legally required to do so.[123] The stakeholder perspective on whether a company is meeting the ethical standards of each and every stakeholder depends significantly on voluntary reporting. These reports enable the stakeholders to approve the manner in which the company operates. If the information that is stated in the report is assessed according to the standards that the specific stakeholder group expects the company to meet, the result will be positive. For example, it might enhance the company's reputation, attract investment and increase market share. On the other hand, if the company fails to meet the expectations of the particular stakeholder group, it can lead to negative sanctions which include harming the reputation of the company and losing investment or market share. Such negative repercussions might be more important to a modern company than paying a fine or compensation for violation of a regulation.[124] Making use of legal instruments and standards in the reporting of CSR issues highlights that these instruments and standards are significant for the enforcement of CSR strategies and are not just in use for expressing general principles or values in companies. Often, legal methods and standards are utilised to delineate qualitative benchmarks when qualitative objectives or evaluations are simply not sufficient for actual action. Even though CSR supposedly involves doing more than what is legally required, the precision of legal standards seems to be effective in the procedure of designing plans for enforcement or reporting on matters that are instilled with political sensitivity as well as being more qualitative than quantitative.[125]

As can be seen from the discussion above, there is a close relationship between CSR and law. Law and legal standards in many different forms, such as statutes, recommendations and declarations of international law, have a significant role in implementing and communicating CSR. Various governments use statutory law to compel or encourage companies to engage in CSR activities, and international law and recommendations also act as a source of CSR. Although engaging in CSR is presumably doing more than what is legally required, CSR appears to operate as informal law. It also appears to be established on the foundation of a set of fundamental principles of law. Governments use statutory law as a way to ensure that companies behave in a certain manner by insisting that certain types of companies report on CSR issues. Governments utilise law by referring to international law and supranational organisations in their recommendations to encourage companies to engage in certain activities. When companies are held responsible for their

123 KPMG has been tracking the trends in reporting on CR since 1993. It is mentioned in the report published in 2017 that the tendency for large companies to include information on CR in their annual financial reports is continuing to increase. See: J. L. Blasco and A. King, (2017). *The Road Ahead: The KPMG Survey of Corporate Responsibility Reporting 2017*. <https://home.kpmg.com/content/dam/kpmg/campaigns/csr/pdf/CSR_Reporting_2017.pdf> accessed 10 October 2017.

124 Buhmann, 'Corporate Social Responsibility: What Role for Law? Some Aspects of Law and CSR' (n116) at 196–197.

125 Ibid.

disregard for human rights, environmental protection, labour rights etc., investors, employees, customers, NGOs and other stakeholders form their judgements based on evaluations of law as well as principles of law.[126]

Justification and motivation for CSR

Next, it is imperative to discuss the legitimacy of the concept of CSR. The debate about whether or not it is justifiable to expect companies to be concerned about broader community issues has been continuing for years.[127] As mentioned before, the traditional outlook has been that the fundamental responsibility of businesses is to manage their own affairs, and anything that prevents a company from maximising its profitability should be considered an unwanted obstruction.[128] This traditional outlook has been increasingly challenged by putting forward arguments supporting greater social responsibility of businesses.[129] In this section, the various arguments that justify CSR and the various reasons that motivate executives to promote CSR will be discussed. The case for CSR can be divided into two perspectives, the normative case and the business case. The normative case states that a company should be socially responsible because morally it is the right way to behave. The focus is on moral and ethical aspects. The business case, on the other hand, has an emphasis on the idea of enlightened self-interest, which means companies exploring the possibility of increasing profitability by being socially responsible.[130] This differentiation can also be termed as extrinsic (financial) and intrinsic (ethical and altruistic) motives.[131] Even though there is a stark difference between the two outlooks, the motivation behind a company engaging in CSR activities might show a combination of both of them.[132]

One of the most important extrinsic motives is attracting employees. Along with showing high levels of moral and ethical conduct, being socially responsible has been shown to provide companies with instrumental benefits and many types of competitive advantages such as more motivated employees, being able to attract and retain desired employees, enhanced reputation and superior financial

126 Ibid at 197–199.

127 M. Schaper and L. Savery, 'Entrepreneurship and Philanthropy: The Case of Small Australian Firms' (2004) 9 *Journal of Development Entrepreneurship* 239 at 240.

128 See B. E. Joyner, D. Payne and C. A. Raiborn, 'Building Values, Business Ethics and Corporate Social Responsibility into the Developing Organization' (2002) 7 *Journal of Developmental Entrepreneurship* 113.

129 Schaper and Savery, 'Entrepreneurship and Philanthropy: The Case of Small Australian Firms' (n127) at 240–241.

130 M. C. Branco and L. L. Rodrigues, 'Corporate Social Responsibility and Resource-Based Perspectives' (2006) 69 *Journal of Business Ethics* 111 at 112.

131 J. Graafland and C. Mazereeuw-Van der Duijn Schouten, 'Motives for Corporate Social Responsibility' (2012) 160 *De Economist* 377 at 379–381.

132 N. C. Smith, 'Corporate Social Responsibility: Whether or How?' (2003) 45 *California Management Review* 52 at 53.

performance.[133] The resource-based perspective suggests that by efficiently controlling and manipulating resources and/or capabilities that are valuable, rare, which cannot be easily imitated and for which no perfect substitute is available, companies can generate competitive advantages that are sustainable.[134] Human resource activities, including activities that improve the employees' outlooks on the quality of the workplace, can be a source of competitive advantage by generating a skilled workforce that is capable of fulfilling the company's business strategy.[135] Hence, human resource activities can give a company competitive advantages that can result in improved financial performance.[136] Turban and Greening hypothesised that companies' CSP[137] is positively related to how attractive they are as employers and their reputation. They conducted their research by obtaining independent ratings of CSP for various companies. They then surveyed students from a senior-level strategic management course to determine the attractiveness of each company as an employer. The results obtained from the study indicated that there is a correlation between independent ratings of CSP and the firms' reputations and attractiveness as employers. It was found that attractiveness as an employer was significantly correlated to community relations, employee relations and product quality. Therefore, companies' CSP can provide competitive advantages by attracting applicants.[138] Other studies have also produced similar results.[139]

Backhaus et al. found that certain dimensions of CSP, such as community relations, environment, employee relations, product issues and diversity, are considered to be more important than other dimensions and have differing impacts on how prospective employees assess companies. They contend that companies with poor environmental records in particular are likely to face problems in recruitment because this issue is particularly important to

133 H. S. Albinger, and S. J. Freeman, 'Corporate Social Performance and Attractiveness as an Employer to Different Job Seeking Populations' (2000) 28 *Journal of Business Ethics* 243 at 243–246.

134 A. McWilliams, D. Siegel and P. M. Wright, 'Corporate Social Responsibility: Strategic Implications' (2006) 43 *Journal of Management Studies* 1 at 3–4; also see J. B. Barney, 'Firm resources and sustained competitive advantage' (1991) 17 *Journal of Management* 99.

135 Branco and Rodrigues, 'Corporate Social Responsibility and Resource-Based Perspectives' (n130) at 121.

136 P. M. Wright, B. B. Dunford and S. A. Snell, 'Human Resources and the Resource Based View of the Firm' (2001) 27 *Journal of Management* 701 at 708.

137 The terms CSP and CSR have been used interchangeably as a lot of the literature refers to the same idea when using either or both terms.

138 D. B. Turban and D. W. Greening, 'Corporate Social Performance and Organizational Attractiveness To Prospective Employees' (1997) 40 *Academy of Management Journal* 658 at 666–669.

139 For example, see B. Ballou, N. H. Godwin and R. T. Shortridge, 'Firm Value and Employee Attitudes on Workplace Quality' (2003) 17 *Accounting Horizons* 329; I. Fulmer, B. Gerhart and K. Scott, 'Are the 100 Best better? An Empirical Investigation of the Relationship Between Being a "Great Place to Work" and Firm Performance' (2003) 56 *Personnel Psychology* 965.

prospective employees.[140] Furthermore, the results of a study conducted by Sims and Keon showed that organisational ethics and values are likely to be related to employees' levels of satisfaction. Individuals are likely to be involved with organisations which have ethical work climates that are consistent with what they prefer.[141] CSR increases organisational commitment and job productivity along with enhancing the perception of CC.[142] Branco and Rodrigues have suggested that effective human resource management can lead to cost reduction and increase the production levels of employees. Along with having a positive effect on employees' motivation and morale, CSR can also enhance their commitment and loyalty to the company. By maintaining employment practices that are socially responsible, which includes providing fair wages, opportunities for training, clean and safe working environments, health and education benefits, childcare facilities and flexible hours, companies can be at an advantage by increasing productivity and morale while decreasing absenteeism. By retaining employees, companies can also save on the costs involved in the training and recruitment of new employees.[143] Now, many companies understand that attracting and retaining high-skilled employees is an essential part of their competitive advantage. Some far-sighted companies have promoted their CSP in order to attract quality employees. For example, companies such as IBM, General Motors and Microsoft had put information in their recruitment brochures advertising their sensitivity to the community and environment, the diversity of their employees and the quality of their work environment, products and services to attract a larger number of job seekers many years ago.[144] Companies are becoming more aware of the necessity to attract the best employees as corporate success is increasingly dependent on a high-quality workforce. Job seekers will not only be attracted to companies that have good CSP reputations, but will also try to get an interview with such companies and will be more likely to accept a job offer from these companies. It has been suggested that companies may even think about advertising to prospective employees that they provide a work environment that is conducive to socially responsible activities and that supports individual employees' self-concepts and social identities.[145]

140 K. B. Backhaus, B. A. Stone and K. Heiner, 'Exploring the Relationship Between Corporate Social Performance and Employer Attractiveness' (2002) 41 *Business and Society* 292 at 309–313.

141 R. L. Sims and T. L. Keon, 'Ethical work climate as a factor in the development of person-organization fit' (1997) 16 *Journal of Business Ethics* 1095 at 1103–1104.

142 W. Hur, H. Kim and J. Woo, 'How CSR Leads to Corporate Brand Equity: Mediating Mechanisms of Corporate Brand Credibility and Reputation' (2014) 125 *Journal of Business Ethics* 75 at 77.

143 Branco and Rodrigues, 'Corporate Social Responsibility and Resource-Based Perspectives' (n130) at 121.

144 Turban and Greening, 'Corporate Social Performance and Organizational Attractiveness To Prospective Employees' (n138) at 659.

145 Ibid at 666–669.

Another key extrinsic motive is maintaining the reputation of the corporation. Good corporate reputations are extremely important due to their potential for value creation and their intangible character, which makes imitation by competing companies a lot harder.[146] Consequently, corporate reputation is a very important intangible asset and can be a source of competitive advantage. It also plays a part as a signal of the main characteristics of a company.[147] In the absence of information about a product of a company or the company itself, consumers rely on the reputation of the company to make a judgement on the company's product.[148] Additionally, a good reputation can be a protection when consumers are made aware of negative information regarding a company.[149] The actions and behaviour of a company's management form a company's reputation, and engaging in CSR activities can be a very effective action to attain competitive advantage.[150] Hence, a lot of companies justify engaging in CSR activities, as doing so will result in improving the company's image and creating a good reputation.[151]

Companies that are well-reputed have a competitive advantage in their fields, whereas companies with poor reputations are disadvantaged.[152] It has been suggested that CSR can establish and maintain corporate reputation as a form of strategic investment.[153] It has been shown by Lai et al.[154] that consumer assessments of CSR activities are positively related to the reputation of the company, and this correlation has been supported by Hsu,[155] who also showed that taking CSR initiatives resulted in high levels of corporate reputation.[156] Customers are frequently attracted to brands and companies that seem to have

146 P. W. Roberts and G. R. Dowling, 'Corporate Reputation and Sustained Superior Financial Performance' (2002) 23 *Strategic Management Journal* 1077 at 1077.

147 Hur, Kim and Woo, 'How CSR Leads to Corporate Brand Equity: Mediating Mechanisms of Corporate Brand Credibility and Reputation' (n142) at 77.

148 K. E. Schinietz and M. J. Epstein, 'Exploring the financial value of a reputation for corporate social responsibility during a crisis' (2005) 7 *Corporate Reputation Review* 327 at 329.

149 D. Lange, P. M. Lee and Y. Dai, 'Organizational reputation: An overview' (2011) 37 *Journal of Management* 153 at 169.

150 T. Melo and A. Garrido-Morgado, 'Corporate reputation: A combination of social responsibility and industry' (2012) 19 *Corporate Social Responsibility and Environmental Management* 11 at 15.

151 Hur, Kim and Woo, 'How CSR Leads to Corporate Brand Equity: Mediating Mechanisms of Corporate Brand Credibility and Reputation' (n142) at 77.

152 C. Fombrun and M. Shanley, 'What's in a name? Reputation building and corporate strategy' (1990) 33 *Academy of Management Journal* 233 at 235.

153 McWilliams, Siegel and Wright, 'Corporate social responsibility: Strategic implications' (n134) at 4.

154 C. Lai, C. Chiu, C. Yang and D. Pai, 'The effects of corporate social responsibility on brand performance: The mediating effect of industrial brand equity and corporate reputation' (2010) 95 *Journal of Business Ethics* 457 at 460–461.

155 See K. Hsu, 'The advertising effects of corporate social responsibility on corporate reputation and brand equity: Evidence from life insurance industry in Taiwan' (2012) 109 *Journal of Business Ethics* 189.

156 Hur, Kim and Woo, 'How CSR Leads to Corporate Brand Equity: Mediating Mechanisms of Corporate Brand Credibility and Reputation' (n142) at 77, 78, 83.

good reputations in CSR areas, and along with the benefit of attracting customers, having a reputation for being socially responsible also increases a company's ability to attract capital and trading partners.[157] Having a good reputation might also provide a cost advantage because suppliers are less likely to be worried about contractual problems when dealing with companies that have a good reputation. Employees also prefer to work for companies that have good reputations and might be willing to work harder for lower remuneration, which could be an advantage.[158] Another benefit of good corporate reputation is favourable regulation. It has been suggested that legislators and regulators will treat companies more favourably if they are known for doing good. Local constituents elect legislators, and as long as those voters are in favour of a company, it is less likely that a company will be subject to extensive scrutiny by regulators, which could be bad. Furthermore, regulators are also members of the community, and therefore are likely to give the benefit of the doubt to companies that are known for being good corporate citizens. Companies that have solid regulatory relations may actually to be able to seek zoning laws in their favour, attract less strict regulations and generate favourable conditions for themselves. Being socially responsible will also enable companies to gain the support of activist groups, for example, pressure groups like Greenpeace.[159] The purchase of many products can be significantly affected by the endorsement of activist groups, and in very competitive fields the extra advantage of possessing a seal of approval from an activist group may translate into better sales.[160]

Furthermore, consumers also prefer companies that are socially responsible, and value being connected with companies that have good reputations.[161] The cognitive associations that consumers have for a company can be a strategic asset as well as a source of competitive advantage that is sustainable.[162] Companies that are socially responsible are set apart from their competitors, and hence socially responsible behaviour positively impacts on consumer attitudes towards the company and also enhances consumer satisfaction.[163] There is a lot of evidence to

157 W. Schiebel and S. Pochtrager, 'Corporate Ethics as a Factor for Success – The Measurement Instrument of the University of Agricultural Sciences Vienna' (2003) 8 *Supply Chain Management: An International Journal* 116 at 117–118.

158 Roberts and Dowling, 'Corporate Reputation and Sustained Superior Financial Performance' (n146) at 1079.

159 See Greenpeace 'What We Do' <https://www.greenpeace.org.uk/what-we-do/> accessed 27 March 2015.

160 C. Fombrun, N. Gardberg and M. Barnett, 'Opportunity Platforms and Safety Nets: Corporate Citizenship and Reputational Risk' (2000) 105 *Business and Society Review* 85 at 93.

161 Hur, Kim and Woo, 'How CSR Leads to Corporate Brand Equity: Mediating Mechanisms of Corporate Brand Credibility and Reputation' (n142) at 75.

162 T. J. Brown and P. A. Dacin, 'The company and the product: Corporate associations and consumer product responses' (1997) 61 *Journal of Marketing* 68 at 68.

163 S. Pivato, N. Misani and A. Tencati, 'The impact of corporate social responsibility on consumer trust: The case of organic food' (2008) 17 *Business Ethics: A European Review* 3 at 4.

suggest that some consumer groups tend to favour products and services from companies that show good CC, and they readily pay a premium price for the products and services of these companies.[164] According to Smith, a study demonstrated that the willingness of consumers to purchase or recommend a product is driven 40 per cent by their perceptions of the product, but 60 per cent by their perceptions of the company. The study suggested that 42 per cent of how people feel about a company depends on their perceptions of how much a company is involved in CSR activities.[165] Also, a study by Brown and Dacin has suggested that CSR associations have significant effects on how consumers respond to new products. Their results showed that there can be a damaging impact on overall product assessments by negative CSR associations. On the other hand, product assessments can be enhanced by positive CSR associations.[166] Consumers who identify themselves with a company willingly are also likely to trust a company and forgive it if it makes a mistake.[167] The more customers perceive a company to be socially responsible, the more they will be motivated to identify themselves with and support the company.[168] Research conducted by Bhattacharya and Sen shows that companies that are perceived to have set themselves apart regarding CSR engagement seem to have a loyal following among a section of their customers.[169] In addition, being involved in CSR activities can indicate to consumers that the management of the company is more competent, which can persuade them that the company produces a higher quality product.[170]

Reduced operating costs is another benefit that being socially responsible might provide. It has been suggested that some CSR initiatives, particularly environmentally-oriented and workplace initiatives, can lead to a dramatic reduction in costs by cutting waste and reducing inefficiencies or enhancing productivity.[171]

164 Fombrun, Gardberg and Barnett, 'Opportunity Platforms and Safety Nets: Corporate Citizenship and Reputational Risk' (n160) at 91–92.

165 J. Smith, 'The Companies with the Best CSR Reputations' (*Forbes*, 2012) <http://www.forbes.com/sites/jacquelynsmith/2012/12/10/the-companies-with-the-best-csr-reputations/> accessed 15 August 2015.

166 Brown and Dacin, 'The company and the product: Corporate associations and consumer product responses' (n162) at 70, 75, 80.

167 C. B. Bhattacharya and S. Sen, 'Consumers respond to corporate social initiatives' (2004) 40 *California Management Review* 9 at 19–20.

168 D. R. Lichtenstein, M. E. Drumwright and B. M. Braig, 'The effect of corporate social responsibility on customer donations to corporate supported nonprofits' (2004) 68 *Journal of Marketing* 16 at 16–17.

169 C. B. Bhattacharya and S. Sen, 'Doing Better at Doing Good: When, Why, and How Consumers Respond to Corporate Social Initiatives' (2004) 47 *California Management Review* 9 at 19.

170 A. McWilliams and D. Siegel, 'Corporate social responsibility: A theory of the firm perspective' (2001) 26 *Academy of Management Review* 117 at 119–120.

171 Schiebel and Pochtrager, 'Corporate Ethics as a Factor for Success – The Measurement Instrument of the University of Agricultural Sciences (BOKU), Vienna' (n157) at 117.

Companies can make significant savings through pollution prevention, which gives them a cost advantage over their competitors. Along with saving the cost of installing and operating end-of-pipe pollution-control devices, pollution prevention might also increase productivity and efficiency. A reduced amount of waste means that the inputs are being utilised better, which results in lower costs for raw materials and waste disposal. By making production operations simpler or by removing non-essential steps in production operations, pollution prevention may also reduce cycle times. Moreover, pollution prevention presents the potential to reduce emissions considerably below the levels that are required, which can reduce the company's liability and compliance costs. Therefore, it is argued that a pollution-prevention strategy can assist in lowering costs, which should consequently lead to enhancing cash flow and profitability for the company.[172] Russo and Fouts analysed 243 firms over two years and found that there is a positive link between environmental performance and economic performance; industry growth moderated the relationship, with returns to environmental performance higher in higher-growth industries. They conducted the analysis using an independently developed environmental rating. The results suggested that "it pays to be green", and that this relationship becomes stronger with industry growth.[173]

Lastly, a company that is considered socially responsible can profit from its reputation in the business community by having an enhanced ability to attract capital and trading partners.[174] Investors can increase reputational capital when they speak positively about a company, buy shares and start an upward spiral in the market value of the company. Fombrun et al. have argued that companies that 'do good' can create positive word-of-mouth and increase share purchases, which finally results in higher market value.[175] It has also been suggested that companies that have better environmental records are more attractive investments as a result of the lower perceived compliance costs and liabilities.[176]

The material discussed above provided some insight into how CSR engagement might benefit a firm in various ways, some of which also related to financial performance. Now, instead of focusing on the impact on specific stakeholder groups, the correlation between CSR engagement and financial

172 S. L. Hart and G. Dowell, 'A Natural Resource-based View of Strategy' (1995) 20 *Academy of Management Review*, 986 at 992–993.

173 M. V. Russo and P. A. Fouts, 'A Resource-Based Perspective on Corporate Environmental Performance and Profitability' (1997) 40 *Academy of Management Journal* 534 at 534, 544.

174 Branco and Rodrigues, 'Corporate Social Responsibility and Resource-Based Perspectives' (n130) at 124.

175 Fombrun, Gardberg and Barnett, 'Opportunity Platforms and Safety Nets: Corporate Citizenship and Reputational Risk' (n160) at 92.

176 G. Filbeck and R. F. Gorman, 'The Relationship between the Environmental and Financial Performance of Public Utilities' (2004) 29 *Environmental and Resource Economics* 137 at 138.

performance in general will be considered.[177] A study by Hillman and Keim supports the argument that effective stakeholder management results in improved financial performance.[178] Wheeler and Sillanpaa have stated that all the available evidence suggests that companies that are managed considering the long-term interests of their key stakeholders are more likely to succeed than companies which take a short-term or "shareholder first" approach. Stakeholder-inclusive companies will increasingly outperform companies which do not take into account the need to actively balance stakeholder interests.[179] Even though a lot of studies show a positive relationship between being socially responsible and enhanced financial performance,[180] some studies have shown mixed results. McWilliams and Siegal have said that the reason the results of empirical studies of the relationship between financial performance and CSR have been inconclusive and have provided positive, negative and neutral results is flawed empirical analysis. These existing studies have numerous significant theoretical and empirical limitations. According to them, a very important issue is that these studies sometimes use models that omit variables that have been demonstrated to be important determinants of profitability.[181]

It has also been suggested that causation may actually run in both directions, which means that better CSP may lead to enhanced financial performance and better financial performance may lead to improved CSP. Companies that are financially strong and have excess resources have more freedom to invest in CSP. Thus, companies with available resources may choose to use those resources by doing good, and that might result in improved CSP overall. However, companies that are in financial trouble might not have the ability to make discretionary investments in CSP activities like philanthropy, but companies that are performing well financially will have resources to use in ways that might have more long-term strategic impacts.[182] Results from a study by

177 The literature on CSR and financial performance is extensive, and a thorough review is beyond the scope of this chapter. Therefore, a brief summary has been offered. For a general discussion see M. Orlitzky 'Corporate Social Performance and Financial Performance: A Research Synthesis' in A. Crane, A. McWilliams, D. Matten, J. Moon and D. Siegel (eds) *The Oxford Handbook of Corporate Social Responsibility* (Oxford, Oxford University Press, 2008).

178 A. Hillman and G. Keim, 'Shareholder Value, Stakeholder Management and Social Issues: What's the Bottom Line?' (2001) 22 *Strategic Management Journal* 125 at 126, 135–136.

179 D. Wheeler and M. Sillanpaa, 'Including the Stakeholders: The Business Case' (1998) 31 *Long Range Planning* 201 at 209.

180 For more examples see S. Brammer, A. Millington and B. Rayton, 'The Contribution of Corporate Social Responsibility to Organisational Commitment' (2007) 18 *International Journal of Human Resource Management* 1701; J. D. Margolis and J. P. Walsh, 'Misery Loves Companies: Rethinking Social Initiatives by Business' (2003) 48 *Administrative Science Quarterly* 268.

181 A. McWilliams and D. Siegel, 'Corporate Social Responsibility and Financial Performance: Correlation or Misspecification' (2000) 21 *Strategic Management Journal* 603 at 607–608.

182 S. Waddock and S. Graves, 'The Corporate Social Performance – Financial Performance Link' (1997) 18 *Strategic Management Journal* 303 at 313–315.

McGuire et al. have shown that a company's prior performance, measured by both stock-market returns and accounting-based measures, is more closely related to CSR than its subsequent performance. They claim that CSR is predicted better by prior performance in comparison to subsequent performance. Consequently, any correlation found between concurrent CSR and performance might to some extent be the result of the company previously performing strongly financially. Companies that are very successful may be more able to afford to be socially responsible. Relations between CSR and subsequent financial performance might also be the result of the company performing well previously and the stability of accounting return data.[183]

Furthermore, Wood and Jones have also suggested that the relationship between CSP and financial performance is still ambiguous. The reasons they provide are the lack of any theory to clarify how CSP and financial performance should be related, the lack of any comprehensive and valid measure of CSR, and the fact that the majority of the studies do not have methodological rigour and are consequently of uncertain validity and confusion regarding which stakeholders are represented by which measures. However, they do state that studies have shown a relationship between social irresponsibility and abnormal negative stock returns.[184] Therefore, even though the correlation between CSR and financial performance remains uncertain, it can be said with greater certainty that social irresponsibility hampers financial performance.

Other than the factors discussed above, which were essentially financial motives, managers might also contribute to CSR for non-financial reasons. The implementation of CSR in companies might also be associated with the personal values and beliefs of managers. These personal values may be expressed when managers get the opportunity to use their discretion, which may arise in various ways.[185] Non-financial motives often reflect intrinsic motives that consider CSR to be an end in itself, without considering the financial benefits. In terms of intrinsic motives, CSR can be perceived as a moral duty, and it can also be considered an expression of altruism. Feeling morally obliged to be socially responsible can originate from ethical principles of moral philosophy or from religious principles. It basically means that one feels obligated to do something because it is the right thing to do, even though one might not find it enjoyable. Managers may also contribute to CSR because they are genuinely concerned about the well-being of others, or because they derive satisfaction from assisting others.[186] Therefore, along

183 J. McGuire, A. Sundgren and T. Schneeweis, 'Corporate Social Responsibility and Firm Financial Performance' (1988) 31 *Academy of Management Journal* 854 at 854, 868–869.

184 D. J. Wood and R. E. Jones, 'Stakeholder Mismatching: A Theoretical Problem in Empirical Research on Corporate Social Performance' (1995) 3 *The International Journal of Organizational Analysis* 229 at 261.

185 C. A. Hemingway and P. W. Maclagan, 'Managers' personal values as drivers of corporate social responsibility' (2004) 50 *Journal of Business Ethics* 33 at 33, 41.

186 Graafland and Mazereeuw-Van der Duijn Schouten, 'Motives for Corporate Social Responsibility' (n131) at 380–381.

with wanting to maintain a good reputation, attract employees, retain customers, reduce costs and persuade investors, CSR engagement can also be driven by ethics and altruism.

Just like humans, companies have power and are subject to power. Both people and companies are assigned responsibility and also claim responsibility. Undoubtedly, power and responsibility are very strongly linked concepts. Possessing power is often considered to be a requirement for the ability to assume responsibility, but possessing power is also seen as a reason why its users, custodians and beneficiaries are expected to use power responsibly.[187] It might be argued that a company cannot simply be regarded as a 'private' institution when it has the power to have a great impact on society. Even though legally it might be required to regard a company as private, the problems within a company often have a significant impact on the community in comparison to their legal ramifications. Hence, it is not feasible to separate the consequences of corporate decision making from the wider context of the commonwealth of society or the public good.[188] Dahl had stated that "every large corporation should be thought of as a social enterprise, that is, as an entity whose existence and decisions can be justified only insofar as they serve public or social purposes".[189]

Parkinson also embraced Dahl's approach. He mentions that the social enterprise perspective is analytically stronger than the argument that as companies possess power, that power should be used responsibly. Large companies should be considered social enterprises because companies possessing social decision-making power are legitimate (which means there are valid reasons for considering this possession justified) only if this situation is in the interest of the public. This is a political theory regarding the legitimacy of private power. As the legitimacy of companies is based on public interest, society has the right to make sure that corporate power is utilised in a manner that is in line with that interest.[190] Hence, the maximisation of profits for shareholders should be considered a way of promoting public interest, instead of as an end in itself. Also, if the company is considered a public or social body, even though under private control, the directors should be held to the same standards of disclosure and ethical conduct as the people who perform public functions.[191] It is important to note that this is a debatable issue and not everyone holds this view. It can be argued that imposing such standards will place an onerous burden on directors,

187 J. Moon, A. Crane and D. Matten, 'Corporate Power and Responsibility: A Citizenship Perspective' (2006) 1 *Responsible Organization Review* 82 at 86–87.

188 T.F. McMahon, 'Models of the Relationship of the Firm to Society' (1986) 5 *Journal of Business Ethics* 181 at 182.

189 R. Dahl, 'A Prelude to Corporate Reform' (1972) 1 *Business and Society Review* 17 at 17 as cited in Moon, Crane and Matten, 'Corporate Power and Responsibility: A Citizenship Perspective' (n187) at 89.

190 J. E. Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Oxford, Oxford University Press, 1995) at 23–24.

191 Ibid at 24.

which cannot be justified as they should be making decisions based on profits. Labelling companies as private enterprises is a way of concealing public business under the cover of corporate privacy. It is a way of distracting governments and the public from focusing on aspects such as lobbying, executive compensation, nonfeasance and bureaucratic error. If companies are regarded as social enterprises, such problems will be issues of public concern about which the public has a right to information, and the government will have the power to get involved to protect the public interest and make sure that the company is complying with ethical standards that are acceptable to the public. Expectations from companies to be responsible will not just be limited to prevention of clear forms of social harm, but may possibly include all aspects of social decision-making power by companies.[192] Nonetheless, any intervention by the government will have to be based on clearly defined guidelines.

It is submitted that the social enterprise perspective is connected to the concept of social licence. More and more, corporate executives discuss the significance of functioning in compliance with their "social license". This means that they are obliged to fulfil society's expectations and also not get involved in activities that society considers to be objectionable. Gunningham et al. have defined social licence as "the demands on and expectations for a business enterprise that emerge from neighbourhoods, environmental groups, community members, and other elements of the surrounding civil society". In some situations, the expectations of society or the requirements of the "social licensors" may be more onerous than what is legally required.[193] It can be argued that society is entitled to its expectations because the company is a social enterprise and should be socially responsible. Since the foundation of the legitimacy of companies is based on public interest, meeting the expectations of society is the requirement to possessing power that is derived from having a social license. Therefore, being socially responsible cannot be something that companies merely choose to do voluntarily; rather, it should be a requirement for simply being able to operate as a company. This also accords with concession theory. In simple terms, under concession theory the ability to form a company is a concession granted to its incorporators by the state. In exchange for granting this set of rights to the incorporators, the state holds substantial authority to regulate the company.[194] If a company acts outside the power that has been granted by the state, it is acting against the public interest.

Moreover, attempts have been made by various business ethicists to identify definite universal moral values or principles. For example, while recommending a collection of fundamental values for an international business code of

192 Ibid.

193 N. Gunningham, R. A. Kagan, and D. Thornton, 'Social License and Environmental Protection: Why Businesses Go beyond Compliance' (2004) 29 *Law & Social Inquiry* 307 at 308.

194 S. J. Padfield, 'Rehabilitating Concession Theory' (2014) 66 *Oklahoma Law Review* 327 at 332–334, 347.

ethics, Asgary and Mitschow[195] have suggested the following on the basis of their review of the literature:

> trust; fairness; do not cheat; honesty; full disclosure of financial information; be responsible for your dealings; respect national sovereignty; support the economic goals of host country; respect social and cultural values and traditions; respect human rights and fundamental freedoms; provide equal opportunity; uphold integrity of your company; be respectful to every person contacted; uphold environmental laws and regulations; be fair and take action not to discriminate; honour contracts, agreements, and assigned responsibilities.[196]

Another example would be Donaldson asserting that there are three core values that businesses should never violate: respect for basic rights, respect for human dignity and good citizenship.[197] The Josephson Institute of Ethics, which is a non-profit ethics centre located in the United States, made a noteworthy attempt to recognise certain universal moral values in 1997. It brought together a group of thirty national leaders representing schools, teacher unions, family support organisations, faith communities, national youth service groups, ethics centres and character education experts, to see if they could reach an agreement on a set of fundamental ethical values which could give a structure for examining ethical issues and creating character education programmes based on a common language that would be accepted by almost everyone, if not everyone. The most significant statement made on this subject was the Aspen Declaration.[198] This was that six core ethical values form the basis of democratic society.[199] It was also claimed that these values surpass religious, cultural and socioeconomic differences. The six core moral values, which have also been referred to by others, are as follows:

1. Trustworthiness (including notions of honesty, candour, integrity, reliability, and loyalty);
2. Respect (including notions of civility, autonomy, and tolerance);
3. Responsibility (including notions of accountability, excellence, and self-restraint);

195 N. Asgary and M. C. Mitschow, 'Toward a Model for International Business Ethics' (2002) 36 *Journal of Business Ethics* 239 at 242.

196 M. S. Schwartz, 'Universal Moral Values for Corporate Codes of Ethics' (2005) 59 *Journal of Business Ethics* 27 at 35.

197 T. Donaldson, 'Values in Tension: Ethics Away from Home' (1996, September/October) *Harvard Business Review* 48 at 53–54.

198 See Schwartz, 'Universal Moral Values for Corporate Codes of Ethics' (n196) at 36.

199 Josephson, M.: 1997, *Ethics in the Workplace: Resource Reading Materials* (Josephson Institute of Ethics, Marina del Rey, CA). pp. 26–27 as cited in Schwartz, 'Universal Moral Values for Corporate Codes of Ethics' (n196) at 36.

4. Fairness (including notions of process, impartiality, and equity);
5. Caring (including notions of concern for the welfare of others, as well as benevolence); and
6. Citizenship (including notions of respecting the law and protecting the environment.)[200]

Even though everyone might not always agree on the extent to which companies should be held responsible for the impact they have or how far they should go to fulfil their social responsibility, there are certain moral values that should not be violated. For example, let us consider fairness. As can be seen from the discussion above, fairness is considered a core value by many business ethicists. Phillips has defined fairness as follows:

> Whenever persons or groups of persons voluntarily accept the benefits of a mutually beneficial scheme of co-operation requiring sacrifice or contribution on the parts of the participants and there exists the possibility of free-riding, obligations of fairness are created among the participants in the co-operative scheme in proportion to the benefits accepted.[201]

Hence, it can be argued that it is only fair that companies have certain obligations in return for the benefits they receive.

Criticisms and concerns

The criticisms aimed at CSR are very similar to the arguments made for shareholder theory and the arguments made against stakeholder theory, which have been discussed extensively earlier in the chapter. Without going into extensive detail, the strongest argument against CSR would be that the purpose of business is to maximise profit. In the words of the Nobel Prize winning economist Milton Friedman:

> there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.[202]

200 Josephson, M.: 1996, Making Ethical Decisions (4th ed.) (Josephson Institute of Ethics, Marina del Rey, CA). pp. 9–17 as cited in Schwartz, 'Universal Moral Values for Corporate Codes of Ethics' (n196) at 36.

201 R. A. Phillips, 'Stakeholder Theory and A Principle of Fairness' (1997) 7 *Business Ethics Quarterly* 51 at 51.

202 Friedman, 'The Social Responsibility of Business Is To Increase Its Profits' (n7) at 122–125. For a succinct deconstruction of Friedman's views, see L. Johnson, 'Corporate Law Professors as Gatekeepers' (2009) 6(2) *University of St Thomas Law Journal* 447 at 451–452.

Gallagher states that this powerful critique, which has been repeated by Friedman many times since then, has hung over discussions about CSR and business ethics ever since. He mentions that perhaps Friedman's argument is so strong because it is so closely attached to the basic mission statement of companies to "maximize shareholder value". It also boosts the beliefs of many managers that they should concentrate on making profits, a belief that is made stronger if the managers are rewarded for their performance through stock options or bonuses. Furthermore, it is argued by many that the shareholders are the legal owners of the company, and as such the argument has strong institutional appeal.[203] Therefore, as can be seen, concerns regarding CSR are almost the same as the arguments made in support of shareholder theory and the arguments made against stakeholder theory.

Other than that, a major concern when it comes to businesses being socially responsible is the competence of managers of companies to deal with social issues. It has been argued that by the nature of their training and experience, managers of companies are not well-equipped to handle complex social problems.[204] For example, Levitt argues that a typical senior executive of a large company has that position because he has expertise in that field of business and not in dealing with social problems.[205] Consequently, it is said that governments are better equipped and are a much more effective protector of the public good than any campaign for CSR.[206]

Significance in a global context and supply chain management

Human rights are a very important aspect of CSR in the developed world. Even though companies have made important economic and non-economic advances, their operations are often perceived to have generated a detrimental impact on human rights. Given the increased economic power and political influence of companies, this impact becomes very significant. Concerns regarding human rights have dominated many CSR agendas as both the socio-economic and the environmental consequences of the operations of companies have increased, which was mostly a result of the interconnectedness of national economies, globalisation and the privatisation of state functions. In current times, the operations of a company can affect almost all aspects of human rights both within and beyond the state. These aspects range from fair working

203 S. Gallagher, 'A Strategic Response to Friedman's Critique of Business Ethics' (2005) 26 *Journal of Business Strategy* 55 at 55–56.

204 H. Mintzberg, 'The Case For Corporate Social Responsibility' (1983) 4 *The Journal of Business Strategy* 3 at 5.

205 T. Levitt, 'Why Business Always Loses' (1968) 46 *Harvard Business Review* 81 at 85–86. Also see H. Mintzberg, 'The Case For Corporate Social Responsibility' (1983) 4 *The Journal of Business Strategy* 3 at 5.

206 A. Karnani, 'The Case Against Corporate Social Responsibility' (23 August 2010) *The Wall Street Journal* <http://www.wsj.com/articles/SB10001424052748703338004575230112664504890> accessed 17 August 2015.

conditions to the rights to health, security and life.[207] Welford has argued that it is essential that we do not give more importance to economic arguments regarding globalisation than we do to human rights arguments. The concentration should be on issues such as discrimination, equality and other abuses of human rights, instead of focusing on free trade, capital and growth. It is a fundamental principle that human rights law is superior to all other regimes of international law, such as international commercial law, and it should not be departed from.[208]

Businesses in the global marketplace now face new challenges due to increasing competition, a focus on efficiency and cost reduction and the satisfaction of consumer demand. Numerous companies have been compelled to think about CSR issues in their operations because of the anti-sweatshop and globalisation movement across the United States and European countries. The way certain companies operate has been partly affected by pressure from consumers, NGOs, local communities and regulations, so that they now try to look after the health and safety of their employees, put effective recycling network systems in place, make more environmentally-friendly products and minimise emissions.[209] Areas such as supply chain sustainability, the triple bottom line, environmental management, corporate greening, green supply and CSR in supply chains are receiving increasing attention in the media, as well as in both academia and the corporate world.[210] A company's reputation might be damaged by poor CSR performance at any level of the supply chain process.[211] The CSR disruption of global supply chains may have impacts that spread locally as well as globally. Engaging in CSR activities might assist companies to avoid the expenses of future lawsuits, bad publicity due to negative media coverage, poor workmanship, financial mismanagement, operation disruption and unreliable business relationships. Many companies are expanding their responsibility for their products further than their sales and delivery locations by also managing the CSR issues of their partners within their supply chain.[212] A growing number of companies, particularly large MNCs, have put sustainability strategies and voluntary codes of conduct into practice along with providing environmental annual reports.[213] However, in spite of many attempts by MNCs to address social and environmental issues in their supply chains, there seems to be

207 A. Begum, 'Corporate social responsibility: Reflecting Australian legal approaches to human rights' (2015) 36 *Company Lawyer* 279 at 279–280.

208 R. Welford, 'Globalization, corporate social responsibility and human rights' (2002) 9 *Corporate Social Responsibility and Environmental Management* 1 at 6.

209 J. M. Cruz, 'Modeling the relationship of globalized supply chains and corporate social responsibility' (2013) 56 *Journal of Cleaner Production* 73 at 73.

210 M. Anderson and T. Skjoett-Larsen, 'Corporate social responsibility in global supply chains' (2009) 14 *Supply Chain Management: An International Journal* 75 at 75.

211 T. Fabian, 'Supply Chain Management in an Era of Social and Environment Accountability' (2000) 2 *Sustainable Development International* 27 at 28, 29.

212 J. M. Cruz, 'Mitigating global supply chain risks through corporate social responsibility' (2013) 51 *International Journal of Production Research* 3995 at 3996.

213 Anderson and Skjoett-Larsen, 'Corporate social responsibility in global supply chains' (n210) at 75.

a gap between the desirability of supply chain sustainability in theory and the slow implementation of sustainability in supply chains in practice.[214] It is argued that the problem appears to be that only a few MNCs "walk the talk" of CSR.[215] Furthermore, when addressing governance and extraterritorial issues, the regulatory approach has faced significant challenges. These include deciding on the extent to which companies should be accountable for human rights violations, whether this accountability should be applicable beyond the territorial boundary of the state, and whether government regulation is sufficient in itself to capture the vastness of corporate affairs.[216] Nonetheless, many regulatory and voluntary initiatives have been taken, both nationally and internationally, to attempt to address the negative impacts on human rights by corporate operations.[217]

We now turn to a more detailed consideration of the issue of supply chain management as it relates to CSR. Since companies are now engaging in supply chains and supplier-based manufacturing which extends beyond national borders, CSR cannot be considered as the individual company's domain anymore. It includes the whole supply chain. Consequently, MNCs are not only expected to be socially responsible within their own jurisdictions, but are also responsible for the practices of their global trading partners, including suppliers, third party logistics providers and intermediaries.[218] The demands for CSR in global supply chains should be particularly observed in consideration of the fact that a huge section of global trade is carried out via systems of governance. These systems of governance connect companies together in many different sourcing and contracting arrangements. It is implied in the term governance that some fundamental actors in the supply chain, usually large MNCs, accept responsibility for the inter-firm division of labour and specific participants' capacities to upgrade their activities.[219] Hence, without exercising ownership they are able to exercise control over large distances.[220] These important

214 F. E. Bowen, P. D. Cousins, R. C. Lamming and A. C. Faruk, 'Horses for courses: explaining the gap between the theory and practice of green supply' (2001) 35 *Green Management International* 41 at 42.

215 Anderson and Skjoett-Larsen, 'Corporate social responsibility in global supply chains' (n210) at 75, 78.

216 Begum, 'Corporate social responsibility: Reflecting Australian legal approaches to human rights' (n207) at 280; also see K. Amaeshi, O. Osuji and P. Nnodim, 'Corporate Social Responsibility in Supply Chains of Global Brands: A Boundaryless Responsibility? Clarifications, Exceptions and Implications' (2008) 81 *Journal of Business Ethics* 223.

217 Begum, 'Corporate social responsibility: Reflecting Australian legal approaches to human rights' (n207) at 280.

218 For a general discussion on this issue, see A. Millington 'Responsibility in the Supply Chain' in A. Crane, A. McWilliams, D. Matten, J. Moon and D. Siegel (eds) *The Oxford Handbook of Corporate Social Responsibility* (Oxford, Oxford University Press, 2008).

219 G. Gereffi, 'Beyond the producer-driven/buyer-driven dichotomy. The evolution of global value chains in the internet era', (2001) 32 *IDS Bulletin* 30 at 30.

220 R. Jenkins, *Corporate Codes of Conduct. Self-Regulation in a Global Economy* (Geneva, United Nations Research Institute for Social Development, 2001).

institutions, which include large retailers, brand-name firms and MNCs, are mostly based in developed countries. These companies derive their immense power from their control over the market and the fundamental resources that are essential in the functioning of the supply chains of which they are a part. As a result of their tremendous power and control, these institutions have a fundamental role in deciding what should be manufactured, the way in which it should be manufactured and who should manufacture it.[221] Jenkins puts forward an argument that the development of global value chains, through which buyers from developed countries are in command of various suppliers in developing nations, has led to appeals that they should be responsible for aspects such as working conditions and environmental impacts, not just quality and delivery dates.[222] The rise of multimedia communication technology has increased the pressure on MNCs to be responsible for the environmental and social conditions of their production locations in developing countries. As a result, it is much more difficult for companies to cover up the conduct and practices of their suppliers that might be considered socially irresponsible.[223]

To neutralise such pressures from many stakeholders, a lot of MNCs have developed and implemented systems and procedures to ensure that certain requirements regarding environmental and social conditions will be met by their suppliers. Although companies have a choice when it comes to the method that they are going to use to implement CSR efforts in their supply chains, quite a few studies demonstrate that the most frequent method used by large MNCs is the implementation of corporate codes of conduct. Nonetheless, it is suggested by empirical evidence that a lot of MNCs have encountered obstacles in implementing these codes of conduct.[224] There are a number of problems that might arise while managing and controlling the codes of conduct in global supply chains. Active commitment is an essential requirement of successful implementation of the codes of conduct. However, not all the actors in the supply chain have sufficient incentive to obey the codes of conduct. Moreover, the enforcement of such codes in global supply chains is very difficult because the companies that are involved are divided legally, economically, geographically, politically and culturally. There will usually be more than one jurisdiction involved. Hence, many agency problems are created by trying to enforce codes of conduct in global supply chains, and this might lead to non-compliance.[225] Another challenge is this regard is that codes

221 Anderson and Skjoett-Larsen, 'Corporate social responsibility in global supply chains' (n210) at 77.

222 Jenkins, *Corporate Codes of Conduct. Self-Regulation in a Global Economy* (n220).

223 Anderson and Skjoett-Larsen, 'Corporate social responsibility in global supply chains' (n210) at 77–78.

224 See J. Leigh and S. Waddock, 'The emergence of total responsibility management systems: J. Sainsbury's (plc) voluntary responsibility management systems for global food retail supply chains' (2006) 111 *Business and Society Review* 409.

225 E. R. Pedersen and M. Andersen, 'Safeguarding corporate social responsibility (CSR) in global supply chains: How codes of conduct are managed in buyer-supplier relationships' (2006) 6 *Journal of Public Affairs* 228 at 228.

cannot be enforced in the same way that legal requirements can be. Critics have also stated that the codes are often public statements of lofty intent and purpose, without any functional and precise content. Therefore, as mentioned before, often there is a gap between what the companies claim their ethical standards are in relation to their supply chains and the actual circumstances of their suppliers. That is why Anderson and Skjoett-Larsen have argued that until now only a limited number of MNCs successfully implement the CSR standards that they claim to have.[226]

Conclusion

In this chapter the two contrasting theories of corporate governance, shareholder theory and stakeholder theory, were discussed. Justifications of both shareholder theory and stakeholder theory have been attempted on many occasions and by various authors. However, some of the particular lines of argument and the concepts which are used to argue for the respective theories have serious shortcomings. The advocates of shareholder theory put forward arguments suggesting that shareholders are entitled to excess profits made by the company as they are residual risk bearers, and that giving managers a clear objective to promote the interests of the shareholders reduces agency costs. Other arguments state that shareholder theory is efficient, shareholders own the assets of the company so the company should be managed for their benefit, maximising profits maximises social welfare, and the shareholders are in a more vulnerable situation in comparison to other parties. On the other hand, some of the criticisms aimed at shareholder theory are that the term 'shareholder value maximisation' is vague, there are problems with the assertion that it is efficient, the residual rights argument and the property rights analysis are flawed, it does not take into account that different shareholders might have different interests, and it does not value the language of morality. Meanwhile, stakeholder theory is justified by arguing that maintaining good relationships with all the stakeholders is a fundamental aspect of being successful, shareholder theory has a very narrow outlook that simply cannot do justice to the huge collaboration of activities and parties involved in running a company, stakeholders also have property rights, considering the interests of all the stakeholders is crucial to the long-term sustainability of the company, and it is ethical to consider the interests of the stakeholders as they have intrinsic value. The main problems with stakeholder theory are focused around its lack of clear goals for managers and solid normative foundations, along with issues with implementation and enforcement. To summarise, even though shareholder theory is advocated for its clarity and alleged ability to maximise efficiency, the theory seems to have many inconsistencies, provides a very narrow outlook that fails to ensure social wealth maximisation, and is devoid of moral basis. On the other hand,

226 Anderson and Skjoett-Larsen, 'Corporate social responsibility in global supply chains' (n210) at 78.

stakeholder theory has a wider approach, which seems fairer but falls short when it comes to enforcement and practicality. It is necessary to continue exploring new approaches and the scope for reform.

The chapter also discussed the concept of CSR, including its definitions, theoretical development, implementation, justifications, criticisms and significance in a global context. There is no universally accepted definition of CSR, but some common elements are present in the various definitions. A number of theories, such as stakeholder theory, social contract theory and legitimacy theory, explain how and why companies engage in CSR. There are various regulations governing CSR, and CSR is implemented in many different ways. It is implemented in both formal, or mandatory, and informal, or voluntary, ways, such as regulations and codes of conduct. The benefits of engaging in CSR activities include attracting high-quality employees, enhancing reputation, attracting consumers, reducing costs and finding investors. However, the financial correlation remains debateable. Nonetheless, there are those who still believe that the only responsibility of business is to maximise profits. Hence, the criticisms of CSR are similar to the arguments for shareholder theory and arguments against stakeholder theory, the strongest one being that the purpose of companies is to make money. Lastly, as a result of globalisation CSR has become a very important issue of concern, especially in relation to supply chain management. In today's world, depending on what sort of leverage a company has over suppliers, a company's affairs can impact on all aspects of human rights. That is why it is essential that companies are held responsible for the social and environmental practices of all the actors in its supply chain.

3 The enlightened shareholder value principle

Introduction

ESV is the idea that long-term business success depends on having regard for the interests of all who contribute to and are affected by the operations of a company, and it is supposed to represent an alternative to a narrow conception of orthodox notions of shareholder primacy. The concept of ESV is enshrined in the Companies Act. This has been achieved in two ways. First, in section 172 there is the directors' duty of promoting the success of the company for the benefit of its members as a whole, which was made more inclusive by attaching a list of factors which directors are obligated to have regard to in fulfilling the duty. Second, the directors were required to file an Operating and Financial Review (OFR), which was eventually repealed and enacted as the Business Review. The Business Review was replaced by the Strategic Report in 2013. These are the two vital pillars of the concept of ESV. As emphasised earlier, section 172 has been the subject of considerable debate. Even though the purpose of incorporating the ESV concept was to ensure that directors think about the long-term consequences of their decision-making along with the impact of their decisions on various stakeholders, it has been argued by many that the section does not make a substantive difference in practice.[1] This chapter aims to provide a summary of the developments that led to the decision to make ESV a significant element in the corporate governance system in the UK and the consequent enactment of section 172 of the Act. It will then provide an analysis of the section, in which consideration will be given to five of the six listed factors. The link between these factors and CSR will also be discussed.[2] This will then be followed by a discussion on the lack of enforcement mechanisms, along with the problems of derivative claims. It is important to note that a lot has been

1 For example, see R. Williams, 'Enlightened Shareholder Value in UK Company Law' (2012) 35 *UNSW Law Journal* 360; A. Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (New York, Routledge, 2013).

2 The impact on CSR will be assessed and discussed in much greater detail in later chapters.

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written on this subject already.[3] Nonetheless, it is essential to consider certain aspects of the section as they contribute to an assessment of whether the ESV concept promotes or assists CSR. Therefore, instead of providing a detailed consideration of all the aspects, only the aspects that will later be used as a springboard to explore new ideas and different issues will be discussed. Finally, the impact of the Strategic Report and recent changes will also be considered.

Genesis of the ESV concept: the institutional developments that led to the enactment of section 172 of the Companies Act

First, consideration is given to how the concept of ESV became part of UK law.[4] The UK government's Department of Trade and Industry commissioned a review in 1998 to examine UK company law and to form proposals for reform measures.[5] The independent body that was set up to oversee this review of company law, the Company Law Review Steering Group, came to be known as the CLRSG and included academics, business persons, company law experts and others.[6] The CLRSG published a series of consultation papers,[7] and the three main consultation documents were: *The Strategic Framework,*[8] *Developing the Framework*[9] and *Completing the Structure*.[10] All of this culminated in a *Final Report* in July 2001.[11] The purpose of the CLRSG was to consider how company law could be modernised for a competitive economy, and this was to be achieved through a thorough review of the law and forming an overall framework. In particular, the review investigated whether the duties of directors should be codified in legislation, and if so, what should be the scope of those duties.[12]

In *The Strategic Framework* the CLRSG mentioned that as the framework of company law should be established on a strong foundation, its concern was to identify in whose interests company law should be formulated to serve, and to

3 In particular, Professor Andrew Keay has contributed significantly to the literature on this subject, especially in his monograph referred to in the chapter on several occasions.

4 What is contained here is merely a summary. For a more comprehensive review, please refer to the actual consultation papers published by the CLRSG. Professor Andrew Keay also provides a very thorough discussion in chapter 3 of *The Enlightened Shareholder Value Principle and Corporate Governance* (n1).

5 Company Law Review, *Modern Company Law for a Competitive Economy*, London, DTI, 1998, at 1.

6 *Modernising Company Law,* Cm 5553-I, DTI, July 2002 (Vol 1) at para 7.

7 Ibid at para 8.

8 *Modern Law for a Competitive Economy: The Strategic Framework*, 1999, London, DTI.

9 *Modern Law for a Competitive Economy: Developing the Framework*, 2000, London, DTI.

10 *Modern Law for a Competitive Economy: Completing the Structure*, 2000, London, DTI.

11 Company Law Review, *Modern Company Law for a Competitive Economy: Final Report* (HMSO, London, 2001).

12 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 66.

define the legal methods to achieve that.[13] In reviewing the structure of the current company law, the CLRSG noted in *The Strategic Framework* that "Companies are formed and managed for the benefit of shareholders, but subject to safeguards for the benefit of actual and potential creditors".[14] It also stated the following [emphasis in original]:

> The law on the formation and management of companies serves the interests of shareholders by conferring on them ultimate control of the undertaking. This operates, broadly, as follows. They purchase shares in the enterprise with money or other assets, either by direct investment on the issue of shares, or by purchase of shares of earlier investors. In return the law confers control over management to ensure that the proceeds of that investment are managed in their interests, normally that its value is increased over time. They are entitled to get the benefit of that value either by distributions, normally cash dividends, or by the sale of shares, or by realising the value of the undertaking in a winding up. The directors are required to manage the business on their behalf, being obliged by *fiduciary duties* which require them to do so honestly, in their best judgement, for the benefit of the company. This normally means for the benefit of the shareholders as a whole. Directors must exercise the powers conferred on them for their *proper purposes*, and subject to duties of *care and skill*.

Hence, the CLRSG was effectively spelling out a shareholder value model.[15]

To address in whose interests company law should be designed, the CLSRG recognised two different approaches, which were either an ESV approach or a pluralist approach.[16] It stated that those who adopt an ESV approach believe that the ultimate goal of companies is to generate maximum wealth for shareholders and that this is the best way of securing overall prosperity and welfare. However, many who hold this point of view also note that in practice neither maximum value for shareholders nor overall prosperity and welfare may be achieved. The reason is that management may fail to identify the fact that often the way to success is through establishing long-term relationships that are dependent on trust. The report stated that:

> It is argued that exclusive focus on the short-term financial bottom line, in the erroneous belief that this equates to shareholder value, will often be incompatible with the cultivation of co-operative relationships, which are likely to involve short-term costs but to bring greater benefits in the longer

13 Company Law Review, *Modern Company Law for a Competitive Economy: Strategic Framework*, 1999, London, DTI at para 5.1.1.
14 Ibid at para 5.1.4.
15 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 67.
16 Company Law Review, *Modern Company Law for a Competitive Economy: Strategic Framework* (n13) at para 5.1.11.

> term. Thus the law as currently expressed and understood fails to deliver the necessary inclusive approach.

It then went on to consider the pluralist approach, which is essentially a variant of stakeholder theory, although the CLSRG did not consider the normative justification for the pluralist approach. The implementation of this approach would require company law to be

> modified to include other objectives so that a company is required to serve a wider range of interests, not subordinate to, or as a means of achieving, shareholder value (as envisaged in the enlightened shareholder value view), but as valid in their own right.[17]

The CLRSG mentioned that adopting an ESV approach would provide the advantage of holding onto the fundamentals of directors' duties,[18] and it wanted to make explicit that the directors do have an obligation, in appropriate cases, to consider the need to build long-term relationships with employees, customers and others to ensure the success of the company over time.[19] It then considered arguments for and against the pluralist approach. Some of the counterarguments were that implementing a pluralist view would mean that the law on directors' duties would have to be reformed. In addition, changes would have to be made in the shareholders' control over the company, which would have to be achieved through their capacity to decide on the composition of the board, and it is unlikely that proposals to change the composition of the board in order to necessitate broader representation would be welcomed.[20] The CLRSG revealed that their goal might be fulfilled more adequately by implementation of a regime of ESV along with increased disclosure and enhanced information flow.[21]

In the *Developing the Framework* paper, the CLRSG explained that they rejected the pluralist approach because most of the responses to the earlier consultation document were against it.[22] Even though the responses explicitly favoured retaining the primacy of the shareholders, there was strong support for doing so in an inclusive manner.[23] This included raising awareness that companies should be managed in a more balanced way and should foster relationships with their various stakeholders.[24]

Thus, the CLRSG formulated proposals for implementing the ESV approach. It made a number of recommendations, the main ones being that

17 Ibid at para 5.1.13.
18 Ibid at para 5.1.17.
19 Ibid at paras 5.1.20, 5.1.22.
20 Ibid at paras 5.1.30, 5.1.31, 5.1.32.
21 Ibid at para 5.1.32.
22 *Modern Law for a Competitive Economy: Developing the Framework* (n9) at para 3.22.
23 Ibid at para 2.11.
24 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 70.

there should be a statutory statement of principles that includes all the general duties of directors, in order to provide guidance to directors along with reflecting the developments in case law as recommended by the Law Commissions.[25] The recommendations were made by the Law Commissions in the report which considered the responses to the joint consultation paper entitled 'Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties'.[26]

Furthermore, directors should be required to promote the success of the company for the benefit of shareholders by taking all the relevant factors for that purpose into consideration. These factors include: a balanced view of the short and long term; the need to maintain effective ongoing relationships with employees, customers, suppliers and others; the need to maintain the company's business reputation; and the impact of its operations on the community and the environment. The directors should also be required to fulfil their duties by maintaining objective standards of skill and care. Lastly, public and listed companies (and perhaps also other companies that are very large and economically very powerful) should be required to provide an OFR as part of their full annual report. This would include everything that the directors think is relevant for users to properly assess the performance and future plans and prospects of the company. It should also cover matters such as the company's relationships with employees and others, and the impact on the company and environment if such aspects are relevant.[27] The duties of directors that were to be codified were also set out by the CLRSG, including a draft of a provision that became section 172 of the Act.[28]

In the last consultation paper, *Completing the Structure*, among other statements, the view was repeated that a pluralist approach was not desirable in the UK.[29] The Final Report included some draft provisions to introduce the ESV principle. The government then published a two-volume White Paper, *Modernising Company Law*, in July 2002.[30] In March 2005 another substantially revised White Paper, *Company Law Reform*, was published.[31] The CLRSG's recommendations are implemented in many of the provisions of the Act. Subsequently, after more consultation, on 4 November 2005 the Company Law Reform Bill was introduced into the House of Lords. After the Bill was introduced and before it was enacted as a statute, the Government enacted the

25 *Modern Law for a Competitive Economy: Developing the Framework* (n9) at para 2.19.
26 See Law Commissions' report 'Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties', Law Com No 261, Scot Law Com No 173, Cm 4436, 1999. The joint consultation paper was issued in September 1998. The paper received over 130 responses and this project contributed to the wider Company Law Review. The Department of Trade and Industry commissioned its review after the Law Commissions had started work on this project. See paras 1.1, 1.3 and 1.5.
27 *Modern Law for a Competitive Economy: Developing the Framework* (n9) at para 2.19.
28 See ibid at para 3.40.
29 *Modern Law for a Competitive Economy: Completing the Structure* (n10) at para 3.40.
30 *Modernising Company* Law, 2002, London. DTI, Cm5553.
31 Company Law Reform. 2005, London, DTI, Cm6456.

Companies Act (Operating and Financial Review (Repeal)) Regulations 2005. This eliminated the requirement for quoted companies to file an OFR.[32] The Company Law Reform Bill caused considerable debate in Parliament. The concept of ESV was incorporated through the enactment of section 172 of the Act combined with section 417 of the Act, which provided for a report known as the Business Review.[33] The Business Review, which was put in place of the OFR, will be discussed later in the chapter. Section 172 became operative from 1 October 2007 and section 417 became operative from 6 April 2008.

An examination of section 172 of the Companies Act 2006

As the section contains a list of inclusive factors that directors need to have regard to instead of just considering shareholder interests, the approach embedded in the section is said to be 'enlightened'. Keay has claimed that this has not taken the matter very far.[34] Bradshaw has argued that ESV is not a challenge to the exclusivity of shareholders, but instead provides a new strength to shareholder exclusivity by way of an unambiguous statement in legislation.[35] Furthermore, while analysing the 'best interests' rule, Langford has suggested that despite the flexibility, the rule cannot be stretched to protect stakeholder interests independently of corporate benefit, because that can threaten the fiduciary basis of the director-company relationship. Protection and promotion of stakeholder interests require more significant change to the regulatory framework and deeper revision of company law.[36] The UK government seems to be under the impression that because directors are now required to take non-member stakeholder interests into account, company law has an enlightened approach. However, the only enlightened aspect seems to be that directors can have regard to stakeholder interests without being subject to legal proceedings. Even then, at the end of the day the actions they take to promote the success of the company have to be for the benefit of the members as a whole. They are not permitted to take actions which might be in the interests of stakeholders if those actions do not also benefit the members as a whole. This has been categorised by Keay as a shareholder-first interpretation.[37]

32 SI 2005/3442.
33 Note that this has also been changed now, and will be discussed later in the chapter.
34 A. Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach' (2007) 29 *Sydney Law Review* 577 at 592.
35 C. Bradshaw, 'The environmental business case and unenlightened shareholder value' (2013) 33 *Legal Studies* 141.
36 R. T. Langford, 'Best Interests: Multifaceted but not Unbounded' (2016) 75 *Cambridge Law Journal* 505.
37 Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach' (n34) at 605–606.

Some believe that this approach achieves a balance between the traditional shareholder approach and the stakeholder approach. However, there is a very strong case for arguing that the section does not provide enough protection for the interests of stakeholders.[38] It is contended that requiring directors to have regard to the interests of stakeholders is not sufficient if they are still obliged to consider the interests of shareholders as paramount, because stakeholders will always be disadvantaged in the event of a conflict. Consequently, if the protection given to stakeholder interest is insufficient, the extent of the impact of the section on CSR is also affected. Now, some of the aspects of the section will be briefly evaluated to show the extent of directors' discretion in the fulfilment of their duties, and why this is problematic.[39] The link between the section and CSR will also be considered.

The good faith requirement

Section 172(1) highlights the importance of the good faith of directors. This is consistent with its predecessor duty, which is the duty to act bona fide in the best interests of the company. The concept of good faith is a major component of the section, as a director is required to act in a way that he considers, in good faith, will promote the success of the company.[40] However, it is quite difficult to determine the meaning of good faith.[41] Under the previous duty, directors were required to act bona fide in what they considered, not what a court may consider, was in the best interests of the company.[42] Therefore, the emphasis was on what the directors themselves considered, and the courts would not impose their views in relation to whether the actions taken by the directors were actually in the company's best interest.[43] Also, a reasonableness test was not applied in judging

38 J. L. Yap, 'Considering the enlightened shareholder value principle' (2010) 31 *Company Lawyer* 35 at 36; also see S. Wen and J. Zhao, 'Exploring the Rationale of Enlightened Shareholder Value in the Realm of UK Company Law – The Path Dependence Perspective' (2011) 14 *International Trade and Business Law Review* 153

39 A very detailed evaluation of the section is provided by Keay in Chapter 4 of *The Enlightened Shareholder Value Principle and Corporate Governance* (n1).

40 A. Keay, 'The duty to promote the success of the company: Is it fit for purpose in a post-financial crisis world?' in J. Loughrey (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar, 2013) at 66.

41 A. Keay, 'Good faith and directors' duty to promote the success of their company' (2011) 32 *Company Lawyer* 138 at 139.

42 *Re Smith & Fawcett Ltd* [1942] Ch. 304.

43 In relation to this, note that the term 'interests of the company' has been considered to be a carelessly or purposefully imprecise judicial construct. See D. Prentice, 'Creditor's Interests and Directors' Duties' (1990) 10 *Oxford Journal of Legal Studies* 265 at 273, in which the expression was referred to as 'indeterminate'. Also, in M. Moore, *Corporate Governance in the Shadow of the State* (Oxford, Hart Publishing, 2013) at 191 it is suggested that "traditionally, Anglo-American courts have been reluctant to articulate exactly what the pursuit of a company's 'interest' entails, preferring instead to reserve such matters for ex ante resolution by corporate contractors themselves".

directors' good faith. Whether a director had breached his or her duty was based on an examination of the director's state of mind, and directors would not be in breach if they believed in good faith that they were acting in the best interests of the company.[44] In *Regentcrest v Cohen*,[45] Jonathan Parker J said that there would be no breach if the directors were able to provide unequivocal evidence that they honestly believed they had acted in the best interest of the company, and that evidence was accepted. A similar approach is taken under the new duty. This is evident in a statement by Margaret Hodge, the government minister responsible for the legislation.[46] She stated that, "We believe it is essential for the weight given to any factor to be a matter for the director's good faith judgement. Importantly, the decision is not subject to the reasonableness test".[47]

Nevertheless, a director's state of mind that he or she acted in good faith will not be accepted by the courts without question. Therefore, an assertion by a director is not impregnable, and the judges do not have to accept it blindly. The courts can hold the director liable for breach by considering evidence from the director, and also by examining objective matters such as whether what the director did or did not do was reasonable.[48] According to Jonathan Parker J in *Regentcrest v Cohen,* if the act in question causes considerable detriment to the company, it will be a harder task for the director to persuade the court that he or she honestly believed that the act complained of was in the best interests of the company.[49] So even though there seems to be a subjective assessment of the director's intention, there can be situations where certain objective matters cannot be ignored, and the judges will decline to accept the director's assertions.[50] In *Charterbridge Corp Ltd v Lloyds Bank Ltd*,[51] it was mentioned by Pennycuick J that in a situation where directors failed to consider whether an action was in the best interests of the company and proceedings had been initiated against them, the court would have to ask whether an honest and intelligent man in a director's position within the company in question could have reasonably believed, taking all the circumstances into consideration, that the transaction was for the benefit of the company.[52] A clear example of a breach is the

44 Keay, 'The duty to promote the success of the company: Is it fit for purpose in a post-financial crisis world?' (n40) at 67.
45 *Regentcrest v Cohen* [2002] 2 BCLC 80.
46 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 100.
47 HC Standing Committee D, Fifteenth Sitting, 11 July 2005, Cols 591–593.
48 *Shuttleworth v Cox* [1927] 2 K.B. 9 [23]-[24]; *Westpac Banking Corp v Bell Group Ltd (in liq)* [2008] WASC 239 [4598].
49 *Regentcrest v Cohen* [2002] 2 BCLC 80; also see Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 103.
50 Also see R.T. Langford and I.M. Ramsay, 'Directors' Duty to Act in the Interests of the Company – Subjective or Objective?' [2015] *Journal of Business Law* 173.
51 *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch 62; [1969] 3 All ER 1185.
52 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 101.

situation in *Knight v Frost*. In this case, a director transferred money that was borrowed for the benefit of one company to an insolvent company in which he held a significant shareholding. It was obvious that he was not acting bona fide in the interests of the company from which the money was borrowed.[53] It was also indicated in the judgement of Jonathan Crow in *Extrasure Travel Insurance Ltd v Scattergood*[54] that the fact that the director's alleged belief was unreasonable might demonstrate and constitute evidence that it was not held honestly at the relevant time.[55]

Even though the discretion held by the directors is significant, it is possible to prove breach, and the courts can decide that a director did not act in good faith. Nonetheless, it is still a difficult hurdle for claimants. Davies has even said that it is impossible "except in egregious cases or where the directors, obligingly, have left a clear record of their thought processes leading up to the challenged decision".[56] On the other hand, it has been argued that this assertion describes the situation too restrictively, because even though, as far as the section is concerned, it is not possible to use the reasonable director test, claimants may still request to have the issue of a director's good faith analysed in light of objective factors.[57] Nevertheless, the courts have shown that the good faith requirement on director's duties is moderately easy to satisfy.[58] It is likely that it will be quite difficult to show that a director has breached their duty of good faith unless there is evidence of really bad behaviour.[59] It has been suggested that the highly subjective nature of the duty in section 172 can be likened, without any significant inaccuracy, to the originating judicially formulated standard of review that allowed director's good faith judgement to render their legal obligations in line with situational expectations.[60] The good faith element remains ambiguous and contentious. The standard imposed on directors still remains quite low, and it is not clear if and when courts will consider objective issues. It remains extremely difficult, although not impossible, for claimants to prove breach. This has also been a matter of concern in

53 *Knight v Frost* [1999] B.C.C. 819; [1999] 1 B.C.L.C 364.
54 *Extrasure Travel Insurance Ltd v Scattergood* [2003] 1 B.C.L.C. 598 [90].
55 Keay, 'Good faith and directors' duty to promote the success of their company' (n41) at 149.
56 P. Davies, *Gower and Davies' Principles of Company Law* (London, Sweet and Maxwell, 2008) at 510.
57 Keay, 'Good faith and directors' duty to promote the success of their company' (n41) at 143.
58 C. Villiers, 'Narrative Reporting and enlightened shareholder value under Companies Act 2006' in J. Loughrey (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar, 2013) at 108.
59 Keay, 'The duty to promote the success of the company: Is it fit for purpose in a post-financial crisis world?' (n40) at 67–68.
60 D. Attenborough, 'The Neoliberal (Il)Legitimacy of the Duty of Loyalty' (2014) 65 *Northern Ireland Legal Quarterly* 405 at 406.

relation to the enforcement of the section, which will be discussed later in this chapter.

Meaning of success

It is suggested that the term success, as in "promoting the success of the company", may be unclear since 'success' is a rather slippery term[61] and the Act itself does not contain a definition. The Law Society had said in its response to the second White Paper and the draft Bill in 2005, regarding the clause that was the precursor to section 172, that the term success would create significant practical problems.[62] Paragraph 327 of the explanatory notes to the Act states that:

> the decision as to what will promote the success of the company, and what constitutes such success, is one for the director's good faith judgment. This ensures that business decisions on, for example, strategy and tactics are for the directors, and not subject to decision by the courts, subject to good faith.

This seems to indicate that the government intended the meaning of success to be dependent on the director's judgement of whether a decision is made in good faith. However, this is an issue of concern due to the criticisms of the good faith requirement discussed above, because the meaning of success may also be what the directors want it to be. Attenborough suggests that the

> provision uses such an opaque term as 'success' because it is a concept which necessarily requires a referent to provide it with a whole meaning. This referent is, perhaps unexpectedly, not prescribed through English companies' legislation as such, but is instead supplied from the shareholders as market participants (e.g. the company's constitution, shareholders' decisions and so on) in any given corporate economy.[63]

In the Lords Grand Committee, Lord Goldsmith made the following comments[64] on 'success' during the passage of the Act:

> … it is essentially for the members of the company to define the objective they wish to achieve. Success means what the members collectively want the company to achieve. For a commercial company, success will usually mean long-term increase in value …
>
> For most people who invest in companies, there is never any doubt about it – money. That is what they want. They want a long-term

61 Ibid at 69.
62 Law Society's Company Law Committee, June 2005 at 6.
63 Attenborough, 'The Neoliberal (Il)Legitimacy of the Duty of Loyalty' (n60) at 423.
64 Lord Goldsmith, Lords Grand Committee, 6 February 2006, columns 255–258, Hansard.

> increase in the company. It is not a snap poll to be taken at any point in time …
>
> … it is for the directors, by reference to those things we are talking about – the objective of the company – to judge and form a good faith judgement about what is to be regarded as success for the members as a whole … they will need to look at the company's constitution, shareholders' decisions and anything else that they consider relevant …

It has been claimed that this guidance also shows the confusion implicit in the section. For example, it is unclear whether it is the directors or the shareholders who should determine the objectives of the company. Also, it is not clear whether there should be any limits on the objects that might be set, or whether capital growth or income return should be the appropriate assumption.[65]

Likely consequences of any decision in the 'long term'

One of the main concerns of the CLRSG, as far as directors duties were concerned, and of the government when section 172 was introduced, was to encourage the idea that companies should be managed for the long term.[66] Even though some of the supporters of the employment of shareholder value in running a company felt that businesses should be run for the long term, this view was not favoured by everyone.[67] According to several finance academics, employing shareholder value produces short-term focus, and short-term earnings performance eclipses everything else.[68] Even though shareholder value should not automatically result in short-terminism, in practice it often does.[69] Certainly, the CLRSG held this stance when it stated that:

> the state of directors' duties at common law are often regarded as leading to directors having an undue focus on the short term and the narrow interests of members at the expense of what is in a broader and a longer term sense the best interests of the enterprise …[70]

65 S. F. Copp, 'Corporate Social Responsibility and the Companies Act' (2009) 29 *Economic Affairs* 16 at 18.

66 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 113.

67 Keay, 'The duty to promote the success of the company: Is it fit for purpose in a post-financial crisis world?' (n40) at 78.

68 S. Wallman, 'The Proper Interpretation of Corporate Constituency Statues and Formulation of Director Duties' (1991) 21 *Stetson Law Review* 163 at 176–177; M. Lipton and S. Rosenblum, 'A New System of Corporate Governance: The Quinquennial Election of Directors' (1991) 58 *University of Chicago Law Review* 187 at 205–215; M. E. van der Weide, 'Against Fiduciary Duties to Corporate Stakeholders' (1996) 21 *Delaware Journal of Corporate Law* 27 at 61.

69 Keay, 'The duty to promote the success of the company: Is it fit for purpose in a post-financial crisis world?' (n40) at 79.

70 *Modern Law for a Competitive Economy: The Strategic Framework* (n8) at para 5.1.17.

Even though the section may appeal to directors who may wish to manage the company by taking into account the long-term impact of their actions, it is questionable whether this will happen in reality.[71] Enforcement might be one of the major obstacles, especially where directors maintain that they acted in good faith.[72] Managing the business for the long term is often in conflict with the company's managers' interests. If the managers only have a temporary interest in the company because their time in the company is limited, they could favour the short term. They will not get much benefit from planning for the long term. It is their successors who will enjoy the economic benefits of the company pursuing long-term interests. Moreover, pursuing long-term interests could actually make their performance look average because there might not be an immediate increase in share price and higher dividends would not be paid as quickly as they might have been if the focus was on the short term instead.[73]

Also, in order to reduce agency costs, managers' remuneration has quite often been correlated with short-term shareholder interests. In addition, there might be pressure from shareholders who might become impatient if they do not receive any benefits and receive reports that the company is being managed for the long term. The threat of hostile takeovers is another issue of concern as some directors may want to keep the shareholders satisfied by acting in their short-term interests to ensure that they reject any takeover offer.[74] It is also quite difficult to measure actions of the directors in order to assess whether they have been pursuing long-term interests. The concept of 'long term' is very hard to define. For example, for some companies established for one or two definite purposes, the upcoming year is the long term. On the other hand, for a traditional business the long term will be very far into the future.[75] It might also depend on what stage a particular company is at, its size and the type of business.

Under common law, directors were permitted to consider both short-term and long-term matters in their decision-making. Section 172 appears to do the same.[76] In the Company Law Reform Bill, which was part of the government's 2005 White Paper, clause B3 clearly stated that directors need to consider any likely consequences of their decisions in both the long and the short term.[77] This has given directors legitimacy and protection in making decisions that are likely to be profitable in the long term, but which might have some unfavourable effects in the short term. The CLRSG has said that directors are under

71 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 246–249.
72 Ibid at 105–106, 241.
73 Ibid at 40, 241–242.
74 Ibid at 115, 241–243.
75 Keay, 'The duty to promote the success of the company: Is it fit for purpose in a post-financial crisis world?' (n40) at 81.
76 Ibid.
77 Cm 6456, 2005, DTI <http://www.berr.gov.uk/files/file13958.pdf> accessed 21 January 2016.

an obligation to "achieve the success of the company for the benefit of the shareholders by taking proper account of all the relevant considerations for that purpose", and this includes taking "a proper balanced view of the short and long term".[78] It elaborated that the effects should not be that the long term should have priority over the short term or the other way around, but that both should be balanced in order to decide what is best for the company's success.[79] The omission of any reference to the short term was to emphasise the significance of the long term, which had been previously ignored by many. Nonetheless, the emphasis on the long term and the exclusion of the short term does not mean that directors are not allowed to focus on the short term if they feel that it will promote the success of the company for the benefit of the shareholders.[80]

Nonetheless, there is a difference between the position under the previous law and the current position under the new law, considering the fact that government stated that the new provision "marks a radical departure in articulating the connection between what is good for a company and what is good for society at large".[81] However, it should be noted that before the introduction of section 172(1)(a), the directors of many corporations did consider the long term in their decision-making, and did not just focus on the short term.[82] Even though focusing on short-term earnings is one of the main reasons why companies are unable to succeed, it is quite uncertain whether section 172 will be able to change the approach of the boards and ensure that directors manage companies while thinking about the long term. The problems associated with enforcement, conflict with the interests of the managers, the threat of hostile takeovers, pressure from impatient shareholders and the lack of clarity regarding what 'long term' means are all reasons why the section might not be able to make sure that companies are managed for the long term. This also affects CSR, because in many ways CSR encompasses actions that can often be seen as promoting the long-term interests of a company and making sure that the future of the company is sustainable.[83] Since it appears that the section cannot always ensure that directors have regard to the consequences of their decisions in the long term, this inability might also impair the impact of the section in encouraging CSR.

78 *Modern Law for a Competitive Economy: Developing the Framework* (n9) at para 2.19.
79 Ibid at 3.54.
80 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 243–245.
81 *Duties of Company Directors*, DTI, June 2007, Introduction and Statement of Rt. Hon Margaret Hodge. <http://webarchive.nationalarchives.gov.uk/20070628230000/http://www.dti.gov.uk/files/file40139.pdf> accessed 21 January 2016.
82 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 117.
83 J. Epstein-Reeves, 'Six Reasons Companies Should Embrace CSR' (*Forbes*, 21 February 2012). <http://www.forbes.com/sites/csr/2012/02/21/six-reasons-companies-should-embrace-csr/#296f32444c03> accessed 22 January 2016.

Interests of the company's employees

For a long time, employees have been considered primary stakeholders in most organisations.[84] It has been suggested that the ESV principle could have the effect of making employees worse off than they previously were. This is due to the disappearance of section 309 of the Companies Act 1985, which set employees apart to be considered by directors. Now, employees have to compete with the other constituents in section 172.[85] However, it should be noted that section 309 of the Companies Act 1985 was also subject to criticism. It stated that the matters to which directors of companies need to have regard in the performance of their functions include the interests of the employees in general, as well as the interests of the company's members.

Section 309 was mainly criticised for two reasons. The duty to consider the interests of the employees, in general, was considered to be more of a procedural duty than a substantive duty. As a result, the impact of the duty was diminished and the ability of employees to show a breach was affected. In addition, the duty was owed to the company. Therefore, in the event of a breach there was no specific remedy that the employees could pursue. Hence, it was submitted that section 309 made little or no practical difference to the situation of employees.[86] Under section 172, the employees must compete with a non-exhaustive list of other stakeholders.[87] From a purely symbolic point of view, section 172 has probably downgraded the importance of the interests of employees. Nevertheless, in practice the employees are in exactly the same position as before the enactment of section 172. They did not have access to any specific remedy under the previous position, and they cannot pursue any remedy under section 172 as the duty is owed to the company.[88]

Stakeholder engagement is crucial for companies to execute their CSR practices effectively, and employees are one such group of primary stakeholders.[89] Being considerate towards the interests of employees is part of a company's demonstration of its commitment to CSR. CSR involves a company taking initiatives to improve the well-being of its employees.[90] In order to bolster their CSR efforts, companies must ensure that the rights of their

84 M. E. Clarkson, 'A stakeholder framework for analyzing and evaluating corporate social performance' (1995) 20 *Academy of Management Review* 92 at 106.
85 Villiers, 'Narrative Reporting and enlightened shareholder value under Companies Act 2006' (n58) at 103.
86 C. Wynn-Evans, 'The Companies Act 2006 and the interests of employees' (2007) 36 *Industrial Law Journal* 188 at 190.
87 Villiers, 'Narrative Reporting and enlightened shareholder value under Companies Act 2006' (n58) at 103.
88 Wynn-Evans, 'The Companies Act 2006 and the interests of employees' (n86) at 192.
89 J. F. Zhang, 'Employee Orientation and Performance: an exploration of the mediating role of customer orientation' (2010) 91 *Journal of Business Ethics* 111 at 111.
90 M. Ismail, 'Corporate Social Responsibility and its Role in Community: An International Perspective' 2 *The Journal of International Social Research* 199 at 199.

employees are protected.[91] Hence, a primary goal for organisational CSR efforts is to enhance employee satisfaction, and later to stimulate the loyalty of the employees.[92] In general, employees who are satisfied are more loyal to an organisation. Therefore, it is quite beneficial for companies to search for methods to support the well-being of employees, both at work and in general.[93] A study demonstrates that the commitment of employees will be harmed by lower job satisfaction. It can also result in higher employee turnover.[94] These facts demonstrate the importance of employees in CSR. By requiring directors to take the interests of employees in account in their decision-making, section 172 also resonates with similar ideas in CSR. Concern for the same issues reflects the link between the section and CSR. Therefore, it is suggested that given the fact that the section has not made much difference to the position of employees, its impact on CSR also appears to be limited to educating directors about the importance of considering this constituent group.

Need to foster the company's business relationships with suppliers and customers

Under section 172(1)(c), directors need to have regard to the need to foster the company's business relationships with suppliers, customers and others. Companies do not operate in isolation, and all companies have suppliers and customers in some form or another. The idea behind this is to ensure that directors manage these relationships in a manner that produces long-term benefits for the company.[95] Again, this ties in with the concept of CSR as being socially responsible, and also involves a company being concerned about the impact of its operations on suppliers and customers.[96] Companies are increasingly inspected by numerous audiences and are made accountable for their suppliers' behaviour.[97] As discussed extensively in the previous chapter,[98] CSR is very important in the context of supply chain management. Supply chain management activities are a matter of huge importance and can potentially play an

91 Q. Zhu, H. Yin, J. Liu and K. Lai, 'How is Employee Perception of Organizational Efforts in Corporate Social Responsibility Related to Their Satisfaction and Loyalty Towards Developing Harmonious Society in Chinese Enterprises?' (2014) 21 *Corporate Social Responsibility and Environmental Management* 28 at 28.

92 Ibid at 29.

93 J. Kuoppala, A. Lamminpaa, I. Vaananen-Tomppo and K. Hinkka, 'Employee well-being and sick leave, occupational accident, and disability pension: A cohort study of civil servants' (2011) 53 *Journal of Occupational and Environmental Medicine* 633.

94 See B. W. Swider, W. R. Boswell and R. D. Zimmerman, 'Examining the job search-turnover relationship: the role of embeddedness, job satisfaction, and available alternatives' (2011) 96 *Journal of Applied Psychology* 432.

95 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 123.

96 Ismail, 'Corporate Social Responsibility and its Role in Community: An International Perspective' (n90) at 199.

97 I. Maignan, B. Hillebrand & D, McAlister, 'Managing Socially Responsible Buying: How to Integrate Noneconomic Criteria into the Purchasing Process' (2002) 20 European Management Journal 641 at 641.

98 See section on Significance in a global context and supply chain management.

increasingly vital part in all of the main themes of corporate sustainability.[99] It has also been suggested that CSR image creates consumers' identification with the company, and this might enhance the consumers' intentions to purchase.[100] Therefore, the need to foster business relationships with suppliers and customers is very closely related to CSR. However, the inclusion of the factor in the section does not seem to add much to the situation that existed before the section came into operation.[101] The inclusion of the factor may assist in highlighting the importance of these two groups of stakeholders to the directors and perhaps more broadly, but the suppliers and customers cannot really enforce the duty or hold the directors accountable. They simply have to rely on other measures to protect themselves.

Impact of the company's operations on the community and environment

Lastly, under section 172(d) directors need to have regard to the impact of their operations on the community and the environment. Again, as with some of the other aspects of the section it is quite hard to comprehend what this actually means. For example, no guidance is provided about how far 'the community' reaches. It has also become harder and harder to accurately determine the business environment of a company due to globalisation. For many companies, stakeholders are distributed all over the world, which means the regulations they have to adhere to will also differ from country to country. The interpretation of this factor can range from simply abiding by the general regulations implemented by the government to going beyond those laws to consider the impact of their operations on the community and environment. Nevertheless, in spite of its vagueness, the inclusion of this factor does seem to link to CSR. What various definitions of CSR have in common is the focus on a simultaneous consideration of social, environmental and economic goals.[102] For example, the European Commission has stated that companies can become socially responsible by integrating social and environmental factors along with other matters. Many consumers also demand that companies produce high-quality products that are environmentally friendly and are manufactured using processes that have a less harmful impact on the environment and communities.[103] Therefore, considering the impact of the company's operations on the community and environment is simply part of being socially responsible.

99 W. L. Tate, L. M. Ellram and J. F. Kirchoff, 'Corporate social responsibility reports: A thematic analysis related to supply chain management' (2010) 46 *Journal of Supply Chain Management* 19 at 33.

100 See M. Chen, P. Tai and B. H. Chen, 'The Relationship among Corporate Social Responsibility, Consumer-Company Identification, Brand Prestige, and Purchase Intention' (2015) 7 *International Journal of Marketing Studies* 33.

101 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 123.

102 See section on CSR Definitions in Chapter 2.

103 J. Lash and F. Wellington, 'Competitive Advantage on a Warming Planet,' (2007) 85 *Harvard Business Review* 94 at 95, 98–99.

However, just like the other factors, it does not seem to add much to the situation under the previous law. Perhaps the only positive outcome is that it emphasises the importance of this factor, in promoting the success of the company, to the directors.

"A reputation for high standards of business conduct"

Under section 172(1)(e) the directors must have regard to maintaining a reputation for high standards of business conduct. This requirement is also quite vague. It seems to be concerned with values and ethics and abiding by a code of conduct.[104] Obviously, it is desirable for a company to be considered trustworthy, and maintaining a high standard of conduct can have this effect.[105] In the absence of any guidance in the Act, it might be useful to consider definitions of corporate reputation elsewhere. Corporate reputation has been defined as "perceptions of how the firm behaves towards its stakeholders and the degree of informative transparency with which the firm develops relations with them".[106] Another definition states that it is the immediate mental picture of a company that develops over the course of time due to consistent performance and which is reinforced through effective communication.[107] Hence, it appears that the reputation of companies has a behavioural and informative component. Legitimate behaviour in establishing the distribution of the value created in the past will result in stakeholders expecting legitimate behaviour in the future. In addition, the possibility of managerial opportunism is also reduced by the sharing of asymmetric information which then leads to increased trust and satisfaction among stakeholders and consequently to improved corporate reputation.[108] This reflects why it is desirable for a company to maintain a reputation for high standards of business conduct, and why it is important for directors to consider this when making decisions.

In reference to the definitions of CSR considered in the previous chapter,[109] this factor also clearly resonates with the notions of CSR. Being socially responsible means conducting business in a way that is ethical and maintaining

104 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 126.

105 Ibid.

106 A. Pérez, 'Corporate reputation and CSR reporting to stakeholders: Gaps in the literature and future lines of research,' (2015) 20 *Corporate Communications: An International Journal* 11 at 15; see also J. M. de la Fuente and E. de Quevedo, 'The concept and measurement of corporate reputation: an application to Spanish financial intermediaries' (2003) 5 *Corporate Reputation Review* 280.

107 C. Fombrun, *Reputation. Realizing Value from the Corporate Image* (Boston, MA, Harvard Business School Press, 1996) as cited in Pérez, 'Corporate reputation and CSR reporting to stakeholders: Gaps in the literature and future lines of research' (n106) at 15.

108 Pérez, 'Corporate reputation and CSR reporting to stakeholders: Gaps in the literature and future lines of research' (n106) at 15.

109 See section on Definitions in Chapter 2.

a reputation for high standards. It means functioning with a certain level of transparency about the company's operations. Furthermore, studies have shown that CSR and CSR reporting have a positive impact on corporate reputation.[110] It is proposed that as there is a clear link between CSR and reputation, there is also a clear link between CSR and section 172. However, it is very questionable whether the section can actually ensure that directors have regard to the factor, considering the discretion given to them in the fulfilment of the duty and the lack of any accountability measures save possibly at the hands of the shareholders.[111]

Lack of enforcement mechanisms and problems with derivative claims

ESV does not provide any mechanism of enforcement for the non-shareholder constituents listed in the section. No legal recourse is available to them, even if their interests are completely ignored by directors when making decisions. Hence, in the event of a breach, the stakeholders are left toothless. The directors owe the duty to promote the success of the company to the company itself. Therefore, if the directors breach this duty and if no action is brought by the company, then under Part 11 of the Companies Act 2006 it is only the shareholders who can bring derivative proceedings on behalf of the company.[112] The absence of any enforcement method for non-shareholder constituents is one of the main criticisms of the section. As has been noted, "a right without a remedy is worthless".[113] This point is also used to make a strong argument that stakeholders are in practically the same position as before the concept of ESV was incorporated in the section. The factors listed in the section may be perceived merely as window dressing.[114] However, the section does give directors the right to take stakeholder interests into account if they want to, thus providing assistance for those directors who do have concern for wider interests. Finally, it is submitted that the lack of enforcement mechanisms also affects the impact of the section on CSR. If directors are being socially irresponsible by failing to take the listed factors into consideration, there is nothing that can be done by the stakeholders.

110 For example, see D. M. Patten and N. Zhao, 'Standalone CSR reporting by US retail companies' (2014) 38 *Accounting Forum* 132; M. Khojastehpour and R. Johns, 'The effect of environmental CSR issues on corporate/brand reputation and corporate profitability' (2014) 26 *European Business Review* 339.

111 The impact of the section on CSR will be explored in depth in later chapters.

112 R. C. Tate, 'Section 172 CA 2006: the ticket to stakeholder value or simply tokenism?' (2012) 3 *Aberdeen Student Law Review* 112 at 115.

113 M. McDaniel, 'Bondholders and Stockholders' (1988) 13 *Journal of Corporation Law* 205 at 309.

114 E. Lynch, 'Section 172: a ground-breaking reform of director's duties, or the emperor's new clothes?' (2012) 33 *Company Lawyer* 196 at 200.

Dependence on shareholders

Since derivative proceedings can only be brought by shareholders, stakeholders are dependent on them to confront the directors legally for any non-compliance with the section. However, there are only a limited number of situations where one could envisage a claim being brought by a shareholder to enforce the rights of stakeholders.[115] Stakeholders have to rely on the presence of philanthropic shareholders who will be willing to confront the directors to enforce their rights. Some shareholders might be concerned about the community as a whole and feel obliged because of their personal concerns about wider issues.[116] In addition, shareholders who consider their shares in companies as long-term investments might be prompted to bring proceedings against directors if they fail to take the long-term interests of the company into account. The failure of directors to promote business relationships with customers and suppliers might raise concerns among shareholders, as it may hamper their long-term interests and damage the company in the future.[117]

Furthermore, an employee who has shares in the company might be interested in taking action if directors are not taking the interests of employees into consideration.[118] In circumstances where the shareholders reside in the same community in which the company's operations take place, the shareholders might take action if they are concerned that the directors' actions will adversely affect the community.[119] This is more likely if that effect might consequently have an impact on their lives.[120] Finally, there is the slight possibility that environmental NGOs might decide to work from inside a company by buying shares in order to bring derivative proceedings.[121] Hence, except for situations in which shareholders are sincerely concerned about wider interests and feel obliged to act in society's interests, an action is only likely to be brought by those shareholders whose own interests are being adversely affected in some other way. As these situations are not very common, shareholders will bring derivative proceedings in the event of a breach of the section in a very limited set of scenarios. Therefore, in the absence of actions being brought by shareholders, there will be no proceedings unless the board decides to take action and bring proceedings against a miscreant director.

Practical obstacles in bringing derivative claims

In the rare situations in which shareholders might be prepared to act in stakeholders' interests and bring derivative proceedings in the event of a breach by the

115 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 137.
116 V. Ho, 'Enlightened Shareholder Value: Corporate Governance Beyond the Shareholder-Stakeholder Divide' (2010) 36 *Journal of Corporation Law* 59 at 105.
117 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 137.
118 Ibid.
119 Ibid at 139–140.
120 Lynch, 'Section 172: a ground-breaking reform of director's duties, or the emperor's new clothes?' (n114) at 201.
121 Ibid.

directors, the process of initiating proceedings creates quite a few practical obstacles for them. The procedure for initiating derivative claims will be discussed briefly before consideration is given to these difficulties. The statutory derivative action replaces the common law.[122] Under section 261 of the Act (in England and Wales and Northern Ireland), once a claim has been instituted the shareholder must apply to the court to obtain permission to continue the claim. The shareholders are required to satisfy the court that they can meet the permission criteria set out in the act.[123] A two-stage process is established in the Act for obtaining permission. First, the courts will have to decide if the claim discloses a *prima facie* case. If the claimant successfully establishes a *prima facie* case at this stage, the claim will then proceed to the next stage, which is a full permission hearing. Then, the company will be directed by the court to present evidence to demonstrate why permission to proceed should be refused. Finally, a decision will be made by the court. Under section 263(2) of the Act, if the court comes to the conclusion that a person acting in accordance with section 172 would not be willing to continue the claim, it must decline to give permission. The court must also decline to give permission if the matter in question was authorised in advance or ratified later. These two situations are absolute bars to derivative proceedings.

Under section 263(3) of the Act, the court must consider a list of factors when deciding whether to give permission. Section 263(3) is set out below:

> (3) In considering whether to give permission (or leave) the court must take into account, in particular:
>
> (a) whether the member is acting in good faith in seeking to continue the claim;
> (b) the importance that a person acting in accordance with section 172 (duty to promote the success of the company) would attach to continuing it;
> (c) where the cause of action results from an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be:
>
> (i) authorised by the company before it occurs, or
> (ii) ratified by the company after it occurs;
>
> (d) where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company;
> (e) whether the company has decided not to pursue the claim;

122 A. Keay and J. Loughrey, 'Something old, something new, something borrowed: An analysis of the new derivative action under the Companies Act 2006' (2008) 124 *Law Quarterly Review* 469 at 477.

123 Ibid.

(f) whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company.

There are a number of problems that may beset a derivative action. Even though the *prima facie* case test is well known, the meaning of the concept remains elusive. The courts have not discussed the meaning of the term in detail, and neither have they discussed what needs to be done by applicants to establish a *prima facie* case.[124] It is rather hard to satisfy the non-exhaustive list set out in section 263(3), which contains a mixture of objective and subjective factors. In addition, there is a lack of clear guidance regarding how the factors should be weighted, and the importance of each factor will also depend on the facts in each individual case. Therefore, the discretion enjoyed by the courts is so wide that the claimants will not have much guidance from case law, as each case will be decided on its own merits. Under factors (b) and (c) as set out above, the wrongdoers themselves are in control and can authorise or ratify the conduct that is contested. In this way, the pursuit of these claims may potentially be futile. Due to these complexities, potential claimants may well decide to stop pursuing their claim at this point. The majority of derivative claims are likely to fail at this stage as well.[125] The process is designed in such a manner that the merits of the claim will be considered even before the application has been allowed to proceed. The perception that the courts might have a very restrictive approach and that derivative claims are only successful in extraordinary situations might also act as a deterrent. In the context of all these difficulties, a derivative claim continues to be considered as a measure of last resort.[126]

Another practical obstacle that is also a deterrent for claimants is the cost involved in bringing these claims. The courts can provide for the company to pay the costs of the proceedings, but this is rarely done. Any award at the end of the process, if it is successful, will be given to the company. Furthermore, the claimants will not be eligible for legal aid. Instead of bringing a derivative claim, it will be much easier for shareholders simply to sell their shares and invest in a corporation that operates according to their values. In addition, as mentioned earlier in the chapter, due to the broad discretion possessed by the directors and the problems associated with the good faith requirement, it is quite hard to establish a breach of section 172. Directors decide how much weight should be given to stakeholder interests and what will promote the

124 A. Keay and J. Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 *Journal of Business Law* 151 at 154.

125 A. Reisberg, 'Derivative claims under the Companies Act 2006: Much ado about nothing?' in J. Armour and J. Payne (eds), *Rationality in Company Law: Essays in Honor of DD Prentice* (Oxford, Hart Publishing, 2009), University College London Law Research Paper No. 09–02, Available at SSRN <https://ssrn.com/abstract=1092629>.

126 Ibid.

success of the company.[127] As directors merely have to show that they acted in a way that they considered, in good faith, was most likely to promote the success of the company, it is asserted that the standard expected of them is too low. The requirement of good faith has been criticised as a rhetorical device that is "replete with uncertainty in conception and highly unworkable in practice".[128] This only diminishes the impact of the section even further.

Stakeholders can purchase shares in a company to bring a derivative claim, since all shareholders can initiate proceedings to bring a derivative claim. However, it is quite likely that courts might strike out such claims, as they will take into account whether the claimant is acting in good faith. These various procedural obstacles for derivative claims are complications for stakeholders such as activist groups, who buy shares in a company and allege that the listed factors have been ignored. Moreover, shareholders who purchase a holding in the company for the sole purpose of bringing derivative claims will most probably face a hostile judiciary. Of course, the court is only likely to realise this if the respondent seeks to lead evidence on this point. The courts will not allow the statutory derivative action to become a mechanism for activists to enforce the section.[129]

The availability of other forms of protection

It may be argued that some groups of stakeholders are protected under other legislation, and they are not entirely reliant on the directors to protect their interests. The Environment Protection Act 1990 has provisions to safeguard the environment. Employees can rely on the Health and Safety Executive and the provisions of certain employment statutes to safeguard their interests.[130] Creditors are protected from certain actions[131] of directors under the Insolvency Act 1986. Nonetheless, these provisions only provide partial and insufficient cover to stakeholders. They only provide some form of remedy based on analysis of past performance, but for protection to be truly effective it is often needed *ex ante*.[132]

127 Tate, 'Section 172 CA 2006: The ticket to stakeholder value or simply tokenism?' (n112) at 116–117.

128 A. Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 *European Company and Financial Law Review* 61 at 101,103.

129 Tate, 'Section 172 CA 2006: the ticket to stakeholder value or simply tokenism?' (n112) at 117. It is important to note that the courts have been reluctant to strike on the basis that the applicant is not acting in good faith. In countries like Australia and Canada, the courts have indicated that they will rarely dismiss on this basis.

130 For example, see Employment Rights Act 1996.

131 For example, Section 214 of the Insolvency Act 1986 protects creditors if directors are involved in wrongful trading.

132 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 141.

Interpretation

The scope and nature of the general duties are stated in section 170 of the Act. Section 170(3) states that

> the general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.

Furthermore, it is stated in section 170(4) of the Act that

> the general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.

Therefore, even though the previous law is replaced by the duties codified in the Act, the previous law will have to be considered in interpreting the Act. Hence, it is reasonable to deduce that there is no change in the common law duties, with the exception of situations in which the wording of the Act contradicts the previous law. Even though there are cases which involved the application of section 172, there has been as yet no detailed analysis by the judiciary of the section and the factors listed in the section. Therefore, as far as the interpretation of the section is concerned, guidance will have to be derived from case law under the previous position, general statements made in the Parliament along with other reports, and the few cases that have involved the application of section 172.

Statements made and guidance provided by other sources

The CLRSG has stated in the *Strategic Framework* that adopting the ESV approach would not necessitate altering the main objective of companies, which is maximising the wealth of the shareholders.[133] Hence, the enactment of the section does not really reform the fundamentals of the directors' duties. Also, in the parliamentary debates on the Act it was emphasised by the government that there is one duty in section 172. This basically means that the duty to act in good faith and the duty to have regard to the factors are not two separate duties. The directors have to decide what is most likely to promote the success of the company for the benefit of the shareholders as a whole. The listed factors are secondary to that superseding duty.[134] Hannigan notes that in

133 *Modern Law for a Competitive Economy: The Strategic Framework* (n8) at para. 5.1.17.

134 An earlier draft of the provision required that the directors 'must' have regard to the listed factors. However, the Bill was amended to remove this second 'must'. It was mentioned that using 'must' twice could have given the indication of a separate duty. See HL Deb, vol 681, cols 845, 883–4 (9 May 2006) and B. Hannigan, *Company Law* (Oxford, Oxford University Press, 2016) at 212.

this way it was also anticipated to limit the scope for allegations of breach of duty resulting from an alleged failure to consider one or more of the factors.[135]

In a study of the public comments of large commercial law firms, just before the enactment of the ESV approach, it was found by Loughrey, Keay and Cerioni that there was a variance of opinion regarding how boards should function in light of section 172.[136] There were two general approaches. One was that directors will have to keep a much more detailed record than they did in the past of the reasons for their decisions on listed factors.[137] Loughrey et al. found in their study that the majority of lawyers felt that section 172 was likely to have an impact on procedural aspects of the board's decision-making. These lawyers thought that the enactment of the section would lead to a more bureaucratic decision-making process. It would also necessitate a need for lengthier board minutes to prove that the directors had considered the listed factors.[138] On the other hand, there were also those who believed that from a bureaucratic perspective the directors did not really have to do a lot more than they were already doing. For example, the Institute of Chartered Secretaries and Administrators had stated that the section only reinforces and combines existing statutory provisions, common law and best practice.[139] It stated that board minutes should record the decisions made. There does not necessarily have to be a detailed record of how each of the factors was taken into account.[140] The GC100 also expressed a similar view.[141] In addition, the Rt. Hon. Margaret Hodge MP also mentioned that the clause does not place an obligation on directors to keep records in any situations in which they would not have to do so now.[142] Lord Goldsmith, speaking for the government, also refused to accept that the section necessitates any form of paper trail.[143] Therefore, it was unlikely that the section had a huge impact on how the minutes are compiled, and does not impose a more onerous requirement than what existed before. However, the recent amendment to the Strategic Report with the additional requirement for a section 172(1) statement[144] might change this. This will be discussed in more detail later in the chapter when addressing the reporting requirement.

135 Hannigan, *Company Law* (n134) at 212.
136 J. Loughrey, A. Keay and L. Cerioni, 'Legal Practitioner, Enlightened Shareholder Value and the Shaping of Corporate Governance' (2008) 8 *Journal of Corporate Law Studies* 79.
137 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 204.
138 Loughrey, Keay and Cerioni, 'Legal Practitioner, Enlightened Shareholder Value and the Shaping of Corporate Governance' (n136) at 102.
139 Institute of Chartered Secretaries and Administrators, *Guidance of Directors' General Duties* – January 2008 at para 3.2.3.
140 Ibid.
141 GC100, Companies Act (2006) – Director's duties, 7 February 2007 at para 6.3(h).
142 Margaret Hodge, Commons Committee, 11 July 2006, column 592.
143 HL Deb, vol 681, GC 841 (9 May 2006).
144 414CZA of the Companies Act 2006.

Cases after the enactment of the section

As mentioned above, we are still awaiting a judgement containing a detailed analysis of the factors listed in section 172. Taking the various concerns surrounding section 172 into consideration, it is quite surprising that there are only a limited number of cases in which the section has been the basis for the proceedings. Mostly, it has been referred to in decisions related to applications made by shareholders to obtain permission to continue derivative claims against directors, as the procedure requires considering whether a person acting in accordance with section 172 would seek to continue the claim.[145] Under section 263(2)(a) of the Companies Act 2006 the court needs to consider whether directors who are acting in accordance with the duty under section 172 would continue the claim. Under section 263(3)(b) of the Companies Act 2006, consideration also needs to be given to the importance that a person acting in accordance with section 172 would attach to continuing the claim. However, the discussion of section 172 in this context is not of much assistance in interpreting the section, as it does not provide any guidance on how the listed factors should be balanced, what would constitute a breach of the section and what complying with the duty under the section would actually require.

Nonetheless, there are a few cases where the section has been considered. For example, in *Stimpson v Southern Private Landlords Association*,[146] the application of section 172(2) was considered. Section 172(2) envisioned that companies can exist for a variety of purposes, which includes non-commercial purposes. It was noted by the court that section 172(2) envisions two types of situations: "where the objects of the company consisted of purposes other than the benefit of its members and where the purposes of the company included purposes other than the benefit of its members".[147] In the first scenario, the duty of the director will be to achieve those purposes. In the second scenario, the director should try to promote the success of the company for the benefit of the shareholders as a whole while simultaneously achieving those other purposes. In the event of the conflict between the dual purposes, the director will have to use a balancing exercise and his honest business judgement.[148] This seems to be consistent with the extent of the discretion that directors enjoyed before the enactment of the section.

Furthermore, the obligation to act fairly between the members was considered in *Re Sunrise Radio Ltd, Kohli v Lit.*[149] This case concerned a rights issue made by

145 See A. Keay, 'Applications to Continue Derivative Proceedings on Behalf of Companies and the Hypothetical Director Test' (2015) 34 *Civil Justice Quarterly* 346; Section 263(2)(a) of the Companies Act 2006.

146 *Stimpson v Southern Private Landlords Association* [2010] BCC 387.

147 Ibid at [26]. These two situations appear to be the same and might not reflect the wording of the section.

148 Ibid. Also see Hannigan, *Company Law* (n134) at 216.

149 *Re Sunrise Radio Ltd, Kohli v Lit* [2010] 1 BCLC 367.

a company for raising capital. Even though the purpose was genuine, it was made at a time when it was probable that minority shareholders would not take up the shares and face dilution of their overall holdings. The directors were found to be in breach of their duty under section 172(1)(f) to act fairly between the shareholders. Finally, as far as a conflict between two or more of the factors is concerned, it was made clear in *Shepherd v Williamson*[150] that resolving such conflicts is an issue of business judgement of the directors, who have to act in good faith and exercise reasonable care and skill. This case was not a claim for breach of duty under section 172. Rather, it involved a petition for unfair prejudice under section 994 of the Act. It is suggested in the judgement that in the event of a conflict between the factors listed in section 172(1), the directors are to balance the interests. In doing so, they are entitled to focus on the interests that they consider will promote the success of the company. Therefore, the balancing exercise involves focusing on what will promote the success of the company. This approach is consistent with the comment made by CLRSG that the promotion of the success of the company was something that was determined by the directors' good faith judgement.[151]

These cases have demonstrated that the key feature of the duty, as with its precursor, acting bona fide in the interests of the company, is the 'good faith' of the directors. Following the discussion above on the good faith requirement, it is quite difficult to hold directors accountable under the section because of the focus on the good faith of the directors. In *Re Charterhouse Capital Ltd*[152] a claim under section 172 failed because there was no evidence that showed that the director had not acted in good faith. None of the cases so far have disclosed the extent to which the courts will believe the good faith argument put forward by a director. All we know at this point is that directors will be held liable if the judge disbelieves a director when he claims that he was acting in good faith.[153] Another point that has been made clear on several occasions is that section 172(1) is the successor to the previous fiduciary duty in common law to act bona fide in the best interests of the company.[154] The duty under section 172 essentially restates the common law duty to act bona fide in the interests of the company. Under the common law duty, the directors were under an obligation to act bona fide in what they considered to be the interests of the company. The interest of the company was construed as the interests of the shareholders as a general body, while balancing the short-term interests of

150 *Shepherd v Williamson* [2010] EWHC 2375 [103]-[104].

151 *Modern Law for a Competitive Economy: Completing the Structure* (n10) at para 3.16.

152 [2015] EWCA Civ 536, [2015] BCC 574.

153 *Breitenfeld UK Ltd v Harrison* [2015] EWHC 399 (Ch) [69]. Norris J said that he rejected the evidence of the director that he was acting in good faith.

154 See *Re West Coast Capital (LIOS) Ltd* [2008] CSOH 72; 2008 Scot (D) 16/5; *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch); also *Shepherd v Williamson* [2010] EWHC 2375 (Ch) [103].

the current members and the long-term interests of the future members.[155] A number of the cases have made references to the previous duty.[156] Hence, the previous case law is likely to remain relevant in the interpretation of the new duty.[157]

The Strategic Report

Operating and Financial Review (OFR)

Other than the inclusive statement of director's duties, which is incorporated in the section, there is another component of the ESV approach. This was the obligation placed on directors to file an OFR, which would give the shareholders a way to satisfy themselves that the directors were running the company in accordance with the duty. Therefore, Section 172 was only one part of the ESV concept that the government wanted to enforce. The other part was the obligation to file an OFR.[158] The requirement to file an OFR was crucial to the CLRSG's final recommendations, and it recommended that the ESV should be accompanied by accountability measures.[159] The provision for the review was included in the clauses of a draft Companies Bill attached to a White Paper in July 2002. The clause that covered the requirement for the OFR provided that companies must publish material information on their activities, which should include details about risks, opportunities and future

155 *Re Smith & Fawcett Ltd* [1942] Ch 304 [306]; Second Savoy Hotel Investigation, Report of the Inspector (1954) HMSO; *Gaiman v National Association for Mental Health* [1971] Ch 317 [330].

156 See *Re West Coast Capital (LIOS) Ltd* [2008] CSOH 72; 2008 Scot (D) 16/5; *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch); also *Shepherd v Williamson* [2010] EWHC 2375 (Ch) [103].

157 It should be noted that the House of Commons Business, Energy and Industrial Strategy and Work and Pensions Committees Report on Carillion stated the following in relation to section 172: "In evidence to us, Carillion's board members did not give the impression that they were acutely conscious of the wide range of legal duties they had, nor of the prospect of any penalties arising from failure in this regard. It is difficult to conclude that they adequately took into account the interests of employees, their relationships with suppliers and customers, the need for high standards of conduct, or the long-term sustainability of the company as a whole. Any deterrent effects provided by section 172 of the Companies Act 2006 were in this case insufficient to affect the behaviour of directors when the company had a chance of survival". See Business, Energy and Industrial Strategy and Work and Pensions Committees, Carillion, Second Joint Report from the Business, Energy and Industrial Strategy and Work and Pensions Committees of Session 2017–19, Tenth Report of the Business, Energy and Industrial Strategy Committee of Session 2017–19, Twelfth Report of the Work and Pensions Committee of Session 2017–19, HC 769, 16 May 2018, at 67.

158 Keay, 'The duty to promote the success of the company: Is it fit for purpose in a post-financial crisis world?' (n40) at 75; *Modernising Company Law,* Cm 5553-I, DTI, 2002 (Vol 1) at para 4.28.

159 *Modern Law for a Competitive Economy: Developing the Framework* (n9) at para 2.19.

plans.[160] The government envisioned that the OFR would be of benefit to a wider range of stakeholders.[161] Other than shareholder interests, the directors had to give consideration to material related to stakeholder interests such as employment, along with environmental, social and community issues that are relevant to the company's business.[162] The goal of the OFR was to ensure sufficient transparency of qualitative information, as it is crucial for investors, shareholders, creditors and others to evaluate the performance of directors and their companies. This would enable them to make a proper assessment of the company's performance and prospects. It was anticipated that the OFR would contain forward-looking information which is required by modern business decision-making.[163] Nevertheless, the OFR was shelved, and the Business Review was enacted in its place.[164]

The Business Review

Section 417 of the Act required that the director's report must contain a Business Review. This should enable shareholders to assess the performance of directors under the section.[165] The withdrawal of the OFR was a blow to many who had advocated in favour of it. Its replacement by the Business Review was met with adverse reactions from NGOs, investors' groups, regulatory bodies and so on. The accounting community considered the Business Review to be an inferior reporting tool in comparison to the OFR.[166] It was also the requirement that led members of the CLRSG, who supported pluralist theories, to agree to the ESV approach.[167] Friends of the Earth even brought judicial review proceedings in respect of the change from the OFR to the Business Review, based on the claim that the Chancellor made this policy reversal too hastily without following the correct procedures or the state's own consultation policy. These proceedings were resolved in an out-of-court settlement on the basis of an agreement that a new consultation would be produced on the issues raised by the lobby group two years after the implementation of the Act. It had been claimed that the Business Review would be much less prescriptive and would offer less guidance compared to

160 Keay, 'The duty to promote the success of the company: Is it fit for purpose in a post-financial crisis world?' (n40) at 75.
161 *Modernising Company Law,* Cm 5553-I, DTI, 2002 (Vol 1) at para 4.32.
162 Clause 75(2) the Draft Clauses on the Operating and Financial Review, *Modernising Company Law,* Cm 5553, DTI, 2002, Annex D.
163 A. Johnston, 'After the OFR: can UK shareholder value still be enlightened?' (2006) 8 *European Business Organization Law Review* 817 at 818, 831, 841.
164 Ibid.
165 Section 417 of the Companies Act 2006.
166 P. Yeoh, 'Narrative reporting: the UK experience' (2010) 52 *International Journal of Law & Management* 211 at 223.
167 Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach' (n34) at 604.

the OFR regarding what should be disclosed.[168] While the OFR seemed to have been directed at stakeholders in general, the Business Review seemed to be concentrated on shareholders.[169] The requirements of the Business Review state that information about environmental concerns, employee issues, community matters and so on only have to be provided if it assists in understanding the development, performance or position of the business of the company. Therefore, there is no explicit requirement to provide information about the company's employees and social issues.[170] Moreover, no obligations are imposed on the directors to explain why these matters will not affect the business if they choose not to provide such information. Davies acknowledged the risk that the Business Review "will be productive of self-serving and vacuous narrative rather than analytical material which is of genuine use". Compared with the OFR, the Business Review seemed to be less comprehensive, and its provisions seemed to be drafted in a more generalised manner in comparison with the provisions contained in the OFR.[171] However, some do maintain that the withdrawal of the OFR did not make much difference in practice,[172] and that the information required under section 417 was quite extensive.[173] Nevertheless, it is unfortunate that the OFR was not properly tried out and given the opportunity to develop as a system for the disclosure of information to investors and other stakeholders.[174] It would have been a worthy experiment which might have increased the accountability of corporate controllers and provided a way for stakeholders to engage with management in a more informed manner, without resulting in substantial increases in company costs.[175]

The Strategic Report and recent amendments

The requirement for the Business Review was replaced by the obligation for certain companies to prepare a Strategic Report. This was the result of the government promulgating the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 in August 2013. These became effective on 1 October 2013, and applied for periods ending on or after 30 September 2013. The main amendment was the requirement for certain companies to

168 Johnston, 'After the OFR: can UK shareholder value still be enlightened?' (n163) at 841.
169 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 171.
170 Johnston, 'After the OFR: can UK shareholder value still be enlightened?' (n163) at 842.
171 Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (n1) at 159.
172 Johnston, 'After the OFR: can UK shareholder value still be enlightened?' (n163) at 840.
173 Keay, 'The duty to promote the success of the company: Is it fit for purpose in a post-financial crisis world?' (n40) at 76.
174 Johnston, 'After the OFR: can UK shareholder value still be enlightened?' (n163) at 842.
175 Ibid at 820.

prepare a Strategic Report as part of their annual report.[176] Directors of companies, other than those companies that are exempt,[177] were required to prepare a Strategic Report for each financial year.[178] According to section 414C(1) of the Act, the purpose of the Strategic Report is to inform members of the company and help them assess how the directors have performed their duty under section 172:

> (7) In the case of a quoted company the strategic report must, to the extent necessary for an understanding of the development, performance or position of the company's business, include—
>
> (a) the main trends and factors likely to affect the future development, performance and position of the company's business, and
> (b) information about—
>
> (i) environmental matters (including the impact of the company's business on the environment),
> (ii) the company's employees, and
> (iii) social, community and human rights issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies.
>
> If the report does not contain information of each kind mentioned in paragraphs (b)(i), (ii) and (iii), it must state which of those kinds of information it does not contain.[179]

There is not much difference here with the previous requirements of the Business Review, except for the fact that the Strategic Report must be presented separately to the Directors' Report. It also has to be approved separately by the board of directors, and signed on behalf of the board by a director or the secretary of the company. Therefore, like its predecessor, it was highly debateable whether the Strategic Report would assist in attaining the goals associated with the introduction of the concept of ESV.

The problems associated with the reporting requirements relating to reporting on section 172 and the need for reform was highlighted by the Green Paper published by the Department for Business, Energy and Industrial Strategy (BEIS) in late 2016, and by the various responses to the Green Paper. In the Green Paper, one of the four options suggested to strengthen the voice of the stakeholders was to strengthen the reporting requirements that are related to stakeholder engagement. The problems relating to the absence of guidelines, which often results in a lack of clear and transparent information regarding the steps that directors have taken to fulfil their duties under section 172, were also

176 Financial Reporting Council, *Guidance on the Strategic Report*, July 2014, London.
177 Section 414B of the Companies Act 2006.
178 Section 414A(1) of the Companies Act 2006.
179 Section 414C(7) of the Companies Act 2006.

acknowledged.[180] It was suggested that stronger reporting requirements should be designed to raise wider awareness, even outside the boardroom, about the duty under section 172, and to provide more assurance that wider stakeholder interests are taken into account when decisions are made.[181] It was mentioned that the government welcomes thoughts on how additional reporting on the wider interests in section 172 could be introduced.[182]

In its response to the Green Paper, the City of London Law Society (CLLS) also supported the notion of strengthening the reporting requirements and mentioned that this option is most likely to result in actual change in terms of stakeholder engagement. They recommended that disclosures should begin with explaining what the board thinks are the relevant constituencies to the company. Then the board should describe what they have done to ascertain the impact of their decisions on those relevant constituencies in order to abide by their duty under section 172 of having regard to the relevant considerations. If this is combined with a proportionate enforcement regime, it will oblige boards to make careful decisions on how stakeholder interests should influence the way they pursue the success of the company. If additional disclosure measures are introduced, it might be useful to allow the disclosure to be on company websites as well, either as part of or instead of the annual report, as the improvement in accessibility of the disclosure to people in general will increase public trust.[183]

The Financial Reporting Council (FRC) also stated that the duty needs to be reinvigorated and there is a need to compel companies to report more efficiently on how they have fulfilled the duty. The FRC recommended that the Strategic Report Regulations should be amended in order to direct boards on linking the reporting under section 414C to the duty under section 172.[184] At the time, there was an absence of specific reporting requirements on how the directors are considering the factors listed in section 172. It was recommended that boards should be compelled to show how they have considered wider stakeholders in their decision-making and mechanisms that will ensure that section 172 is delivering its purpose more efficiently should be considered. The FRC believed that the best way to accomplish this would be to introduce a legislative requirement to report against the section.[185] This means companies

180 Department of Business, Energy and Industrial Strategy, Corporate Governance Reform, Green Paper, November 2016 at 40–41, para 2.30.

181 Ibid at 41, para 2.31.

182 Ibid at 41, para 2.35.

183 Response of the City of London Law Society Company Law Committee to the Green Paper (February 2017), at p.10, available at <https://www.citysolicitors.org.uk/storage/2017/02/CLLS-Response-to-the-Green-Paper-on-Corporate-Governance-Reform.pdf> accessed 15 August 2017.

184 Financial Reporting Council, Response to the Department of Business, Energy and Industrial Strategy Corporate Governance Reform Green Paper (17 February 2017), at p. 5, available at <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/FRC-Response-to-BEIS-Green-Paper-consultation-on-C.pdf> accessed 15 August 2017.

185 Ibid.

will be required to report on how the duty under section 172 was fulfilled. They also proposed bringing corporate governance reporting within the scope of their monitoring powers so that can examine "the quality and integrity of such reporting and engage with companies accordingly".[186]

After receiving the responses to the Green Paper, the Business, Energy and Industrial Strategy Committee of the House of Commons also stated in their report that the best way to ensure that directors take their duty of having regard to wider stakeholders seriously is to require more accurate reporting that will be backed up by strong enforcement.[187] In highlighting the fact that stakeholders have the right to expect better standards regarding reporting on section 172, they agreed that directors should be obliged to report on how they have fulfilled their duty under section 172.[188] This seemed to be a different approach to section 172, as the section was designed to refine shareholder primacy, not to promote stakeholder theory. It was also suggested that this should also be in an accessible and useful form rather than being a mere addition to the boilerplate statements that some companies provide to comply with requirements.[189] The following recommendations were made:

> We recommend that the FRC amends the Code to require informative narrative reporting on the fulfilment of section 172 duties. Boards must be required to explain precisely how they have considered each of the different stakeholder interests, including employees, customers and suppliers and how this has been reflected in financial decisions. They should also explain how they have pursued the objectives of the company and had regard to the consequences of their decisions for the long term, however they choose to define this. Where there have been failures to have due regard to any one of these interests, these should be addressed directly and explained … The FRC should encourage companies to be more imaginative and agile in communicating digitally with stakeholders throughout the year and should actively push back on the use of boiler-plate statements in annual reports, using wider powers …[190]

In its response to the Green Paper, the government expressed its agreement regarding the need for a formal reporting requirement that will force directors to give consideration to how they take wider matters into account. It was anticipated that an increase in transparency will also assure the investors that the

186 Ibid at 1.
187 Business, Energy and Industrial Strategy Committee, Corporate Governance, Third Report of Session 2016–2017, HC 702, 5 April 2017 at 17, para 30.
188 Ibid at 18, para 33.
189 Ibid.
190 Business, Energy and Industrial Strategy Committee, Corporate Governance, Third Report of Session 2016–2017, HC 702, 5 April 2017 at 60–61, paras 5–6.

company is being operated in a sustainable manner.[191] It was mentioned that more consideration will be given to the idea of the new reporting requirement, and the government anticipated that the requirement would entail including explanations on the way the company identified and sought the perspectives of its main stakeholders, along with discussion on the suitability of the methods that were adopted, and how the acquired information affected the decisions made by the board. The concerns regarding the accessibility of the disclosures, so that it is included on websites in addition to the Strategic Report, were also noted.[192] In response, the government stated that secondary legislation will be introduced so that all companies, of a significant size, will be required to provide explanations on how their directors are fulfilling their duty under section 172 to have regard to wider interests.[193] It was also mentioned that considerations will also be given to the size of the companies that will be subject to the requirement.[194]

Recently, the Companies (Miscellaneous Reporting) Regulations 2018 inserted section 414CZA in the UK Companies Act 2006. Under, section 414CZA:

> (1) A strategic report for a financial year of a company must include a statement (a "section 172(1) statement") which describes how the directors have had regard to the matters set out in section 172(1)(a) to (f) when performing their duty under section 172.
> (2) Subsection (1) does not apply if the company qualifies as medium-sized in relation to that financial year (see sections 465 to 467).

So, this has now added a further requirement for a section 172(1) statement, within the Strategic Report for large companies, to explain how the directors have had regard to matters listed in section 172(1)(a–f), within the strategic report for large companies. Moreover, an additional requirement is that the statement should also be disclosed on the company's website. Under section 430, quoted companies were already required to publish annual accounts and reports on their websites. The publication requirement was extended to unquoted companies.[195] This requirement became effective from the financial year beginning on 1 January 2019. Reporting on the legislative requirement is also supported by the FRC's Guidance on the Strategic Report.[196] The

191 Department for Business, Energy and Industrial Strategy, Corporate Governance Reform, The Government Response to the Green Paper Consultation, August 2017 at 31, para 2.35.
192 Ibid at 32, para 2.36.
193 Ibid at 32.
194 Ibid at 32, para 2.37.
195 Section 426B of the Companies Act 2006.
196 Financial Reporting Council, Guidance on the Strategic Report (July 2018), available at <https://www.frc.org.uk/getattachment/fb05dd7b-c76c-424e-9daf-4293c9fa2d6a/Guidance-on-the-Strategic-Report-31-7-18.pdf> accessed 10 July 2020.

Guidance was first published by the FRC in June 2014 and has been updated now to improve the link between the purpose of the Strategic Report and section 172. In the updated guidance, companies are encouraged to take into account the broader matters that can impact the performance of the company over the longer term. This includes the interests of wider stakeholders.[197]

Conclusion

If the intention of Parliament was to increase protection of the interests of non-shareholding stakeholders, the concept of ESV does not seem to go far enough in ensuring that aim. As a result, the impact it has on CSR is not as strong as hoped. It is rather difficult for claimants to prove a breach of the section, as the standard for the good faith requirement is quite low. A lot of the terms used in the section, such as success, long term and community, are unclear and reflect the implicit confusion in the section. It can be said that section 172 frames the duty only in the form of a 'nudge regulation' to educate directors to behave ethically.[198] Moreover, the lack of enforcement mechanisms leaves stakeholders very vulnerable in the event of a breach. In situations where the shareholders might be willing to bring claims on behalf of the stakeholders, the complexity and costs of bringing derivative proceedings act to discourage them. Lastly, many concerns have been raised in relation to the reporting requirement. We have to wait and see whether or not the recent changes addressed above will have any positive impact.

197 Ibid.

198 Attenborough, 'The Neoliberal (Il)Legitimacy of the Duty of Loyalty' (n60) at 425–426.

4 The impact of ESV on CSR

Theoretical and empirical analysis

Introduction

In the previous chapters, the concepts of ESV and CSR have been discussed separately. Consideration has also been given to how the two concepts correlate and resonate as they contain some of the same ideas. This chapter presents a theoretical analysis that aims to determine whether the concept of ESV is capable of promoting or assisting CSR, and then it considers empirically whether this has occurred. The first part of the chapter will involve a discussion on three empirical studies carried out previously. The three studies that will be discussed in this chapter are studies conducted by Peter Taylor in his PhD thesis,[1] by ORC International for the Department for Business, Innovation and Skills (BIS) on the evaluation of the Companies Act 2006[2] and by Olaojo Aiyegbayo and Charlotte Villiers on the enhanced business review.[3] In order to use the results derived in these studies to analyse whether the concept of ESV promotes or assists CSR, it is essential to briefly discuss the methodology used in the studies. This will then be followed by a summary and analysis of the relevant aspects of the results. It is contended that the results from those studies assist in demonstrating whether the concept of ESV promotes or assists CSR. The second part of the chapter is constituted by a study of the material published about or relating to the two concepts in public documents of companies that are accessible from company websites, such as corporate governance reports, annual reports, CSR reports, etc. It is submitted that this study will shed light on whether the ESV principle promotes or assists CSR. It might also shed light on whether companies have been affected in what they do by the introduction of ESV.[4]

1 P. Taylor, 'Enlightened Shareholder Value and the Companies Act 2006' (unpublished PhD thesis, May 2010), Birkbeck College, University of London.
2 Department for Business, Innovation and Skills (August 2010) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31655/10-1360-evaluation-companies-act-2006-volume-1.pdf> accessed 14 March 2017.
3 O. Aiyegbayo and C. Villiers, 'The enhanced business review: has it made corporate governance more effective?' (2011) 7 *Journal of Business Law* 699.
4 It should be noted that the study on corporate reports was completed before the addition of the new requirement for a section 172(1) statement within the Strategic Report for large companies.

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Discussion of previous studies

Taylor's study

In Peter Taylor's PhD thesis he conducted a study to assess the impact of the enlightenment statutes of the Companies Act 2006 on companies and institutional investors.[5] First, a pilot interview was conducted with a major London law firm to make a preliminary assessment of companies' reactions to the Act and to assist in selecting an appropriate methodology.[6] He then chose to use an approach consisting of a survey and in-depth interviews.[7] The questionnaire, which was sent to 175 companies that were listed on the FTSE 350, was used to give an overview of companies' responses to the Act and to derive ideas for approaching the in-depth interviews. The questionnaire was designed so that the officers of companies were asked to add comments to their responses if they wanted to.[8] In-depth interviews were conducted with the nine respondents who were willing to participate.[9] Representatives of certain selected institutional investors were also interviewed in relation to the impact of the Business Review.

A total of 26 replies were received in relation to the survey, which represented a response rate of nearly 15 per cent.[10] The companies were asked whether, in comparison to the period before the Act came into force, they now had a greater regard for the factors listed in section 172(1). A total of 23 per cent, or six companies, stated that the Act would have the effect of causing a greater regard for one or more of the listed factors.[11] The most significant effect seemed to be the higher regard now for the impact of operations on the community and environment, since 30 per cent of the respondents believed that the Act has been beneficial in that aspect.[12]

If the companies' officers responded positively to the aforementioned question, they were invited to provide reasons for doing so. Some of the comments made are as follows:

> I have answered 'yes' because the consideration is now more formal. The consideration of the relevant areas is now documented and preparers of board papers are required to include the relevant information in their papers.[13]
>
> We had a high regard for all of these factors well before the Companies Act made this a regulatory requirement. The Act only leads to slightly more care taken to demonstrate these factors are being covered.[14]

5 Taylor, 'Enlightened Shareholder Value and the Companies Act 2006' (n1) at 140.
6 Ibid at 143.
7 Ibid at 144.
8 Ibid at 145–146.
9 Ibid at 147, 162.
10 Ibid at 151.
11 Ibid at 151–153.
12 Ibid at 161.
13 Ibid at 153.
14 Ibid at 154.

Focuses attention. Annual report CSR section is more significant.[15]

The comments made by some of the respondents indicate that the formalisation of the duties, which now raises them to a higher profile, has resulted in having greater regard for the factors. Thirteen companies, or 50 per cent of the respondents, also responded positively to the question of whether there is a proposal to create an 'audit trail' of board decisions.[16] Hence, the formalisation has also caused half the companies to introduce schemes to enable an 'audit trail' of the decisions made by the boards to show compliance.[17] Twenty-one companies also said that they had taken legal advice on the statutory implications of carrying out directors' duties in accordance to section 172(1).[18] Companies were also asked if the disclosure of information in accordance with the now repealed section 417 assists in reducing the pressure for short-term results in favour of longer-term investments with potentially a more beneficial result. Only one company responded positively to this question.[19]

As explained in the previous chapter, requiring directors to have regard to the listed factors is what links the ESV principle to CSR. Being socially responsible includes having regard to those factors. Since almost a quarter of the respondents stated that the Act will cause the directors of their companies to have a greater regard for the listed factors, it is submitted that this can be interpreted as the Act causing the directors to have a greater regard for CSR. Even though it is important to remember that this is only based on responses from six companies, the results show that the ESV principle at least had the potential to have a positive impact on a few companies.

Another noteworthy factor is a recognised risk that questionnaire methodology carries. The replies might have been based on the general perceptions of the respondent about what effect the Act may have, rather answering on behalf of the company.[20] On the assumption that the respondents were answering on behalf of the company, since at least some companies seem to think that the formalisation would cause their directors to have higher regard for the factors, it is contended that the ESV principle is capable of promoting or assisting CSR. Furthermore, since half the companies also stated they were proposing to create an 'audit trail' of board decisions to demonstrate compliance with section 172 if required, it can be deduced that the section has drawn more attention to the listed factors, and thus to CSR. Now, due to the added requirement for a section 172(1) statement for large companies, more companies might contemplate on doing this. Also, as the majority of the respondents stated that they sought legal advice in relation to the statutory implications of carrying out the duty, it can be asserted that the section has made companies aware of the

15 Ibid at 154.
16 Ibid at 159.
17 Ibid at 161.
18 Ibid at 158.
19 Ibid at 157.
20 Ibid at 162.

importance of taking the listed factors into account. Therefore, it is submitted that based on the results of the Taylor study, the ESV principle does, to a certain extent, promote or assist CSR in some companies. However, given the relatively small number of respondents, and the fact that the majority of the respondents did not think that the Act would cause directors to have a greater regard for one or more of the listed factors, the scope of the study is very limited and the results cannot really be generalised.

As far as section 417 is concerned, there seems to be almost no impact on CSR. Only one respondent thought that the disclosure of information in accordance with section 417 assisted in reducing the pressure for short-term results in favour of longer-term investments.[21] Only four companies stated that the disclosure of information in accordance with section 417 made companies more risk-averse, and therefore the great majority thought that it had no effect on attitudes to risk.[22] Of course, what we do not know is whether the change to the Strategic Report and the recent amendments, in particular the additional requirement for a section 172(1) statement, has changed the opinions of the respondents.

Lastly, another interesting aspect of the study was when the companies that agreed to participate in the in-depth interviews were asked about the contradiction in a certain Minister's claim that the director's duties are simply a codification of the common law duties on the one hand, but on the other hand that they link the activities of companies to what is good for society at large. Three companies were aware of the statement. One company interpreted the statement as a desire that companies should have a sense of CSR, and its officer defended the company in the following manner:

> I do think that's interesting in that, particularly in our case, we are about 85 per cent in the UK and a lot of our business is in labour-dependent contracting and therefore we're very clear how important corporate social responsibility is. We have had, since the mid-90s a very long sustainability programme.[23]

Another company did consider the statement when deliberating on how to respond to the Act, but did not attach a lot of importance to it because advice indicated that the Act does not attach any additional legal requirement to the situation that existed before. An officer of the third company made the following comment:

> Well, I suppose that if a company is doing well, it's contributing to society by employing people and paying taxes. Certainly, we don't see any need to alter what we are doing to fit in with that statement. I did read it, as did

21 Ibid at 157.
22 Ibid at 158.
23 Ibid at 171

> my board member colleagues, and I wonder whether the Minister was expecting companies to somehow change some of their policies so as to not concentrate wholly on shareholders. We took advice and decided that no change was necessary – but, I suppose, it does remind you that, in the end, companies exist for the wider community.[24]

These statements seem to reflect that some companies appear to believe that they are already socially responsible, and in any case their liability is not really extended under the new position. However, in a way the statutory directors' duties do remind them about their responsibility to the wider community. Perhaps, in this way the ESV principle at least serves an educational purpose, even if it does not provide any remedy for stakeholders in the event of a breach. It can be argued that the principle promotes or assists CSR simply by reminding companies about the importance of the factors listed in the section.

Evaluation of the Companies Act 2006 by ORC

In November 2009 BIS commissioned ORC International to conduct an evaluation of the Companies Act 2006. In order to evaluate the impact of the Act, an assessment of the awareness of and compliance with the main rules implemented through the Act was essential.[25] The principal aim of the study was to examine the impact of the Act on businesses in the UK, and to investigate whether the Act was fulfilling its policy goals. The policy goals listed in the report are: improving stakeholder engagement and promoting a long-term investment culture, securing better regulation, and a 'Think Small First' approach, making the process of setting up and running a company easier and giving flexibility for the future.[26]

This was a large and sanctioned study involving both quantitative and qualitative research methods.[27] There were three main means of collecting data. In the quantitative study, computer-aided telephone interviews, which were based on a questionnaire, were conducted with 1,000 UK businesses. This was spread out across a range of company sizes, and interviews were conducted with those responsible for the corporate governance of the businesses. In addition, in-depth interviews were conducted with 15 stakeholders. Lastly, 15 businesses of interest were identified from the quantitative study and face-to-face or telephone case studies were conducted with them.[28] Before moving on to the results and analysis, it is important to note that the final implementation phase of the Act was in October 2009, and the evaluation report was published in August 2010. At that point, it was still too early to analyse the impact of the Act and assess whether its policy goals had been fulfilled.[29]

24 Ibid at 170–171.
25 Department for Business, Innovation and Skills (n2) at 5.
26 Ibid at 18.
27 Ibid at 21.
28 Ibid at 21.
29 Ibid at 13.

Among many other questions, the interviewees were asked about their awareness of changes to certain individual measures in the Act. Of all the companies, 79 per cent were aware of the changes related to the role of directors. Also, there was 81 per cent awareness from large private, public and quoted companies about the Business Review.[30] However, when the companies were asked whether the way in which directors fulfil their duties was affected by the statutory statement as a whole, the majority (62 per cent) said no. Only 22 per cent of the companies agreed and 16 per cent were unsure.[31] So, in spite of a very high awareness of the codification of the duties, it had not stimulated overwhelming change.

Only large private, public and quoted companies were asked about whether they were aware of the duty under section 172. Among a total of 253 companies, 95 per cent responded positively.[32] It is contended that this high level of awareness is positive in the sense that the change brought about by the section has been promoted. However, when the companies that were aware of the duty were asked whether it had affected the behaviour of directors, 17 per cent said that it had, but 64 per cent said that it had not and 20 per cent did not know.[33] Therefore, regardless of the high level of awareness, the duty did not have a major impact on changing behaviour. Some of the reasons why some of officers of the companies did not make any changes were that they felt they already had the right culture and were confident about their procedures. Even though this neutrality regarding behavioural change reflects that there was no apparent cultural change in the decision-making processes of companies, it is essential to remember that some companies still thought that the advent of ESV had affected directors' behaviour. It is submitted that this impact on the minority was still quite encouraging. For example, the following comment was made in one of the case studies:

> Definitely directors are much more wary now about that much wider range of aspects they need to take into account in decision making, which is why our governance is structured in the way it is, to get more information into the boardroom.

Most of the stakeholders interviewed were positive about the codification of the directors' duties, for reasons such as: "it gives directors a better chance to fully understand their responsibilities"; "it focuses directors [sic] minds"; and "it has led to better documentation of decision making". In addition, it has assisted in changing the nature of the debate about CSR. For example, the following comment was made: "It has changed the nature of the debate in CSR. Now [sic] understood that companies do have responsibility to the environment and

30 Ibid at 39.
31 Ibid at 66.
32 Ibid at 71–72.
33 Ibid at 72–73.

not just the company itself. It's shifted away. The purpose is now more to serve society".[34]

However, others were a bit more hesitant, and there were apprehensions regarding whether the codification of the duties had brought about the anticipated change to behaviour and whether it had been endorsed in the manner that was initially envisioned. One particular stakeholder made reference to the requirement that directors have to balance stakeholder interests and that this does not encourage a change in behaviour in the board room. Another stakeholder saw section 172 as a gesture in the correct direction but did not think that it would have the impact that was desired. One of the comments made was:

> My personal view on this is that it is a gesture in the right direction, but the way that the particular section is framed is unconvincing in its potential impact, because it uses this phrase 'Directors must have regard to specified stakeholder related factors', nobody really understands exactly what the legal force of that is, and also directors are faced with a situation whereby they are required to have regard to a number of stakeholder factors, some of which are almost by definition mutually exclusive.[35]

Even though, as a whole, section 172 was considered to have the potential to have an impact on the behaviour of directors in the long term, the problem, as summarised by one of the stakeholders, was that it was not really understood what the exact legal force of section 172 is.[36] There seems to be mixed views from the stakeholders interviewed regarding the impact of the codification of the directors' duties on CSR and of section 172 on the behaviour of directors. Therefore, as far as assessing whether ESV promotes or assists CSR, the results from the interviews of the stakeholders are inconclusive.

Similarly, perceptions of the Business Review were also mixed. Most of the stakeholders were relatively content with it and also believed it presented a good structure that could improve stakeholder engagement. However, some mentioned that quality of the information was inadequate, and that there was confusion among businesses regarding what needed to be submitted.[37] It is also interesting to note that in the feedback on areas for improvement, two areas were directors' duties and the Business Review. In terms of directors' duties, it was suggested that to increase behavioural change, more clarity and guidance were required to enhance awareness and understanding of section 172.[38] There was still confusion regarding what the term 'have regard' means.[39] Similarly, more clarity on the process of the Business Review was required for improving

34 Ibid at 62.
35 Ibid at 63.
36 Ibid.
37 Ibid at 78.
38 Ibid at 15.
39 Ibid at 163.

the quality of the information given in the report and for making sure that it is not perceived as 'boilerplate'.[40] Again, at this stage, we do not know whether the change to the Strategic Report has improved the state of affairs. Nevertheless, the recently added requirement of a section 172(1) statement[41] and the guidance provided by the FRC[42] might, to a certain extent, address concerns in relation to the quality of information required and the confusion regarding what needs to be submitted.

In conclusion, it has been established in this evaluation by BIS that section 172 has not brought about the cultural shift and behavioural changes that some thought was desired by the Act. However, some companies have stated that the section did have an impact on the behaviour of directors. Assuming that impact was positive, meaning the directors were now more concerned about the factors listed in the section, it is submitted that the section is capable of promoting or assisting CSR. Nonetheless, there is always the possibility that the companies thought that the section had an impact on the behaviour of directors when in reality it did not. Furthermore, even though there were mixed views from stakeholders on both section 172 and the Business Review, some stakeholders were positive about the codification of the duties and one even commented on its positive impact on CSR. It is also quite evident that added clarity in relation to the section will also assist in bringing about behavioural change. The problem is that arguably this has not occurred even now.

Study on the "enhanced" Business Review

Olaojo Aiyegbayo and Charlotte Villiers conducted a study to assess the impact of the requirement of a Business Review, under the now repealed section 417, on the relationships between company boards and their investors. They referred to the requirement under the section as the "enhanced" Business Review. As mentioned earlier, the purpose of the review is to assist shareholders in assessing whether the directors have fulfilled their duty under section 172. The main aim of the study was to enquire from the participants what they thought was the impact of the enhanced Business Review on the relationship between management and investors, as well as what its influence was on corporate governance. In particular, they investigated whether the managers' awareness of stakeholder interests was increased by the enhanced Business Review.[43] It is submitted that the results derived from this particular aspect of the study can assist in demonstrating whether the concept of ESV is capable of promoting or assisting CSR.

40 Ibid at 15.
41 Section 414CZA of the Companies Act 2006
42 Financial Reporting Council, Guidance on the Strategic Report (July 2018), available at <https://www.frc.org.uk/getattachment/fb05dd7b-c76c-424e-9daf-4293c9fa2d6a/Guidance-on-the-Strategic-Report-31-7-18.pdf> accessed 10 July 2020.
43 Aiyegbayo and Villiers, 'The enhanced business review: has it made corporate governance more effective?' (n3).

The research was concentrated on primary corporate governance actors such as investor relations managers, along with corporate governance directors from institutional investment firms. Institutional investors were chosen because they are usually considered to be the most informed investment stakeholder, and they have control over a massive percentage of the entire stock market in the UK. Investor relations managers were chosen because of their involvement in the preparation and distribution of the contents of annual reports. Semi-structured interviews were conducted with the participants, in which they were asked to answer a number of questions about their observations of the impact of the Business Review on the current state of narrative reporting. The researchers also consulted the annual reports of the companies of the investor relations managers who participated in the research, to enable them to form links to the results from the interviews.[44]

The interviews confirmed that the annual reports remain a very important source of information for investors. However, all the participants thought that companies failed to report their non-financial key performance indicators (KPIs) and principal risks effectively. They claimed that the companies struggled to justify the basis of selecting their non-financial KPIs and principal risks, and to explain their relevance to the corporate strategy and objectives. As the non-financial KPIs include stakeholder interests, such as the employees, suppliers, the community and the environment, and the reporting on these factors is not very effective, it is submitted that it is unlikely that the Business Review had any substantial impact on CSR. It was also mentioned in the conclusion that there has been no significant improvement in the narrative reporting practices of corporations. Listed companies in the UK seemed to continue to be strong in the areas in which they were strong in 2006 reports, but struggled in the areas in which they were weak in 2006.[45] So, the requirement for the Business Review had not been as effective as the regulators had hoped it to be. As the impact of the Business Review itself on narrative reporting was minimal, it can be deduced that its impact on CSR was probably insignificant. Clarification of existing regulation was required to assist those who are responsible for preparing these reports and improved statement of guidance was needed. Even though the requirement for the Business Review was considered a positive legal development, a number of issues required further guidance and clarification. This included clarification of safe harbour provisions so that the managers will not have to fear litigation as a result of any forward-looking statements they make or explanations of non-financial KPIs that are included.[46] We do not know whether the change to the Strategic Report has improved things. As noted in the previous chapter, there were not any significant differences with the previous requirements of the Business Review and the Strategic Report. However, it will be interesting to see whether

44 Ibid.
45 Ibid.
46 Ibid.

the more recent addition of the requirement of a section 172(1) statement[47] and the updated guidance provided by the FRC[48] has a positive impact.

The impact of ESV on CSR: evidence from corporate reports

This study aims to determine whether the concept of ESV is capable of promoting or assisting CSR by analysing corporate rhetoric embodied in various corporate documents and websites.[49] The research was conducted through an examination of the public documents of all the retail companies listed in the FTSE 100 Index of the London Stock Exchange. The section begins by explaining the methodology of the study in detail, along with justifying the reasons behind taking certain approaches. The methodology also includes a discussion on the value of corporate reports. After that the findings of the study are discussed, and analyses of the findings are provided. This is then followed by an examination of the limitations of the study, and a conclusion.

Methodology

The research for this study was conducted by collecting data from the public documents available through the official websites of all retail companies listed on the FTSE 100. The FTSE 100 index is a share index composed of the 100 largest companies that are listed on the London Stock Exchange according to highest market capitalisation. The eight retail companies that are included in the FTSE 100, in order of market value, are as follows: Associated British Foods plc (parent company of Primark), J Sainsbury plc, Tesco plc, Morrisons Supermarkets plc, Kingfisher plc, Marks and Spencer group plc, Next plc and Travis Perkins plc. The data studied was text data collected from company websites and documents that are produced by the companies themselves to communicate their positions. The documents that were examined, depending on availability, were Annual Reports and CSR/Sustainability Reports.[50] Consideration was also given to mission statements.

Conventionally, public companies generate annual reports as a response to compulsory requirements that exist in most Western economies.[51] The annual

47 Section 414CZA of the Companies Act 2006.

48 Financial Reporting Council, Guidance on the Strategic Report (n42).

49 It should be noted that some of the material in this study draws on an article: 'A. Keay and T. Iqbal, "The Impact of Enlightened Shareholder Value" (2019) 4 *Journal of Business Law* 304 (Sweet & Maxwell)'. This article was co-authored with Professor Andrew Keay. The author is very thankful to the publisher and Professor Keay for allowing her to draw upon the material that she has published in this article. She acknowledges that she has used the material with the permission from the publisher and Professor Keay.

50 The list of documents used for each company is set out in the Annex.

51 P. A. Stanton and J. Stanton, 'Researching corporate annual reports: an analysis of perspectives used' <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.196.9076&rep=rep1&type=pdf> accessed 15 November 2017.

report is considered to be an important device for financial communication between management, shareholders and others.[52] It has even been claimed that an annual report is the main form of corporate communication.[53] It is considered to have credibility as a communication tool because it includes legally required and audited financial statements.[54] The research that is presented in this study was primarily based on the annual report, because it seems to be the most inclusive document that is produced compulsorily, and it is also the most publicised document.[55] Also, all the aspects that the author wished to consider, as detailed below, are usually addressed by the companies in their annual reports.[56] The CSR reports were considered for obvious reasons, which are that the study has been conducted to assess the impact on CSR, and these reports are focused completely on stakeholders.[57]

Many people dismiss the comments of companies on their own websites as mere rhetoric and therefore as meaningless.[58] Critics have stated that a lot of the very vocal corporate advocates of CSR are involved in only superficial efforts, which cannot be considered anything more than window dressing in order to satisfy the demands of some of a company's most powerful stakeholder groups.[59] Activities related to CSR, such as companies publishing codes of conduct or incorporating the CSR rhetoric into company reports and websites, might be mostly symbolic and insignificant unless they are supported by substantive actions.[60] However, it has

52 S. A. Bartlett and R. A. Chandler, 'The Corporate Report and the Private Shareholder: Lee & Tweedie Twenty Years On' (1997) 29 *British Accounting Review* 245.

53 C. A. Adams, A. Coutts and G. Harte, 'Corporate Equal Opportunities (Non-) Disclosure' (1995) 27 *British Accounting Review* 87 at 92.

54 See R. D. Hines, 'The Usefulness of Annual Reports: the Anomaly between the Efficient Markets Hypothesis and Shareholder Surveys' (1982) 12 *Accounting and Business Research* 296.

55 A. Keay and R. Adamopoulou, 'Shareholder Value and UK Companies: A Positivist Inquiry' (2012) 13 *European Business Organization Law Review* 1 at 12.

56 The KPMG Survey of Corporate Responsibility Reporting 2017 shows that more and more large companies include information related to corporate responsibility in their annual reports. See J. Blasco and A. King, *The Road Ahead: The KPMG Survey of Corporate Responsibility Reporting 2017* (2017) KPMG International Cooperative, at 21–22, available at: <https://home.kpmg.com/content/dam/kpmg/campaigns/csr/pdf/CSR_Reporting_2017.pdf> accessed 22 January 2018.

57 The requirements for the preparation, distribution and filing of accounts and reports are set out in Part 15, sections 380 to 474 of the Companies Act 2006.

58 L. M. Fairfax, 'Easier said than done? A corporate law theory for actualizing social responsibility rhetoric' (2007) 59 *Florida Law Review* 771 at 771.

59 W. D. Schneper, M. Meyskens, A. Soleimani, S. Celo, W. He, W. Leartsurawat, 'Organizational Drivers of Corporate Social Responsibility: Disentangling Substance from Rhetoric' (2015) 80 *S.A.M. Advanced Management Journal* 20 at 20; K. Walker and F. Wan, 'The harm of symbolic actions and green-washing: Corporate actions and communications on environmental performance and their financial implications' (2012) 109 *Journal of Business Ethics* 227.

60 Schneper, Meyskens, Soleimani, Celo, He and Leartsurawat, 'Organizational Drivers of Corporate Social Responsibility: Disentangling Substance from Rhetoric' (n59).

been argued that stakeholder rhetoric has normative implications and intrinsic value.[61] Fairfax has claimed that even though shareholder primacy is reflected in the practices of various corporations, the corporate embrace of stakeholder principles in their rhetoric suggests that companies recognise that audiences do not completely support the claim that corporate conduct should be governed by shareholder primacy.[62] Corporate stakeholder rhetoric can be defined as "discourse or communication evidencing a corporation's commitment to or concern for groups and interests beyond shareholders, including customers, employees, creditors, suppliers, and society".[63] Nowadays, corporate documents are filled with stakeholder rhetoric, which is also evident in the results of this study. Companies have officers and entire teams dedicated to stakeholder interests. It has been contended that the creation of these positions and teams not only reflects a growth in the acceptance of stakeholder rhetoric, but also shows the willingness of companies to provide the structural support necessary for applying the principles contained in that rhetoric.[64] Perhaps the prevalence of stakeholder principles in different reports produced by companies shows that these issues are being incorporated, at least rhetorically. Even though it would be wrong to characterise companies embracing stakeholder rhetoric as a complete victory for the proponents of stakeholder theory, the growing embrace of such rhetoric endorses the idea that companies are moving away from an exclusive focus on the maximisation of shareholder wealth.[65] Hence, corporate rhetoric has intrinsic value as a persuasive and expressive device, and the use of stakeholder rhetoric by companies might be a way of showing their dissatisfaction with the notions of shareholder primacy.[66]

Fairfax has proposed another way in which corporate stakeholder rhetoric can be of value. She has examined empirical evidence to show that corporate rhetoric has a stronger connection with how companies behave than most would chose to believe.[67] A lot of the commentators have dismissed or not given much thought to the idea that corporate stakeholder rhetoric can actually have any significant impact on how companies behave. This tendency can be largely attributed to the fact that stakeholder rhetoric is largely considered to constitute marketing mechanisms used to enhance public image. Hence, its potential to have any substantial behavioural implications is dismissed. However, there is a substantial percentage of companies whose rhetoric is aligned

61 L. M. Fairfax, 'The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms' (2006) 31 *The Journal of Corporation Law* 675 at 677, 678.
62 Ibid at 678.
63 Fairfax, 'Easier said than done? A corporate law theory for actualizing social responsibility rhetoric' (n58) at 779.
64 Fairfax, 'The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms' (n61) at 694.
65 Ibid at 698.
66 Ibid at 712.
67 Fairfax, 'Easier said than done? A corporate law theory for actualizing social responsibility rhetoric' (n58) at 771.

with their practices. This shows that the notion that rhetoric has no real connection to behaviour is not correct. Fairfax claims that corporate rhetoric can actually be used strategically to encourage companies to engage in practices that are beneficial to stakeholders.[68] According to the social psychology literature, the expression of a commitment by an individual substantially increases the chances of that person to behave in a way that is consistent with the commitment made. The likelihood of the commitment affecting behaviour is enhanced when the commitment is made public, is written or is repeated. Hence, she argues that if corporate rhetoric can be considered to be corporate commitment, then it can have an impact on how companies behave. Since the commitments made by companies in annual reports or other reports are written, public and also repeated, the likelihood of having an impact on corporate behaviour should increase. However, there are certain limitations to these deductions, as the social psychology literature referred to is based on commitments made by individuals, not by corporations.[69] Nonetheless, these arguments demonstrate that corporate rhetoric may be of value, and due to the accessibility of the various reports, the author believes it is a respectable source that is available in order to analyse the impact, if any, of ESV on the CSR practices of companies.

The data from the reports were collected during the periods from May to July 2016 and from October to November 2016. The author decided to examine the documents for the following years: 2006, 2008, 2010, 2012 and 2015. The reason behind selecting these years was to enable the author to gain a broad appreciation of how, if at all, ESV had made an impact. It was gauged that the years chosen would enable the assessment of the situation immediately before the enactment of section 172, immediately after its enactment, sometime after its implementation and finally, the most up to date situation at the time of the study. Focusing on reports published during the aforementioned time periods enabled the author to not only examine the impact of the ESV principle, but also to observe whether its impact changed over the years. It was essential to compare the data collected from years both before and after it was put into effect, to see if it has made any or a significant difference to corporate behaviour. However, as mentioned earlier, it should be noted that the study was completed before the recent addition of the further requirement for a section 172(1) statement that became effective from the financial year beginning on 1 January 2019. Nonetheless, the findings of the study remain important, as they show whether ESV has had an impact on CSR and whether this impact has changed over the years. There is one aspect of the study that is directly affected by the change. This has been highlighted in the discussion on findings.

The aim of this book is to analyse whether the concept of ESV is capable of promoting or assisting CSR, in both a domestic and an international context. If it is, can it or should it do so in a better way? If it is not, how could it be reformed in

68 Ibid at 775, 776.
69 Ibid at 775–777.

order to do so? In order to assess whether the concept of ESV is capable of promoting or assisting CSR, everything mentioned in the documents that was about and related to the two concepts, directly or indirectly, was examined.[70] For coding purposes, this involved paying attention to the following aspects addressed in the reports: the company's statement of purpose, information on corporate governance, any indication of whether the company had embraced the concept of ESV, any material published about the stakeholders mentioned in section 172, any information on how the directors have performed their duty under section 172, any material published on CSR, and any mention of the ESV concept within CSR.

First of all, the company's statement of purpose was considered to see what the company stated as its ultimate goal and whether this goal changed over time. This would reveal whether the company focuses solely on maximising shareholder interests, whether it has a stakeholder approach or whether it has a completely different goal altogether. Also, if the ultimate goal of the company changed significantly after the implementation of section 172, it could mean that the ESV principle has had a considerable impact. Second, information on corporate governance was studied to see the commitment of the company to promote good corporate governance and to assess whether this varied over the years. Third, the documents were scrutinised to see if there was any explicit mention of the company embracing the concept of ESV or section 172, and any information on how the directors have performed their duty under the section. The author thought an explicit mention of the ESV principle or section 172 would perhaps indicate that the directors acknowledged the new duty under the Act and were committed to fulfilling that duty. Even if it was not mentioned explicitly but there was more emphasis on the stakeholders mentioned in section 172 after its enactment, that change could have been attributed to its implementation. Under the new specific Strategic Report requirement for a statement on how directors, in performing their duty, have had regard to the matters set out in section 172, all the companies in this study will have to have to address section 172 now. As mentioned earlier, this became effective from the financial year beginning in January 2019. Therefore, this aspect of the study has been directly affected by the new requirement. To address this, the author revisited the websites of the companies examined in the study to assess whether they had complied with the new requirement. This is discussed further in the analysis of the findings. Lastly, the material published by companies on CSR was studied, together with investigating whether the concepts of ESV and CSR were mentioned together. If the concepts were mentioned at the same time, it would be a very strong indication that the ESV principle is capable of promoting or assisting CSR. Even if the two concepts were not mentioned together but the stakeholders addressed in section 172 were considered by the companies as part of their CSR initiatives, this would reaffirm the link between the two concepts and show that the ESV principle is capable of promoting or assisting CSR.

70 The relationship between the concept of ESV and CSR was explored in Chapter 3.

The focus of this study was on retailers, as these companies tend to have long supply chains and cross-border contact, and this category presented a manageable number of companies that could be studied. The purpose of this book is to analyse the impact of the ESV principle on CSR not only in a domestic context but also in an international context. Therefore, focusing on retailers seemed useful as they have various stakeholders in different countries, including developing countries where the workers are particularly vulnerable. The annual reports and CSR reports that were analysed included information about these stakeholders and the operations of the companies outside the UK. Furthermore, the author believed that focusing on companies in the same sector would also generate better results as the comparison of the data would be easier and more coherent.

Findings and analysis

Before moving forward to the findings of the study, it is important to note that the results of the study are based on what is stated by a company about its operations and not on whether what is asserted is also put into practice. This issue will be discussed later in the chapter.

Ultimate objectives of companies

The study sought to categorise all the retail companies in the FTSE 100 based on whether the ultimate goal or objective of the company was to enhance shareholder value or whether the company was run with a stakeholder approach, and if their approach had changed as a result of the enactment of section 172. The results are based on the analysis of what was communicated by the companies in their annual reports, CSR reports and websites. In the absence of a clear goal stated by the company, the author classified the company based on an overall analysis of its operational goals and strategies.

Only one (12.5 per cent) of the companies seemed to have enhancing shareholder value as their primary goal, and that company was Next plc. In its Annual Report and Accounts published in January 2015, it stated that "the primary financial objective of the Group is to deliver long term return to shareholders through a combination of sustainable growth in earnings per share ("EPS") and payment of cash dividends".[71] It was also mentioned in the Chairman's statement that "our strategy will remain the same, focused on our products, our profitability and returning cash to our shareholders".[72] Furthermore, the operating objectives of the company, which are developing the Next brand, investing in online growth, investing in profitable new space, improving

71 Annual Report and Accounts January 2015, at p. 22, available at: <http://www.annualreports.com/HostedData/AnnualReportArchive/n/LSE_NXT_2015.pdf> last accessed 31 January 2018.

72 Ibid at 2.

service and controlling costs, also seem to be mostly inclined towards promoting shareholder value.[73]

The research showed that seven (87.5 per cent) of the companies seem to have ultimate goals that are directly in line with the stakeholder approach or are inclined in that direction. This means that for these companies the primary goal seems to be focused on their key stakeholders or all stakeholders. This can include the employees, the customers, the suppliers, the community, the environment, etc. Alternatively, their ultimate goal, while something different, does correlate with the stakeholder approach. In this context, by a stakeholder approach, the author does not only mean companies that focus on all the stakeholders, but also companies that are focused on certain key stakeholders. An example of a company with a clear stakeholder focus is J Sainsbury's plc. It claims its goal is "to make all our customers' lives easier every day by offering great quality and service at fair prices", and its vision is to "to be the most trusted retailer where people love to work and shop".[74] Thus, it has a strong focus on customers and employees. Similarly, Tesco plc's core purpose is "serving Britain's shoppers a little every day".[75] It also adds that the following values assist it to understand how to execute this into practice: "no one tries harder for customers", "we treat people how they want to be treated", and "every little help makes a big difference".[76] Their focus seems to be on customers, employees and communities.[77]

Associated British Foods plc is an example of a company where the ultimate goal is something different from the other companies mentioned, but it seems to be indirectly in line with the stakeholder approach. It states in its Annual Report and Accounts 2012 that its aim is "to achieve strong, sustainable positions in markets that offer potential for profitable growth, and deliver quality products and services that are central to people's lives".[78] So, along with achieving sustainable positions in markets, its primary goal is also to deliver quality products and services for its customers. Lastly, Marks and Spencer states that its "business is built upon strong values of Innovation, Inspiration, Integrity and In Touch", and "these values have been at the heart of how we do business since starting out as a Penny Bazaar at Leeds Kirkgate Market in 1884".[79] It states that these values influence how it acts, and run through everything that it does. They make the Marks and Spencer difference by enhancing lives every day through the products and services it offers to its customers

73 Ibid at 4.

74 Annual Report and Financial Statements 2015, at p. 2 available at: <http://www.annualreports.com/HostedData/AnnualReportArchive/j/LSE_GB0767628_2015.pdf> last accessed 31 January 2018.

75 Available at: <https://www.tescoplc.com/about-us/core-purpose-and-values/> last accessed 31 January 2018.

76 Ibid.

77 Ibid.

78 Annual Report and Accounts 2012, at p. 1, available at: <http://www.abf.co.uk/documents/pdfs/ar2012/abf-annual-report-2012.pdf> last accessed 31 January 2018.

79 Available at: <https://corporate.marksandspencer.com/aboutus/our-heritage> last accessed 31 January 2018.

everywhere.[80] Hence, in the end, the focus seems to be on customers as a result of abiding by these values.

The only company which seemed to have an obvious shareholder approach, Next plc, also recognises the importance of stakeholders. It addresses all its stakeholders in great detail in the annual reports as well as the CSR reports. For example, it states the following in its Annual Report and Accounts January 2015:

> NEXT is committed to the principles of responsible business. This means addressing key business related social, ethical and environmental matters in a way that aims to bring value to all of its stakeholders, including customers and shareholders. Continuous improvement lies at the heart of NEXT's approach and is achieved by acting in an ethical manner, developing positive relationships with suppliers, recruiting and retaining successful and responsible employees, taking responsibility for our impact on the environment and through contributions to charities and community organisations."[81]

Hence, in spite of being focused on shareholder value, Next plc claims to consider the interests of all of its stakeholders. It is almost as if they were going through section 172(1) point by point. Taking the interests of the stakeholders while promoting the success of the company for the benefit of the shareholders seems to be consistent with the ESV principle as embodied in section 172. Mentioning that the interests of the stakeholders are taken into account might contribute to showing that the duty under section 172 is being fulfilled.

All the companies that follow a kind of stakeholder approach, either directly or indirectly, also have regard to shareholder interests. Shareholder interests, profits and declaring dividends are acknowledged by all the companies. This is fair given that shareholders are also stakeholders. Even though these companies are keen to promote shareholder interests and acknowledge their importance, the companies do not state that they consider the maximisation of shareholder interests to be the primary goal. The shareholders are part of all the stakeholders in whose interests the company is run. For example, even though Morrison Supermarkets plc might be seen as being stakeholder oriented, it also that states its financial objectives are "sales growth that exceeds the market" and "earnings that meet the expectations of our shareholders".[82] Similarly, Associated British Foods plc states that "the group takes a long-term approach to investment and is committed to increasing shareholder value through sound commercial,

80 Annual Report and Financial Statements 2015, at p. 6, available at: <https://corporate.marksandspencer.com/documents/reports-results-and-publications/annual-reports/annual-report-x2015.pdf> last accessed 31 January 2018.

81 Annual Report and Accounts January 2015, at p. 28, available at: <http://www.annualreports.com/HostedData/AnnualReportArchive/n/LSE_NXT_2015.pdf> last accessed 31 January 2018.

82 Annual Report and Financial Statements 2008, at p. 8, available at: <https://www.annualreports.com/HostedData/AnnualReportArchive/w/LSE_MRW_2008.pdf> last accessed 3 March 2021.

responsible and sustainable business decisions that deliver steady growth in earnings and dividends".[83]

Even though all the companies which follow a stakeholder approach acknowledge the importance of shareholder interests, it is questionable whether these companies are technically acting in accordance with section 172, because the provision states that the directors should promote the interests of the company for the benefit of all the shareholders. Stakeholder interests should be considered, but the ultimate goal should be promoting the interests of the shareholders. Therefore, giving stakeholder interests more importance than shareholder interests could arguably be in violation of section 172. Perhaps the fact that some companies have a stakeholder approach and consequently prioritise stakeholder interests instead of just taking them into consideration demonstrates that the concept of ESV has not made much difference in practice. However, it can also be argued that it is simply essential to take the interests of the stakeholders into account to promote the success of the company for the benefit of all the shareholders. If they fail to do this, it will not be possible to promote shareholder interests. Therefore, it can be also be claimed that all the companies that have been analysed are being run according, or close, to the ESV principle as all the companies seem to consider both shareholder and stakeholder interests.

Nonetheless, to truly understand whether the ESV principle made any difference in practice or whether it encouraged companies to take stakeholder interests into account, it is important to consider how the companies operated both before and after the implementation of section 172. After analysing the goals, objectives, mission statements and strategies of all the companies for the years 2006, 2008, 2010, 2012 and 2015, the author has come to the conclusion that section 172 has had little or no impact on the ultimate goal or objectives of companies. It has not made companies more concerned about stakeholder interests. Consequently, this means that it has not made much of an impact on CSR either. This will be discussed further later in the chapter. Now, some examples that show that the ESV principle has made little or no difference to how companies are managed will be considered.

First, the company which appears to have a greater orientation to shareholder interests will be considered. The primary goal of Next plc did not change much throughout the years. Its primary financial objective, which also seemed to be its primary goal, continued to be to deliver sustainable long-term growth in earnings per share in 2008,[84] 2010,[85] 2012[86] and

83 2015 Annual Report and Accounts, at p. 9, available at: <http://www.abf.co.uk/documents/pdfs/2015/abf-annual-report%202015.pdf> last accessed 31 January 2018.

84 Annual Report and Accounts January 2008, at p. 3, available at: <http://www.nextplc.co.uk/~/media/Files/N/Next-PLC-V2/documents/reports-and-presentations/archive/jan08.pdf> last accessed 31 January 2018.

85 Annual Report and Accounts January 2010, at p. 3, available at: <http://www.nextplc.co.uk/~/media/Files/N/Next-PLC-V2/documents/reports-and-presentations/archive/jan10-c.pdf> last accessed 31 January 2018.

86 Annual Report and Accounts January 2012, at p. 3, available at: <http://www.nextplc.co.uk/~/media/Files/N/Next-PLC-V2/documents/reports-and-presentations/2011/ar2012.pdf> last accessed 31 January 2018.

2015.[87] Even in 2006, the focus seemed to be on sales and profits. The chairman mentioned that its sales had doubled, which was accompanied by the doubling of profits and increase in earnings per share.[88] Therefore, as far as the primary goal of the company was concerned, the ESV principle made no difference in practice. The seven companies that were more stakeholder-oriented continued to be so after section 172 came into force. Even though the wording of the primary goal might have differed throughout the years, the general approach remained almost the same. For example, Tesco's primary goal continued to be focused on customers. It expressed its goals as core values as "more than the weekly shop"[89], "no-one tries harder for customers", "treat people how we like to be treated"[90] and "every little helps".[91] The general idea remained the same. Similarly, the group mission, group vision and group values of Travis Perkins plc remained almost the same throughout the years.[92] The only company in which the primary goal seemed to be considerably different in 2010[93] in comparison to 2006[94] was Kingfisher plc. It seemed to shift from a more balanced set of objectives which included "sustainable long-term growth and returns for shareholders", "outstanding value, choice and service for customers", "rewarding careers and personal development for staff", "unrivalled growth opportunities for suppliers" and "responsible growth that is socially and environmentally sustainable"[95] to improving returns to shareholders.[96] However, the shift to stronger focus on

87 Annual Report and Accounts January 2015, at p. 22, available at: <http://www.nextplc.co.uk/~/media/Files/N/Next-PLC-V2/documents/reports-and-presentations/2014/next-annual-report-2015-final-web.pdf> last accessed 31 January 2018.

88 Annual Report and Accounts January 2006, at p. 2, available at: <http://www.nextplc.co.uk/~/media/Files/N/Next-PLC-V2/documents/reports-and-presentations/archive/2006-01-25.pdf> last accessed 31 January 2018.

89 Annual Report and Financial Statements 2008, available at: <https://www.tescoplc.com/media/1437/annual_report_2008.pdf> last accessed 31 January 2018.

90 Corporate Responsibility Review 2008 at p. 27, available at: <https://www.tescoplc.com/media/1150/cr_report_2008.pdf> last accessed 31 January 2018.

91 Annual Report and Financial Statements 2010, at p. 18, available at: <https://www.tescoplc.com/media/754665/annual_report_2010.pdf> last accessed 3 March 2021.

92 For example see 2006 Annual Reports and Accounts, at p. 5 available at: <http://www.annualreports.com/HostedData/AnnualReportArchive/T/LSE_TPK_2006.pdf> last accessed 31 January 2018.; 2008 Annual Reports and Accounts, at Introduction available at: <http://www.annualreports.co.uk/HostedData/AnnualReportArchive/T/LSE_TPK_2008.pdf> last accessed 31 January 2018; and 2010 Annual Reports and Accounts, at p. 6 available at: <http://www.annualreports.com/HostedData/AnnualReportArchive/T/LSE_TPK_2010.pdf> last accessed 31 January 2018.

93 Annual Report and Accounts 2009/10, at pgs. 2–5, available at: <https://www.kingfisher.com/content/dam/kingfisher/Corporate/Documents/Investors/Annual-Reports/annual_report_2010.pdf.downloadasset.pdf> last accessed 3 March 2021.

94 Annual Report and Accounts 2005/06, at p. 5, available at: <http://www.kingfisher.com/files/reports/annual_report_2006/managed_content/files/pdf/ar06.pdf> last accessed 31 January 2018.

95 Ibid.

96 Annual Report and Accounts 2009/10, at pgs. 2–5, available at: <https://www.kingfisher.com/content/dam/kingfisher/Corporate/Documents/Investors/

profits and improving return to shareholders probably happened due to those years being a challenging period for the company in terms of performance.[97] Later in the study period, the focus shifted back onto customers again.

Hence, since primary goals of the various companies were not considerably different before and after the enactment of section 172, and the companies continued to portray themselves as, for the most part, adopting the same approach, it is contended that it might be concluded that the ESV principle has not made much difference in practice. It can also be argued that the section has not made much difference in practice because some or all of the companies were already doing what section 172 requires, because doing so just made good business sense.

Explicit mention of ESV or section 172

Interestingly, at the time the study was conducted, three (37.5 per cent) of the companies had explicitly mentioned the duty under section 172. For example, Associated British Foods plc stated in its Annual Report and Accounts 2010 that the purpose of the Business Review is to enable shareholders to assess how the directors have performed their duties under section 172 of the Companies Act 2006 which is the duty to promote the success of the Company. It then went on to highlight in which sections of the report the information that fulfils the requirements of the Business Review can be found.[98] It not only acknowledged the duty but also specifically listed the sections and page numbers in the annual report that show how that the duty has been fulfilled. This manifests a very thorough approach being adopted to demonstrate the fulfilment of the duty, even though a section 172(1) statement was not required at the time. Similarly, Marks and Spencer plc acknowledged the statutory duties introduced in the Companies Act 2006 in its Annual Report and Financial Statements 2008. It mentioned that the directors have been briefed on their new statutory duties. It was also stated that the central duty is the duty to act in good faith in a way that promotes the success of the company for the benefit of the members as whole. It then went on to list the factors the directors need to have regard to.[99] Acknowledging the duty in a different manner, Kingfisher plc mentioned the duty in its Corporate Responsibility Summary Report 2007/08:

> Kingfisher recognises that CR is an essential part of effective governance. During 2007, a new UK Companies Act came into force and brought with it a requirement for directors to have regard to social and

Annual-Reports/annual_report_2010.pdf.downloadasset.pdf> last accessed 3 March 2021.

97 Ibid at 1–5.

98 Annual Report and Accounts 2010, at p. 51, available at: <http://www.abf.co.uk/documents/pdfs/2010/2010_annual_report.pdf> last accessed 31 January 2018.

99 Annual Report and Financial Statements 2008, at p. 39, available at: <http://annualreport2008.marksandspencer.com/pdf/m&s_annual_report_2008.pdf> last accessed 31 January 2018.

> environmental impacts when making business decisions. Kingfisher Review of progress during the year enables its directors to comply with this requirement through its CR management processes which set out clear lines of responsibility from the Board level down to the individual operating companies (see page 6). The company also meets the Act's requirements on CR reporting by including progress on CR within the Business Review section of the Annual Report and Accounts – the Business Review will be further enhanced over the coming year. A new CR risk register was developed in 2007 to ensure a common approach across the Group to the way risks are identified and managed.[100]

Perhaps the fact that three of the companies specifically acknowledged the duty and tried to demonstrate how the duty was fulfilled shows that section 172 had made a difference in practice. It shows that some companies were taking measures to ensure that their directors are aware of the duty to have regard to stakeholder interests, and were also communicating that to their shareholders. Hence, this aspect of the study has generated a different result than the previous aspect, as the lack of change in the primary goals of the company suggested that the ESV principle did not have a substantial impact in practice. On the other hand, it should be noted that the majority of the companies did not explicitly acknowledge the duty under the section at the time. Furthermore, even though some companies explicitly acknowledged the duty and one company even mentioned it in conjunction with CSR, the author did not find much difference in how the companies reported on stakeholders and CSR before and after section 172 was put in force. This issue will be explored further in the next section.

As mentioned earlier, the new requirement for the Strategic Report, set out in the Companies (Miscellaneous Reporting) Regulations 2018, requires all companies qualifying as large under the Companies Act 2006 to include a section 172(1) statement.[101] This requirement, which applies to all the companies in this study, came into force recently. As the new requirement affects the findings of this aspect of the study, the author revisited the websites of the companies to assess the possible impact of the new requirement and to confirm whether or not a section 172(1) statement was produced. All the companies in the study produced a section 172(1) statement in their annual reports once the section came into force.[102]

100 Corporate Responsibility Summary Report 2007/08, at p. 4, available at: <https://www.kingfisher.com/content/dam/kingfisher/Corporate/Documents/Sustainability/Reports_publications/Archive/Kingfisher%20CR%20Report%202007_08.pdf> last accessed 3 March 2021.

101 See section 414CZA of the Companies Act 2006.

102 For Associated British Foods plc, see: Annual Report and Accounts 2020, available at: <https://www.abf.co.uk/documents/pdfs/2020/ar2020/ar2020.pdf> last accessed 9 November 2020; For J Sainsbury plc, see: Annual Report and Financial Statements 2020, available at: <https://www.about.sainsburys.co.uk/~/media/Files/S/Sainsburys/documents/reports-and-presentations/annual-reports/sainsburys-ar2020.pdf> last accessed 9 November 2020, For Tesco plc, see: Annual Report and Financial Statements 2020, available at: <https://www.tescoplc.com/media/755761/tes006_ar2020_web_

Kingfisher plc, which had also mentioned the duty under section 172 before the enforcement of the new requirement, mentioned that its directors are aware of the duty under section 172 and acknowledged that every decision they make will not necessarily result in a positive outcome for all of their stakeholders. However, they aim to make sure that their decisions are consistent by considering the company's strategic priorities and having processes in place for decision-making.[103] J Sainsbury plc acknowledged that the approach they take to section 172 also applies to their subsidiaries in a way which is relevant to their own individual size and complexity.[104] Next plc even mentioned that, in November 2018, the directors actually received training from external counsel to remind them of their duties. It stated that this put their Board in a position where it could purposefully apply section 172 throughout the 2019/20 financial year.[105] It is suggested that the new requirement has, to a certain extent, steered corporate reporting in a positive direction, as the companies that were not acknowledging section 172 explicitly during the period of the study were obligated to do so now. However, the degree of detail provided by the companies on how they engaged with their stakeholders and the impact of those engagements and impact on decision-making varied. This is not surprising as the degree of detail provided by the companies on all the various stakeholders varied throughout the years.

updated_200505.pdf> last accessed 9 November 2020; For Morrisons Supermarkets plc, see Annual Report and Financial Statements 2019/20, available at: <https://www.morrisons-corporate.com/investor-centre/annual-report/> last accessed 09 November 2020; For Kingfisher plc, see: 2019/20 Annual Report and Accounts, available at: <https://www.kingfisher.com/content/dam/kingfisher/Corporate/Documents/Investors/Annual-Reports/KF054-Book-LR-200625.pdf.downloadasset.pdf> last accessed 9 November 2020; For Marks and Spencer Group plc, see Annual Report & Financial Statements + Notice of Annual General Meeting 2020, available at <https://corporate.marksandspencer.com/documents/msar2020/m-and-s_ar20_full_200528.pdf> last accessed 9 November 2020; For Next plc, see: Annual Report and Accounts January 2020, available at: <https://www.nextplc.co.uk/~/media/Files/N/Next-PLC-V2/documents/2020/annual-report-and-accounts-jan20.pdf> last accessed 9 November 2020; For Travis Perkins plc, see: Annual Report and Accounts 2019, available at: <https://www.travisperkinsplc.co.uk/sites/travis-perkins/files/investors/travisperkins-annual-report-19.pdf> last accessed 9 November 2020.

103 2019/20 Annual Report and Accounts, at p. 19, available at: <https://www.kingfisher.com/content/dam/kingfisher/Corporate/Documents/Investors/Annual-Reports/KF054-Book-LR-200625.pdf.downloadasset.pdf> last accessed 9 November 2020.

104 Annual Report and Financial Statements 2020, at p. 15 available at: <https://www.about.sainsburys.co.uk/~/media/Files/S/Sainsburys/documents/reports-and-presentations/annual-reports/sainsburys-ar2020.pdf> last accessed 9 November 2020.

105 Annual Report and Accounts January 2020, at p. 73, available at: <https://www.nextplc.co.uk/~/media/Files/N/Next-PLC-V2/documents/2020/annual-report-and-accounts-jan20.pdf> last accessed 9 November 2020.

ESV and CSR: impact and link

In the next part of the study, the various reports of the companies were analysed to see how the companies reported on the stakeholders and whether it improved or changed in any way after the advent of the ESV principle. All the companies reported, directly or indirectly, on the various stakeholders mentioned in section 172 before its implementation. The extent of the detail in which each company dealt with the different stakeholders varied, but all the stakeholders listed in section 172 were more or less addressed. For example, all the companies mentioned focusing on the long term. Similarly, information was provided by the various companies on their employees, customers, suppliers, impact on the community and environment. For example, the Chief Executive of Travis Perkins plc stated the following about the company's impact on the environment in its 2006 Annual Reports and Accounts:

> The environmental impact of business activities has received an unprecedented amount of attention in 2006. The Group has long recognised its corporate responsibility to carry out its activities and operations whilst minimising its environmental impact.
>
> Having personally studied environmental issues over 30 years ago, it remains a surprise to me that some business leaders have expressed themselves surprised at the need to improve corporate performance in the area.[106]

Another example is Associated British Foods plc when discussing Primark's relationship with its suppliers:

> Having decided on the 'look', the buyers then go into action ordering samples from suppliers, checking out garment quality and agreeing commercial terms prior to placing orders. No corners can be cut but speed is of the essence. Success is down to the special relationship that Primark's buyers have forged over many years with their suppliers. It may come as a surprise to know that nearly half of the merchandise bought comes from just fifty suppliers with whom Primark has had a consistent relationship for more than a decade.[107]
>
> Primark was accepted as a member of the Ethical Trading Initiative (ETI) in May. The ETI is an alliance of companies, trade unions and non-profit organisations that aims to promote respect for the rights of people in factories and farms worldwide. As a member of the ETI, Primark has

106 2006 Annual Reports and Accounts, at p. 16, available at <http://www.annualreports.com/HostedData/AnnualReportArchive/T/LSE_TPK_2006.pdf> last accessed 31 January 2018.

107 Annual Report and Accounts 2006, at p. 14, available at <https://www.abf.co.uk/documents/pdfs/2006/2006_annual_report.pdf> last accessed 31 January 2018.

> committed to monitoring and progressively improving working conditions in the factories that supply Primark's products.[108]

However, examination of all the reports of the eight companies for all the years mentioned above showed that there was no substantial change in how the companies reported on their stakeholders after the enactment of section 172. This seems to reaffirm the results from the previous empirical studies discussed in the first part of the chapter, namely that a lot of the companies had the right culture already. Therefore, based on this observation, the ESV principle had made little or no impact on the interests of stakeholders and how companies communicate about their impact on stakeholders. Similarly, keeping in mind that a considerable amount of the information on stakeholders was included in the CSR sections in reports, how companies reported on CSR did not change as a result of the implementation of the ESV principle either.

Nonetheless, the reports were then specifically analysed to see whether there was a change or variation in how the companies reported on CSR as a result of the ESV concept being put into force. There was no noticeable change that could be attributed to the ESV principle. For example, Travis Perkins plc did not publish a separate CSR report in any of the years, which is quite unusual in comparison to the other companies. It stated the following in the section on CSR in its 2006 Annual Report and Accounts:

> The Company has not produced a separate corporate social responsibility statement in the report and accounts since it believes these matters are sufficiently important to receive the personal attention of individual directors rather than risking less focus through the exercise of collective responsibility. Instead full details of those areas normally covered by such a report are contained in the reports of the directors responsible for such matters:
>
> | | |
> |---|---|
> | Environment | Chief Executive's review |
> | Health and Safety | Chief Operating Officer's review |
> | Supply Chain | Chief Operating Officer's review |
> | Employees | Chief Operating Officer's review |
> | Community Relations | Chief Executive's review |
>
> The Board takes account of the significance of social, environmental and ethical matters in its conduct of the Company's business and as part of the system of internal control receives reports on the risks associated with the above matters.[109]

108 Ibid at p. 15.

109 2006 Annual Report and Accounts, at p. 39, available at <http://www.annualreports.com/HostedData/AnnualReportArchive/T/LSE_TPK_2006.pdf> last accessed 31 January 2018.

Interestingly, the company maintained the same approach throughout 2008,[110] 2010[111] and 2012.[112] The approach changed slightly in 2015. It did not make a similar statement in the 2015 Annual Report, and there were sections in the report which covered CSR or sustainability issues,[113] but as in previous years a separate CSR report was not produced. So, section 172 did not make any difference at all. Similarly, no significant change could be observed even for the companies which produced separate CSR reports. Only one company, Kingfisher plc, linked the two concepts in its Corporate Responsibility Summary Report 2007/08, as discussed earlier. Even then, there was not much difference in the amount of information on stakeholders. Therefore, it is submitted that based on the results of this study, the ESV principle has not promoted or assisted CSR. Of course, this does not necessarily mean that CSR was not being practised.

However, the findings from this study have established a clear link between the two concepts. This is evidenced by the fact that all companies seem to think that being socially responsible means having regard to the factors listed in section 172. Even if the section was not explicitly linked with CSR by the majority of the companies, the companies' discussions on CSR involved considering the various stakeholders listed in section 172, so they were linked indirectly. For example, J Sainsbury plc.'s discussions on CSR in its various reports are focused on five key principles: "be the best for food and health", "show respect for our environment", "source with integrity", "make a positive difference to our community", "and be a great place to work".[114] It is clear

110 Ibid.

111 2010 Annual Report and Accounts, at p. 48, available at <http://www.annualreports.com/HostedData/AnnualReportArchive/T/LSE_TPK_2010.pdf> last accessed 31 January 2018.

112 Annual Report and Accounts 2012, at p. 56, available at <http://ir2.flife.de/data/travis_perkins/igb_html/pdf/1000001_e.pdf> last accessed 31 January 2018.

113 See 2015 Annual Report and Accounts, at pgs. 70–92, available at <http://www.annualreports.com/HostedData/AnnualReportArchive/T/LSE_TPK_2015.pdf> last accessed 1 February 2018.

114 For example, see Annual Report and Financial Statements 2006, available at <http://www.annualreports.com/HostedData/AnnualReportArchive/j/LSE_GB0767628_2006.pdf> last accessed 30 April 2018; Corporate Responsibility Report 2008, available at <https://www.about.sainsburys.co.uk/~/media/Files/S/Sainsburys/documents/reports-and-presentations/2008/cr2008-report.pdf> last accessed 30 April 2018; Annual Report and Financial Statements 2010, available at <http://www.annualreports.com/HostedData/AnnualReportArchive/j/LSE_GB0767628_2010.pdf> last accessed 30 April 2018; Corporate Responsibility Report 2010 available at <https://www.about.sainsburys.co.uk/~/media/Files/S/Sainsburys/documents/reports-and-presentations/2010/cr2010-report.pdf> last accessed 30 April 2018; 20 x 20 Sustainability Update November 2012 available at <https://www.about.sainsburys.co.uk/~/media/Files/S/Sainsburys/documents/reports-and-presentations/2012/20x20-sustainability-plan-2012.pdf> last accessed 30 April 2018.

that their focus is on customers, environment, suppliers, community and employees. These are almost all the stakeholders mentioned in section 172.

In its Corporate Responsibility Report 2010, Associated British Foods plc set out the following definition for CSR:

> It's about recognising the impact we have on all our stakeholders, whether they are our people, shareholders, customers, consumers or the communities in which we operate. Then it's balancing what may be conflicting demands in order to act in ways that meet our responsibilities as a business to those stakeholders.[115]

Again, this is very similar to the concept of ESV. Another example that reaffirms this link between the two concepts is how Next plc explains what corporate responsibility means to it. The following excerpt is from its Corporate Responsibility Report in January 2010:

> For Next, corporate responsibility means addressing key business-related social, ethical and environmental impacts in a way that aims to bring value to all our stakeholders, including our shareholders.
>
> We are a large UK based retailer, offering a wide range of products in clothing, footwear, accessories and homeware through retail stores and home shopping. This report aims to cover the issues that we believe are of most concern to our various stakeholders and is structured around the main areas of responsibility we have identified:
>
> - Our Suppliers – we will work for positive social, ethical and environmental improvements in our supply chain
> - Our Customers – we will work to ensure we meet or exceed our customers' expectations through the delivery of excellent products and service
> - Our People – we will work to provide an environment where our employees are supported and respected, treated fairly and taken care of, listened to and are motivated to achieve their full potential
> - Environment – we will work to actively reduce the impacts of our business on the natural environment
> - Community – we will work to deliver value through our community contributions and support for charities and other organisation.[116]

115 Corporate Responsibility Report 2010, at p. 6, available at <http://www.abf.co.uk/documents/pdfs/2010/2010_corporate_responsibility_report.pdf> last accessed 31 January 2018.

116 Corporate Responsibility Report to January 2010, at p. 4, available at <http://www.nextplc.co.uk/~/media/Files/N/Next-PLC-V2/documents/cr-reports/cr-2010.pdf> last accessed 31 January 2018.

Hence, the company's approach towards corporate responsibility is almost the same as that which the concept of ESV aims to promote.

Therefore, according to the results of this study, even though the ESV principle does not seem to have promoted or assisted CSR, it is submitted that it can promote or assist CSR, as there is a clear link between the two concepts. To the companies considered in this study, being socially responsible means having regard to the factors listed in section 172. If the ESV principle could be strengthened or reformed so that it could be enforced properly, it is submitted that it could promote or assist CSR more effectively. If the issues of lack of any enforcement mechanisms on the part of stakeholders and the difficulty surrounding derivative claims which were discussed in the previous chapter could be dealt with, it would be possible for the concept of ESV to promote CSR even more. Suggestions for reform will be discussed in detail in a later chapter.

Limitations and the need for reform

This study has a number of limitations. The major one is its reliance on data published by the companies in question. There is always the possibility that what is communicated by the companies via its websites, annual reports or CSR reports is different from what it actually does in practice. The words in these reports might reflect what the company aspires to be rather than what the company actually is, what it does and how it relates to others. Associated British Foods plc can be used as an example here. When retailers give contracts to suppliers overseas, the suppliers' factories are sometimes audited by them. Associated British Foods plc mentioned the following in its Annual Report and Accounts 2010:

> Primark further developed its ethical trading agenda during the year and now has a highly experienced ethical trade team of full-time staff supporting the Ethical Trade director, in the UK, Bangladesh, China, India and Turkey. The target of 1,000 audits set last year was comfortably exceeded with 1,136 audits completed, representing 94% of our top 250 suppliers and 87% of the products we purchase. Over half of the audits carried out in 2010 were follow-up audits demonstrating our commitment to ensuring that our suppliers continue to improve. We provide support for them through dedicated training whether on site in factories or through informal supply training sessions, and online. Engaging directly with our suppliers is central to our objective of continually improving working conditions. With 95% of the factories shared by other high street brands, we also continue to collaborate with other retailers and non-governmental organisations on addressing the industry challenges, both through our membership of the Ethical Trading Initiative (ETI), and externally with non-ETI members. As well as working with our suppliers we have continued the process of building an ethical supply culture

> amongst our own staff and the subject is a feature of the induction training provided to all new employees.[117]

It also mentioned the following in its Annual Report and Accounts 2012:

> Primark continued to make significant progress with its ethical trade programme during the year. A member of the Ethical Trading Initiative (ETI) since 2006, it is now ranked at 'Leader' level which is the highest status achievable. The ETI classifies a Leader as "tackling the root causes of labour rights problems beyond individual workplaces with collaborative initiatives aimed at the sectorial level and in raw material or component supply". Achievement of this ranking demonstrates the hard work and commitment made by Primark to ensuring that workers making our products are paid fairly, treated well, and work in decent conditions. The impact of our in country teams of ethical trading specialists has been significant in supporting sustainable improvements within supplier factories, providing greater visibility across the supply chain as well as improving the management of our audit programme. We conducted 1,795 audits in the last calendar year and ethical trade training continues to be provided to every new Primark employee.[118]

In spite of claiming to have a highly experienced ethical trade team that supports the Ethical Trade Director in Bangladesh, and the fact that it conducts audits and is ranked at the highest level in the Ethical Trading Initiative, the company was sourcing clothes from one of the factories that collapsed in the Rana Plaza in Bangladesh.[119] This example not only demonstrates that corporate rhetoric in relation to stakeholders may be questionable, but also highlights the need for reform in this area. Of course, Primark would say that things are not perfect, and some defaults are not able to be achieved. Perhaps if the ESV principle were to be reformed so that it could actually be enforced in such situations, companies would be forced to be socially responsible and to ensure that the guidelines they lay down are being enforced. The danger of setting a goal with so many audits, as Primark does, is that the goal becomes all-consuming and the reason for the audits can get lost. It shows that sometimes simply adhering to voluntary codes of conduct and soft guidelines is simply not sufficient.

Marks and Spencer Group plc has also mentioned in various reports about working with its suppliers to address issues such as the living wage and working

117 Annual Report and Accounts 2010, at p. 15, available at <http://www.abf.co.uk/documents/pdfs/2010/2010_annual_report.pdf> last accessed 31 January 2018.

118 Annual Report and Accounts 2012, at p. 23, available at <http://www.abf.co.uk/documents/pdfs/ar2012/abf-annual-report-2012.pdf> last accessed 31 January 2018.

119 Primark, 'Rana Plaza', available at <https://www.primark.com/en/our-ethics/news/rana-plaza> last accessed 22 November 2016.

hours. For example, it stated the following in its Annual Report and Financial Statements 2010:

> One of the things that sets us apart from other retailers is the way we work with our suppliers. This year we've helped our suppliers to set up 10 Ethical Model Factories to demonstrate how good employment practices can result in a more productive workforce and allow for higher wages. We provided over 80,000 hours of supplier training (four times more than last year) and held best practice conferences around the world.[120]

It also mentioned in its How We Do Business Report 2010 that it is assisting its suppliers in dealing with difficult issues with various mechanisms such as collaborative networking, conferences and launching an Ethical Exchange website. It has worked on setting up best practice projects such as ethical model factories and worker's rights training programmes.[121] However, an undercover BBC investigation found that Syrian refugees, including children, had been working on garments for Marks and Spencer along with some other brands in Turkey. Even though Marks and Spencer claimed that its inspections showed no Syrian refugees working in its supply chain in Turkey, the investigation found seven Syrians working in one of the main factories producing clothes for it in Turkey. Marks and Spencer then called the findings unacceptable and extremely serious. It also promised that any Syrians who were working in the factory would receive permanent employment. It then said, "Ethical trading is fundamental to M&S. All of our suppliers are contractually required to comply with our Global Sourcing Principles, which cover what we expect and require of them and their treatment of workers." It also said that it would not tolerate such breaches of its principles, and it would do all that it can to make sure something like this did not happen again.[122]

The question is whether it is acceptable for companies to shy away from taking responsibility by stating that they had no knowledge of what was happening, and that they will try to ensure that it does not happen again.[123] Additionally, as was mentioned previously, Next plc has also made claims about acting ethically, promoting principles of responsible business and developing good relationships with its suppliers. The same BBC investigation revealed that

120 Annual Report and Financial Statements 2010, at p. 39, available at <http://annualreport2010.marksandspencer.com/downloads/M&S_AR10.pdf> last accessed 31 January 2018.

121 How We Do Business Report 2010 at p. 34, available at <http://annualreport2010.marksandspencer.com/downloads/M&S_HWDB_2010.pdf> last accessed 31 January 2018.

122 BBC, 'Child refugees in Turkey making clothes for UK shops' (2016) <http://www.bbc.co.uk/news/business-37716463> accessed 4 December 2017.

123 The Telegraph, 'M&S and ASOS among British retailers found employing child refugees in factories' (2016) <http://www.telegraph.co.uk/news/2016/10/24/ms-and-asos-among-british-retailers-found-employing-child-refuge/> accessed 4 December 2017.

one of the factories claimed to be producing clothes for Next while employing Syrian refugees and Turkish children. Next responded by claiming that the clothes were being made by another supplier and the ones that were seen in the investigation might have been just a sample. As Next distributes samples quite widely, a factory might be in possession of a sample even if it does not supply to the company.[124] Again, these examples demonstrate that corporate rhetoric on stakeholders might not always be accurate.

Furthermore, if a company fails to report on stakeholder interests in a positive manner, it might alienate those stakeholder groups. Employees are likely to be more reluctant to want to work for, and customers are less likely to buy from, a company that blatantly states that it does not care about anything other than profits. This might encourage companies to enhance their public image and reputation by exaggerating to what extent they consider stakeholder interests. There was no way for the author (or most other people) to verify what was published in these reports, certainly without access to sensitive company documents or their suppliers. Therefore, as mentioned before, the results of the study are based completely on what a company states it does, and not on whether it actually does those things in practice.

Lastly, this study was focused on only the retail industry, and there is a possibility that the results could vary if the study was focused on a different industry or across industries.

Summary

This study involved the analysis of the annual reports, CSR reports and websites of all the retail companies in the FTSE 100 to assess whether the concept of ESV can promote or assist CSR, and if not, whether it could be reformed to do so. In order to complete this assessment, a number of factors were considered. First of all, the investigation to determine the ultimate objective of the companies revealed that there is no change in this regard as a result of the ESV principle. However, three of the companies explicitly mentioned the duty under section 172 even when this was not required. This might show that as the companies were assuring the public that their directors were aware of the duty, there has been some change in practice. The study also revealed that currently the ESV principle does not seem to promote CSR, because the reporting on various stakeholders and CSR also does not appear to have changed due to the implementation of the ESV principle. Nonetheless, it is submitted that the concept of ESV is capable of promoting or assisting CSR, since the results have established a clear link between the two concepts. The stakeholders that are mentioned in section 172 are also usually discussed in the

124 The Independent, 'Refugee children "making Marks & Spencer clothes" in Turkish factories, BBC claims' (2016) <http://www.independent.co.uk/news/child-labour-sweatshops-refugees-marks-and-spencer-panorama-clothes-sold-in-uk-britain-british-high-a7376706.html> accessed 4 December 2017.

CSR sections of reports. Also, the ways in which some of the companies define CSR seem to correlate with the concept of ESV. Hence, if the concept of ESV could be properly executed, primarily by resolving the issue of the lack of enforcement mechanisms, there is a great possibility that the concept of ESV could assist or promote CSR.

Comparison of results with previous studies

It is worth considering the results of earlier studies in comparison with the results of this study, particularly to see whether there are any significant changes that have happened over the years. In the Taylor study, a number of the respondents believed that they now had a greater regard for the factors included in section 172(1), and hence it was argued that perhaps this means that the ESV principle does promote or assist CSR. However, in the study on corporate reports, it was concluded that the ESV principle has not changed how various companies report on their stakeholders and CSR. Nonetheless, since the stakeholders listed in section 172 are usually covered in CSR sections of reports, and how some companies seem to perceive CSR matches the concept of ESV, it was submitted that the ESV principle could promote or assist CSR.

The BIS study established that section 172 did not bring about the behavioural changes and cultural shift that some thought were intended by the Act. This conclusion can also be supported by the results of the empirical study, which revealed that there has been no change in the ultimate objective of the companies as a result of the enactment of section 172. Also, the majority of the companies did not explicitly mention the new duty under section 172. However, it should be noted that three of the companies did mention the new duty explicitly, which might demonstrate that it did bring about some behavioural changes and cultural shift.

Lastly, it was revealed in the Aiyegbayo and Villiers study that the impact of the Business Review itself on narrative reporting remained quite insignificant. Consequently, it was inferred that the impact of the Business Review on CSR is also likely to be of no importance. The results of the empirical study also show that there has been no change in how companies report on CSR that can be attributed to the ESV principle. Thus, the results of these two studies are compatible as well.

Conclusion

In the first part of the chapter, three previous empirical studies were considered, and the findings of those studies were used to determine whether the ESV principle promotes or assists CSR. In Taylor's study, almost a quarter of the participants expressed that the Act would cause directors to have a greater regard for the factors listed in section 172. This can be interpreted as the ESV principle promoting or assisting CSR, because the directors will have greater regard for stakeholder interests as a result of the section. It was also deduced

from the study that section 172 has drawn more attention to CSR by drawing more attention to the listed factors. However, the majority of the respondents also thought there would not be greater regard for the listed factors as a result of the Act. In the BIS study, it was concluded that section 172 did not bring about the cultural shift that some expected, but some companies stated that the section did have an impact on the behaviour of directors. A lot of the company officers felt that they already had the right culture. Lastly, it is concluded from the results of the study by Aiyegbayo and Villiers that the enhanced Business Review did not have a substantial impact on CSR.

The results of the empirical study on the impact of ESV on CSR based on corporate rhetoric seem to be consistent with previous studies, in the sense that the ESV principle has not made a significant change in practice. The ultimate objectives of companies and the concern for stakeholders' interests and CSR did not really change much after the implementation of section 172. However, even though it has been found that the ESV principle has not really promoted or assisted CSR, a clear link between ESV and CSR has been established, as all the factors that are mentioned in section 172 are usually dealt with by companies as part of their CSR sections or reports. Hence, it is proposed that if the issues regarding enforceability could be corrected, then the ESV principle will be capable of assisting or promoting CSR, since enforcing the ESV principle would mean making companies socially responsible. Therefore, it is submitted that the ESV principle as embodied in section 172 could be reformed to promote or assist CSR, and there is a clear need for such a reform. Lastly, it will be interesting to see the impact of the new requirement of a section 172(1) statement in the future, as at this point is to too early to analyse the impact of this requirement and examine whether the goals that led to its implementation has been fulfilled. Therefore, there is scope for further research regarding this requirement in the future.

5 The ESV principle, CSR and multinational corporations

A case study

Introduction

In the previous chapters it was established that ESV is the notion that companies should aim for shareholder wealth in the long run, pursuing sustainable growth and profits based on responsible consideration of all the relevant stakeholder interests. Section 172 of the Companies Act 2006 incorporates the ESV approach by formally compelling directors to have regard to stakeholder interests when making decisions promoting the success of the company. It was argued that ESV resonates with the notion of CSR because its idea of value is based on long-term sustainability and it acknowledges the importance of considering stakeholder interests in achieving that goal.[1] In the last chapter, a theoretical analysis of whether the concept of ESV is capable of promoting or assisting CSR was presented, and then it was considered empirically whether this had occurred. However, whether the concept of ESV is capable of promoting or assisting CSR was analysed only in a domestic context. This chapter starts to explore the issues in an international context, in consonance with the objective of the book. As one of the aims of this book is to assess whether implementing an ESV approach has had or could have any impact on the CSR practices of MNCs that originate in the UK and operate in developing countries, this chapter seeks to present the findings of case study that was conducted to address this aspect.[2] As highlighted earlier, even though there has been a great deal of academic discussion on the concept of ESV, its link to CSR has

1 See Chapter 1, Chapter 2 and Chapter 3.

2 It should be noted that by developing countries the author is referring to countries that are classified as low- and middle-income countries by the World Bank. See: World Bank (2018) *How does the World Bank classify countries? – World Bank Data Help Desk* <https://datahelpdesk.worldbank.org/knowledgebase/articles/378834-how-does-the-world-bank-classify-countries> accessed 20 January 2018; World Bank (2018) *World Bank Country and Lending Groups – World Bank Data Help Desk* <https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups> accessed 20 January 2018; World Bank (2018) *How are the income group thresholds determined? – World Bank Data Help Desk* <https://datahelpdesk.worldbank.org/knowledgebase/articles/378833-how-are-the-income-group-thresholds-determined> accessed 20 January 2018.

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not been thoroughly assessed. Moreover, its potential to have an impact on CSR in an international context has not been explored in depth, if at all. This chapter begins with briefly describing the methodology, including the choice of the case study design, the selection of the case and participants, and the process of analysing the data. Then, it presents the empirical evidence. There are reflections on the findings of the case study along with deliberations on what the findings of the study mean and what implications they might have.

Methodology of the case study

Qualitative research and the choice of case study design

A qualitative research design was adopted to address the aspect of the research that has been presented in this chapter. It has been suggested by Kirk and Miller that qualitative research

> fundamentally depends on watching people in their own territory and interacting with them in their own language, on their own terms. As identified with sociology, cultural anthropology, and political science, among other disciplines, qualitative research has been seen to be 'naturalistic', 'ethnographic,' and 'participatory'.[3]

What this means is the research is carried out in a natural context, which would often be the field, rather than in an environment created by the author.[4] Hence, this allows the participants to interact in their own language, which is advantageous. Qualitative methods handle data that is not collected in countable form. The data needs techniques such as coding and content analysis in order for it to be examined,[5] promoting a more inductive approach in terms of the relationship between theory and research. In qualitative studies the focus is on generating new theoretical insights and on the ways in which individuals interpret their social world, discarding the practices and norms of the natural scientific model.[6] So, the epistemological position can be described as interpretivist.[7] The emphasis is on exploring, explaining and uncovering phenomena.[8] Its ontological position is constructionist, which suggests that social properties are the result of the interactions between individuals instead of

3 J. Kirk and M. L. Miller, *Reliability and Validity in Qualitative Research* (Beverly Hills, SAGE, 1986) at 9.
4 L. Webley, 'Qualitative Approaches to Empirical Legal Research' in P. Cane and H. M. Kritzer (eds), *The Oxford Handbook of Empirical Legal Research* (Oxford, Oxford University Press, 2010) at 927.
5 M. Hammond and J. Wellington, *Research Methods: The Key Concepts* (Oxon, Routledge, 2013) at 107.
6 A. Bryman, *Social Research Methods* (Oxford, Oxford University Press, 2012) at 36.
7 Ibid at 380.
8 Hammond and Wellington, *Research Methods* (n5) at 107.

phenomena which are distinct from the individuals involved in their construction.[9] As the aim of the author was to explore and explain social reality instead of aiming to test a predetermined hypothesis, a qualitative research design was more appropriate. The author did not want to impose a predetermined format on the world. Instead, the author wanted to explore what is happening through the eyes of the participants in the study. The author wanted to derive knowledge from actual experience, rather than from theory or belief. The intention was to avoid limiting the areas of enquiry too much, thereby offering more flexibility. Therefore, as the study aimed to present an analysis of the social reality along with exploring ideas to improve that reality, a qualitative research design was preferred. Then, a case study design was employed.

The case study method has been defined in various ways.[10] The key features of a case study can be summarised as the focus on a single case or a very small number of cases, and an in-depth analysis of the features of each case to gain a solid understanding of the particular case. This can then be used to contribute to theory by generating knowledge and informing policy. It has been argued that a case study can be utilised to generate theory, and specifically grounded theory.[11] Grounded theory, which is often described as an approach to analysing qualitative data,[12] simply means a theory that was developed from data that was collected methodically and examined through the research process.[13] There are certain advantages of using data derived from a case study to build grounded theory. Building theory from case studies is likely to generate theory with less research bias in comparison to theory built from axiomatic deduction.[14] Due to the close connection between the theory and the data, it is very probable that the theory can be tested further and even expanded by future studies. Also, the resultant theory is likely to be valid empirically because the data is constantly questioned and compared from the commencement of the process, and therefore a certain level of validation is done implicitly.[15] As far as generalisability is concerned, if a case study is conducted properly, it should also usually provide understanding of situations involving similar groups, individuals and events.[16]

Using a case study design enabled the author to collect in-depth information about a specific industry and a major event within that industry which

9 Bryman, *Social Research Methods* (n6) at 380.

10 See R. C. Bogdan and S. K. Biklen, *Qualitative Research for Education* (Boston, Allyn and Bacon, 2003) at 54; B. L. Berg, *Qualitative Research Methods for the Social Sciences* (Upper Saddle River, NJ, Pearson Education, Inc., 2007) at 283; H. Simmons, *Case Study Research in Practice* (London, SAGE, 2009) at 21.

11 Berg, *Qualitative Research Methods for the Social Sciences* (n10) at 285.

12 Bryman, *Social Research Methods* (n6) at 387.

13 A. Strauss and J. M. Corbin, *Basics of Qualitative Research: Techniques and Procedures for Developing Grounded* Theory (Thousand Oaks, CA, SAGE, 1998) at 12.

14 K. Eisenhardt, "Building theories from case study research" (1989) 14 *Academy of Management review* 532 at 546–547.

15 Ibid.

16 Berg, *Qualitative Research Methods for the Social Sciences* (n10) at 295.

demonstrated whether the concept of ESV promoted or assisted, or is capable of promoting or assisting, CSR in an international context, and if there is a need for reform. Due to time limitations, it was impossible to examine all the MNCs that originate in the UK and operate in other countries. Therefore, it was anticipated that analysing an industry, along with a major event within that industry in a developing country where MNCs that originate in the UK are involved, would give a good picture of the problem and would generate results that might be representative of the situation in other countries. Instead of just relying on material produced by MNCs, the author wanted to explore the reality of the situation, and this could only be done from the field. This was expected to generate themes that would assist in understanding whether the ESV principle promotes or assists CSR in an international context and whether there is a need for reform. It would also provide knowledge that would assist in policy development, such as suggestions for reform, by demonstrating the key problems within the area. It is important to note again that even though the concept of ESV has been the subject of extensive research and studies, its impact in an international context has not been considered. In the absence of any literature to rely on, the most effective way to address this aspect of the research was to conduct a study that would allow the author to observe the reality of the situation in order to attempt to fulfil the objectives of the research. Hence, after developing the plan to use a single case approach, the case was identified.

Selection of the case study: RMG industry in Bangladesh and the Rana Plaza factory disaster

The case selected for addressing the international impact of the ESV principle on CSR and the scope for reform is the RMG industry in Bangladesh, with some focus on the Rana Plaza factory disaster. Before establishing the link between the industry, along with the incident, and the research questions, it is essential to discuss the background of this industry and the aforementioned disaster. Even though human rights are generally considered almost entirely as the duty of the state towards its citizens,[17] the power of MNCs has always been an issue of concern in this regard.[18] Sometimes it can be difficult for countries to make their domestic social, environmental and human rights standards stronger, since they might be questioned by foreign investors. This situation is mainly found in poorer or developing countries where it is hard to hold MNCs liable for human rights violations due to the absence of significant institutional capacity to implement national

17 See S. Gallhofer, J. Haslam and S. Walt, 'Accountability and transparency in relation to human rights: a critical perspective reflecting upon accounting, corporate responsibility and ways forward in the context of globalisation' (2011) 22 *Critical Perspectives on Accounting* 765; and S. R. Ratner, 'Corporations and human rights: A theory of legal responsibility' (2001) 111 *The Yale Law Journal* 443.

18 Ratner, 'Corporations and human rights: A theory of legal responsibility' (n17).

standards, even when the countries have the will to do so. These countries might be inhibited from trying to enact effective accountability legislation because they might have to compete internationally for investment.[19] Some countries are hesitant to enforce regulations in relation to the human rights conduct of corporations because of the cost of taking such steps and the likelihood of foreign policy repercussion.[20] MNCs can simply transfer their operations to countries with fewer or more lenient human rights regulations. As a result of the importance of foreign investment and the creation of employment, the host states might have to make great compromises as far as other local interests are concerned.[21] It seems absurd that while companies are able to operate across borders with relatively few restrictions in today's world, they only have to abide by the national laws of the countries in which they operate.[22] Ruggie has stated that:

> the root cause of the business and human rights predicament today lies in the governance gaps created by globalization – between the scope and impact of economic forces and actors, and the capacity of societies to manage their adverse consequences. These governance gaps provide the permissive environment for wrongful acts by companies of all kinds without adequate sanctioning or reparation. How to narrow and ultimately bridge the gaps in relation to human rights is our fundamental challenge.[23]

These gaps in governance and their catastrophic consequences have been manifested by the Rana Plaza factory disaster in the RMG industry in Bangladesh. The RMG industry has played a huge role in the economic growth and societal development in Bangladesh.[24] In the past decade, the economy of the country grew by almost 6 per cent every year.[25] The RMG industry has promoted huge economic growth and the empowerment of

19 P. Frankental, 'No accounting for human rights' (2011) 22 *Critical Perspectives on Accounting* 762 at 762–763.
20 Gallhofer, Haslam and Walt, 'Accountability and transparency in relation to human rights: a critical perspective reflecting upon accounting, corporate responsibility and ways forward in the context of globalisation' (n17) at 770–771.
21 J. Siddiqui and S. Uddin, 'Human rights disasters, corporate accountability and the state: Lessons learned from Rana Plaza' (2016) 29 *Accounting, Auditing & Accountability Journal* 679 at 687.
22 Frankental, 'No accounting for human rights' (n19) at 762–763.
23 J. Ruggie, 'Protect, respect and remedy: a framework for business and human rights' (2008), at p. 3, available at <https://business-humanrights.org/sites/default/files/reports-and-materials/Ruggie-report-7-Apr-2008.pdf> accessed 10 March 2017.
24 F. Hassan, 'RMG industry of Bangladesh: Past, present and future' (*Dhaka Tribune* 19 September 2014) <http://www.dhakatribune.com/long-form/2014/09/15/rmg-industry-of-bangladesh-past-present-and-future/> accessed 8 April 2017.
25 World Bank, 'Bangladesh Overview' <www.worldbank.org/en/country/bangladesh/overview> accessed 11 March 2017.

women.[26] Even though the export garment sector did not really exist when the country gained its independence in 1971, Bangladesh became one of the world's leading suppliers of garments in the course of a few decades.[27] The sector is worth £13.5 billion, and 80 per cent of the country's export economy consists of garments exports.[28] However, this development has come with significant drawbacks.

MNCs continually work with Bangladeshi suppliers to reap the benefits of the poor safety standards and low wages in the country, which allow them to bolster their price competitiveness and consequently make more profits.[29] A combination of the socio-economic conditions in Bangladesh and the MNCs' limitless desire for cheap products leads to constant abuse of human rights in this sector. Indirect sourcing or subcontracting, via purchasing agents and in a way that is not transparent to regulators, is a key characteristic of the RMG industry in Bangladesh. This provides a way to increase margins and production capacity while keeping the cost of production low. As a result of a lack of an effective regulatory framework, the widespread use of subcontracting has created a supply chain that is driven by the pursuit of lowering costs. The way the system works allows the dominant buyers, or the MNCs, to increase the value they gain from the chain when dealing with the weaker suppliers. These buyers put pressure on suppliers to decrease costs, reduce production time and increase efficiency.[30] However, buyers demand that the suppliers meet specific requirements for the products along with maintaining various social standards. So, the MNCs gain a higher share of the final value than the suppliers. The suppliers are required to deliver on the quality, and the value associated with the quality is passed to the MNCs, but the risk and cost is passed down the chain to their workers.[31] This has resulted in increasing risks for businesses and their workers

26 For women's empowerment see M. Munni, 'Women empowerment and garment industry' (*The Financial Express*, 7 March 2017) <http://www.thefinancialexpress-bd.com/2017/03/07/63709/Women-empowerment-and-garment-industry> accessed 8 April 2017.

27 S. Labowitz, and D. Baumann-Pauly, '*Business as Usual is Not an Option: Supply Chains and Sourcing after Rana Plaza*' (2014), Centre for Business and Human Rights, Stern School of Business, New York University <http://www.stern.nyu.edu/sites/default/files/assets/documents/con_047408.pdf> accessed 10 March 2017 at 16.

28 BBC, 'Bangladesh urged by UN to reform garment industry' (2013) <http://www.bbc.co.uk/news/world-asia-24997096> accessed 14 April 2017.

29 B. ter Haar and M. Keune, 'One Step Forward or More Window-Dressing? A Legal Analysis of Recent CSR Initiatives in the Garment Industry in Bangladesh' (2014) 30 *The International Journal of Comparative Labour Law and Industrial Relations* 5 at 6–7.

30 Acona 'Buying Your Way into Trouble? The Challenge of Responsible Supply Chain Management' (2004) London: Insight Investment Management Ltd. <https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjwsvqq85_vAhWeSEEAHb0PBnsQFjAAegQIARAD&url=https%3A%2F%2Fcarnstone.com%2FdownloadInsightFile%3Finsight%3D4&usg=AOvVaw2ko4toUETsMRZacItFJd_u> accessed 9 March 2021.

31 S. Barrientos, 'Contract Labour: The "Achilles Heel" of Corporate Codes in Commercial Value Chains' (2008)39 *Development and Change* 977 at 982.

because of decreasing wages and worsening working conditions. It has undermined investment in technology and training, and has hampered development in quality and productivity.[32] A supply chain that consists of many subcontracts makes it very challenging for MNCs and the government to monitor the actions of the subcontractors. Even though some retailers might have strong policies against their suppliers engaging in subcontracting, the model makes it very hard for their compliance auditors to spot the subcontractors that might be part of their supply chain.[33] Hence, an incident such as the Rana Plaza disaster was almost inevitable.

The Rana Plaza was an eight-storey building that housed five garment factories along with other shops and a bank. Before the collapse, there were around 2,200 registered employees in the building, in addition to those who were employed at the bank and the shops on the first floor.[34] On 24 April 2013, the building collapsed. At the time, the number of people inside was unknown.[35] Before discussing the aftermath of the incident, it is important to mention the events that led to the collapse of the building. Initially, the owner of the Rana Plaza was only given permission to build a five-storey commercial building with a basement. In spite of the fact that foundation of the building was meant to support only five storeys, the owner was allowed to extend the building by adding more storeys. Furthermore, the building was being used for industrial purposes rather than commercial purposes. This was problematic because power generators were installed on higher floors of the building as they were needed for industrial purposes. Consequently, cracks developed in the building the day before the building collapsed.[36] When three cracks were found in the reinforced concrete pillars that supported the eight-storey building, an engineer sent by the Savar municipality declared the building unsafe.[37] The bank on the first floor sent its employees home as it was getting very dangerous. In spite of the fact that inspectors who visited the factories voiced concerns, the garment workers were obliged to return to work. The cracks were visible and

32 Labowitz and Baumann-Pauly, '*Business as Usual is Not an Option: Supply Chains and Sourcing after Rana Plaza*' (n27) at 6.

33 Siddiqui and Uddin, 'Human rights disasters, corporate accountability and the state: Lessons learned from Rana Plaza' (n21) at 687–688.

34 J. Burke, 'Rana Plaza: one year on from the Bangladesh factory disaster' (*The Guardian*, 19 April 2014) <https://www.theguardian.com/world/2014/apr/19/rana-plaza-bangladesh-one-year-on> accessed 14 April 2018.

35 BBC, 'Bangladesh factory collapse toll passes 1,000' (2013) <http://www.bbc.co.uk/news/world-asia-22476774> accessed 10 February 2018.

36 M. A. Ansary and U. Barua, 'Workplace safety compliance of RMG industry in Bangladesh: Structural assessment of RMG factory buildings' (2015) 14 *International Journal of Disaster Risk Reduction* 424 at 426; see also *The Economist*, 'Disaster in Bangladesh: Rags in the ruins' (4 May 2013) <http://www.economist.com/news/asia/21577124-tragedy-shows-need-radical-improvement-building-standards-rags-ruins> accessed 14 March 2017.

37 Burke, 'Rana Plaza: one year on from the Bangladesh factory disaster' (n34).

grew larger by the day. It has been mentioned that the managers almost did not even need to threaten the workers as they were employed on a "pay cheque to pay cheque" basis, and they knew that they could be dismissed for refusing to return to work. The managers were also under pressure to meet deadlines from international buyers. Missing a deadline would mean that the factories would have to bear all the costs of the production, and this could cause the companies to become insolvent.[38]

The collapse of the Rana Plaza resulted in the death of around 1,134 workers[39] and injured approximately 2,500 more.[40] These workers were making garments for MNCs originating in Europe, the United States and Australia.[41] Some of the retailers in the UK for whom garments were being made by the Rana Plaza factories were Primark, Matalan and Bonmarche.[42] The Rana Plaza disaster was one of the most catastrophic industrial accidents in the world. It happened only 5 months after the Tazreen factory fire in Dhaka, which resulted in the deaths of more than 120 workers.[43] The sheer magnitude of this disaster caught the public eye and revealed the problems in terms of workplace safety in the RMG industry. However, a closer inspection demonstrated that incidents such as this are the inevitable consequence of a sourcing model which is the basis of many global supply chains.[44] This type of incident also raises questions about the ability and willingness of the government to protect the human rights of the workers in this industry.[45] It is quite evident that the government of Bangladesh lacks the resources and capacity to protect the basic rights of its workers,[46] and in the RMG sector the disregarding of international labour standards and codes of conduct is

38 D. O'Rouke, 'Fashion firms must pay the price of safety in Bangladesh' (*The Guardian*, 17 September 2013) <https://www.theguardian.com/sustainable-business/fashion-brands-retailers-bangladesh-factory-safety> accessed 14 April 2017.

39 T. Hoskins, 'Reliving the Rana Plaza factory collapse: a history of cities in 50 buildings, day 22' (*The Guardian*, 23 April 2015) <https://www.theguardian.com/cities/2015/apr/23/rana-plaza-factory-collapse-history-cities-50-buildings> accessed 14 April 2017.

40 The Guardian, 'Rana Plaza collapse: dozens charged with murder' (2015) <https://www.theguardian.com/world/2015/jun/01/rana-plaza-collapse-dozens-charged-with-murder-bangladesh> accessed 14 April 2017.

41 M. M. Ali and A. Medhekar, 'A poor country clothing the rich countries: case of garment trade in Bangladesh' (2016) 12 *Economy of Region* 1178 at 1179.

42 Clean Clothes Campaign, 'Who has paid up and who is dragging their heels' (no date) <http://www.cleanclothes.org/ranaplaza/who-needs-to-pay-up> accessed 14 March 2017.

43 Hoskins, 'Reliving the Rana Plaza factory collapse: a history of cities in 50 buildings, day 22' (n39).

44 Labowitz and Baumann-Pauly, '*Business as Usual is Not an Option: Supply Chains and Sourcing after Rana Plaza*' (n27) at 9.

45 Siddiqui and Uddin, 'Human rights disasters, corporate accountability and the state: Lessons learned from Rana Plaza' (n21) at 680.

46 Labowitz and Baumann-Pauly, '*Business as Usual is Not an Option: Supply Chains and Sourcing after Rana Plaza*' (n27) at 9.

commonplace.[47] There is a need for an even playing field of rules, which are created at international level and can either be enforceable against the companies directly or be implemented efficiently by the countries that are signatories to these rules.

What about the possible link between ESV and the RMG industry in Bangladesh? The list of factors that directors need to have regard to under section 172, which incorporates the ESV principle, includes the need to foster the company's business relationships with suppliers, customers and others, the impact of the company's operations on the community and the environment and the desirability of the company maintaining a reputation for high standards of business conduct. Since a number of MNCs based in the UK source garments from suppliers in Bangladesh,[48] many of their stakeholders are companies and individuals in the RMG industry in Bangladesh. It can be argued that these stakeholders include not only the suppliers but also the workers that are employed by these suppliers. These workers are directly involved in the manufacturing of the products of the MNCs. There is a direct connection between these MNCs based in the UK and the RMG industry in Bangladesh. Therefore, the operations of the MNCs have an impact on the suppliers along with their workers, and can potentially have an impact on the communities and environment as well.

The RMG industry also plays a part in demonstrating whether the MNCs are maintaining a reputation for high standards of business conduct. Their standards are reflected in the manner in which they operate there. The Rana Plaza factory disaster is an example of what has gone wrong in that industry. Therefore, it needs to be considered whether MNCs that originate in the UK and were involved with the factories in the Rana Plaza ignored the need to foster their business relationships with suppliers, customers and others, and the impact of their operations on the community and environment. Moreover, considering that this incident caught the attention of the whole world and the companies involved faced a significant amount of bad publicity, it might be asserted that they did not maintain their reputation for high standards of business conduct. Hence, examining whether section 172 has any impact when MNCs, based in the UK, operate in the RMG industry in Bangladesh would assist in the understanding of whether the ESV principle promotes or is capable

47 Labowitz and Baumann-Pauly, '*Business as Usual is Not an Option: Supply Chains and Sourcing after Rana Plaza*' (n27) at 9; S. Dasgupta, 'Attitudes towards Trade Unions in Bangladesh, Brazil, Hungary and Tanzania' (2002) 14 *International Labour Review* 413.

48 For example, see K. McVeigh, 'Asda, Primark and Tesco accused over clothing factories' (*The Guardian*, 16 July 2007) <https://www.theguardian.com/business/2007/jul/16/supermarkets.retail2> accessed 18 April 2018; Marks & Spencer, 'M&S Interactive map' <https://interactivemap.marksandspencer.com/?parentFolderPiD=56fa5de072529d3e644d25d1> accessed 18 April 2016; H&M 'Our supplier factory list' <http://sustainability.hm.com/en/sustainability/downloads-resources/resources/supplier-list.html> accessed 18 April 2016.

of promoting CSR. It might be able to show whether section 172 is capable of protecting all stakeholder groups. As the Rana Plaza factory disaster is a recent example of companies not acting responsibly, it could also show the need for reform in this area, and even demonstrate the changes that need to be made. So, examining this situation could assist in showing how the concept of ESV can promote CSR in a better way, or could be reformed to promote CSR.

The RMG industry of Bangladesh, with a focus on the Rana Plaza factory disaster, can be seen as a key case. It potentially serves as a good case study because, as mentioned earlier, a lot of companies in the UK source garments from suppliers in Bangladesh. Thus, conducting a case study in this industry is likely to be very beneficial in demonstrating the international impact of ESV on CSR. It was anticipated that the situation of the suppliers in this industry will also be representative of suppliers in other developing countries who provide goods or services to MNCs based in the UK. Furthermore, the purpose of this case study can be categorised as instrumental as it was done with a purpose in mind.[49] It was done to assess whether the concept of ESV promotes or assists CSR, or whether it is capable of doing so. Therefore, the case study was playing a supporting role to assist the understanding of another issue, namely the impact of ESV on CSR in an international context. Case studies can also be categorised as to whether the purpose behind conducting the study is evaluative, explanatory, exploratory or a combination of these purposes. An evaluative case study is conducted in order to investigate whether something has worked or how well it has worked.[50] Since the case study was conducted to analyse whether the concept of ESV had worked, it certainly had an evaluative purpose.

The participants and semi-structured interviews

The author wanted to interview individuals who could provide information about operations of the MNCs in the RMG industry in Bangladesh and the role MNCs play in terms of protecting the rights of the workers who work for their suppliers. It was decided that semi-structured interviews would be conducted with individuals working for NGOs involved in the improvement of working conditions in the garment industry, company directors or owners of companies that employ workers and sell goods, human rights activists, trade union leaders and individuals who work with the Bangladesh Garment Manufacturers and Exporters Association (BGMEA) in Bangladesh. It was anticipated that these individuals would be able to comment on the impact of having so many parties in the supply chain on the rights of the workers in the RMG industry, the effectiveness of various international guidelines such as the UN guiding principles on human rights, the involvement of MNCs and the impact

49 G. Thomas, *How to do Your Case Study: A Guide for Students and Researchers* (London, SAGE, 2011) at p. 98.

50 Ibid at 99.

of the Rana Plaza factory disaster. They would be able to provide information on whether, given the economic and socio-political condition of Bangladesh, the country will ever be able to truly protect the rights of its workers. The author believes that this might also be a reflection of the situation in other developing countries. Furthermore, these individuals would be able to provide insight on what the impact might be if MNCs could be held accountable in their country of origin for the actions of their foreign suppliers. It was anticipated that the data gathered from the interviews would demonstrate whether section 172 has worked in protecting the suppliers or ensuring the reputation of the corporation. It should also provide insight into the potential impact if MNCs were to have an active involvement in the whole process and they could be held accountable in their home state.

The 26 participants in the study were divided into 2 groups. The first group consists of participants who make up the industry. It included 16 company owners, some of whom are also involved in the management of the BGMEA, and three individuals who are employed as senior-level executives in companies that produce ready-made garments. The 16 company owners are individuals who own a substantial part of the respective companies and are also involved in the management of these companies. These participants are referred to as Owners 1 to 19. The participants represent a wide range of companies in terms of size and capacity. The number of workers employed in the factories owned by these companies varied from 250 to 60,000. Some of these companies work directly with MNCs and some receive work through buying houses. Some of the brands that these companies are or were producing garments for include H&M, Marks and Spencer, Primark, Asda, Tesco, Wal-Mart, K-mart, Target, Zara, Macy's, JC Penny, Mothercare, Van Heusen, Lidl, Gap, Uniqlo, Nike, Adidas, North Face and Timberland. A small number of companies were also going through a transition process as a result of new compliance requirements being enforced after the collapse of Rana Plaza. This means some or all of their factories had to shut down operations in order to make improvements that would meet the new requirements. Nonetheless, the responses from and the insights of the owners of these companies were of equal value to the project.

The second group consists of participants who are involved in promoting the rights of workers and ensuring their health and safety. This group was comprised of four individuals who work for NGOs that operate within the garment industry, two representatives from garment trade union organizations and one activist from a women's rights organisation. These participants have been referred to as NGOs 1 to 7, as using coding references for each separate category might have led to confusion. All these individuals have extensive experience in working for the improvement of working conditions in factories that produce ready-made garments. Some of these participants were working on ongoing projects in certain factories for the betterment of the workers. Some of them also worked towards enhancing the quality of life of these workers by providing them assistance and training on a number of aspects such as legal services, financial matters, free health services, the right to form unions, etc.

Since the investigation was commenced with a clear focus and well-defined areas of interest instead of a general idea to conduct research on a given topic, the semi-structured interview was chosen as the method of data collection. In that way, fairly specific topics may be discussed, but at the same time the participants have flexibility to respond in the way they want to, and the author has the opportunity to introduce other issues as the conversation develops. A degree of systematisation in questioning was also essential because a number of participants were being interviewed.[51] The author had a list of specific topics, which can be called the interview guide,[52] but using this method also provided the flexibility to ask questions that were not in the interview guide, based on the responses of the participants. The majority of the questions asked of the two groups of participants were the same, but some of the questions were different as the participants included a wide variety of professionals.

In-depth semi-structured interviews were conducted with the participants between 15 August 2016 and 7 October 2016 in Dhaka and Chittagong, the two leading cities in Bangladesh. The appointments were arranged based on what was convenient for the participants. Most of the interviews were conducted in the participants' offices as this is the norm in those cities. However, if the participants expressed discomfort about being interviewed in their offices, the author arranged a hired conference room or other place to conduct the interviews. The participants were asked whether they preferred to communicate in English or Bengali, which is the native language of Bangladesh. The author is fluent in both languages and is capable of conducting the interviews in either language. Eight of the 26 participants preferred to communicate in Bengali. The author then translated these interviews before beginning the process of analysis. Data analysis followed the procedure of grounded theory,[53] which consists of open, axial, and selective coding.[54]

Empirical evidence

This section presents the data gathered on various aspects that indicate whether implementing an ESV approach has had any impact on the CSR practices of MNCs originating in the UK and operating in developing countries through their supply chains, and whether there is a need for reform. The participants' responses have been categorised under four major themes: 1) the aftermath of the collapse of the Rana Plaza; 2) the involvement of MNCs; 3) other factors which potentially have an impact such as the role of the government, the

51 C. Marshall and G. B. Rossman, *Designing Qualitative Research* (Thousand Oaks, California, SAGE, 1999) at 108.

52 Bryman, *Social Research Methods* (n6) at 471.

53 Webley, 'Qualitative Approaches to Empirical Legal Research' (n4) at 943–944; A. L. Strauss, *Qualitative Analysis for Social Scientists* (Cambridge, Cambridge University Press, 1987) at 11–25.

54 See J. W. Creswell, *Qualitative Inquiry and Research Design: Choosing Among Five Traditions* (Thousand Oaks, California, SAGE, 1998) at 150–151.

attitude of the owners and the presence of multilateral organisations; 4) current problems in the industry. The official language of Bangladesh is Bengali, and English is often used secondarily. Some of the participants were not fluent in English but were able to make themselves understood adequately. For authenticity, in quotations, their statements have been recorded exactly as they gave it. Due to the many blemishes in language, an indication in the quote of incorrect impression has not been provided.

Aftermath of the Rana Plaza factory disaster

The participants were asked about the impact that the Rana Plaza factory disaster had on the RMG industry, especially in terms of the working conditions of the workers. The study found that the collapse of the Rana Plaza has resulted in significant improvements in the RMG industry in Bangladesh as far as workplace safety is concerned. In this section, the impact of the incident will be considered in depth. First, the general changes will be explored. Then there will be a discussion on the specific changes that were made as a result of the Accord on Fire and Building Safety in Bangladesh[55] ("Accord") and the Alliance for Bangladesh Worker Safety[56] ("Alliance"). The Accord and the Alliance were initiatives taken after the Rana Plaza factory disaster to ensure that factories comply with certain standards. Both the initiatives will be considered further in this section. Lastly, the contribution of the media in instigating these changes will be assessed.

General observations

The study showed that the incident had both positive and negative impact on the RMG industry in Bangladesh. As Owner 5 remarked:

> Because of Rana Plaza, the business of our country has been portrayed a bit negatively. Due to generalisations being made about all of Bangladesh because of the collapse of one factory, we have all become Rana Plaza in the eyes of foreigners and customers. As a result, the image of the country has been considerably harmed. This shouldn't have happened. I don't think it is justified as there are also very good factories in Bangladesh. There are factories which maintain international standards. Even those who were in mid-level management, they're also maintaining the factories very well. Since the incident of Rana Plaza has been shown so widely, the international buyers have developed a negative opinion about Bangladesh … So after that, there has been some harm done to the image. But

55 See Accord on Fire and Building Safety in Bangladesh, 'About the Accord' <http://bangladeshaccord.org/about/> accessed 18 April 2016.

56 Alliance for Bangladesh Worker Safety, 'About the Alliance for Bangladesh Worker Safety' <http://www.bangladeshworkersafety.org/who-we-are/about-the-alliance> accessed 18 April 2016.

> the positive side is, we were not addressing certain issues before but right now we're trying to function by maintaining the international standard. After the Rana Plaza, various aspects like monitoring, auditing the factories, working for the rights of the worker, working for health and safety, working for building safety, investing in fire safety, we are trying to maintain proper standards in everything. Even though this is very expensive, especially for someone who is a mid-level investor. Even though it is expensive, we are not compromising in anything when it comes to these aspects. So, in terms of Rana Plaza, there has been good and bad, positive and negative impact … the garment sector in Bangladesh has gone to a different height after the Rana Plaza.
>
> [Translation]

Owner 3 also expressed similar views. He thought that the collapse of Rana Plaza was a blessing in disguise. However, there was a major impact on business. A large number of factories were shut down because those factories could not be improved. His factory had survived because he had the capacity and scope to make the improvements demanded by the MNCs, but there are many factories that did not have the scope or space to make those improvements. For example, the infrastructure of these factories was such that the required standards could not be met. Some of these factories did not have the space where extra staircases or a water reservoir, in case of fire incidents, could be built. Therefore, these factories had to be shut down. Owners 1 and 14 also expressed similar views in their contributions. This suggests that factories that could meet the new requirements imposed by the MNCs, because they had financial and structural capacity to fulfil these requirements, survived. However, a lot of the factories were closed. Owner 7 mentioned that he thought that only a very small quantity of factories will survive. Owner 16 also mentioned that a major percentage of the small factories were closed and now it was the medium and large factories that were left running.

Furthermore, Owners 15 and 18 mentioned that the standards that are being imposed now are in fact North American standards. Commenting on the impact of Rana Plaza and the extent of the standards being imposed, Owner 15 said that after the collapse of Rana Plaza, the MNCs became very vigilant. He thought that this was positive. They had the opportunity to learn a lot from the MNCs and made a lot of improvements based on their suggestions. However, these suggestions were very stringent as they followed the NFPA standards, which are North American standards. They were compelled to follow these standards, but he did not mind as he felt that they were heading in the right direction. However, he complained that sometimes the MNCs exceeded the limit of their mandate. Now, in the name of fire safety, electrical safety and building safety, they were trying to put some sort of unionisation in his factory. He did not appreciate that.

Owner 18 elaborated further and pointed out:

> I mean we take it positively, we don't take it negatively. Though the standards are a lot higher than the usual factories in other countries. China, if you go to China, if you go to Pakistan, India, you will not find this much of, say, fire safety, building safety, electrical safety standards. The standard we are following right now is actually North American and European standard. So, if you go to a factory in North America or Europe, they are following the same standards that we are following right now. So, it's a good thing that overall safety level, overall compliance level of factory, have come up drastically because of these changes. It costs a lot of money, but it is definitely for the betterment of the industry.

However, he expressed concerns over the costs and stated that it is ironic that the MNCs do not want to pay more. Owner 19 also mentioned that due to these new requirements ultimately the cost of the products would increase. He was afraid about whether the MNCs would continue to work with them if the costs increased. Putting forward a slightly different view, Owner 2 mentioned that the incident did not have much of an impact on his operations as he already had most of the required facilities. They might not have been structured in the way they are now, but he did have those facilities. Nonetheless, he agreed that it had an impact on the industry as a whole.

Owner 6, in his contribution, stated that the MNCs were partially responsible for the incident and said that it would not have happened if there had been ethical buying practice in place. Putting it more bluntly, Owner 18 made the following statement:

> I mean Rana Plaza is the fault of the customers [MNCs] themselves. I mean, if you pay well, if the company can afford to rent a good place or you know, pay more to the workers, this wouldn't have happened. The customers who are continuously pushing for the price to come down, if my customer is paying ten dollars and after two years, they tell me that I will pay you eight dollars for the same product, I have to reduce my cost. Where do I go? To find a cheaper place, to set up my factory. And that cheaper place comes with its, let's say faults … Rana Plaza happened because you are asking for a cheap product, cheap price. If you would have paid maybe even ten cents more to the same company, it could have rented a better place. This Rana Plaza wouldn't be a garment factory. It would be something else. So, at the first place when you know that the factory is in such a messy building, why are you even placing order there? So, I mean it happens for both the reasons. Maybe the owner can be guilty to reduce the cost and move to a very dodgy place, or the customers can be greedy to earn more money. He doesn't care about where he's producing his product.

There were mixed comments from the NGO group. NGO 1 started by acknowledging that there has definitely been some progress, but also pointed out that after the incident a lot of the MNCs said that they would not place any orders. They just imposed the requirements, but NGO 1 asked how these could be fulfilled without any support from the MNCs. She also mentioned that a lot of these changes might be good for the workers but might not be good for business in Bangladesh overall. NGOs 2 and 7 both had very positive outlooks. NGO 2 said that if the status of the workplace, the work environment and the rights of the workers now were compared with the situation before the Tazreen factory fire and the Rana Plaza disaster, they have improved tremendously. He added that the Rana Plaza factory disaster was an incident that shook the world. The participant said that there were people protesting in front of international stores. This made the MNCs investigate these issues better. Even though we cannot bring back those who died or give the workers who lost their ability to live normal lives their health back, according to NGO 2, the industry has come to this position today because of what happened. In the same manner, NGO 7 remarked:

> Yes, Rana Plaza was, without a doubt, a very tragic incident. But I think that even though 1200 or 1300 or a few thousand workers have lost the ability to live normal lives, Rana Plaza played a big role in saving the lives of thousands of workers in Bangladesh. In this sector, no changes were made till workers died. If you see from the 90s till 2010, there have been fire accidents in many factories. After that, you hear a lot of talk about taking action but after a few days it dies down. We are always more focused on current issues. So, when a new issue arises, the other incident is forgotten about. So, in that regard, the collapse of Rana Plaza was a big threat for the Bangladesh garment sector. So, I think that the government played a robust role in that and the international workers organisations took a strong stance for the workers of Bangladesh as well.
>
> [Translation]

However, he was worried that the situation might be reverting back to the way it was before in terms of workers' rights, but he thought the other issues were fine.

NGOs 3 and 4 had completely different thoughts on the issue. NGO 3 suggested that there have been some improvements in safety measures and wages have increased slightly as a result of the collapse of Rana Plaza. However, these changes were not made willingly. It was only done to diffuse the negativity faced by the RMG industry as a result of Rana Plaza. It was only done as a cover-up. NGO 4 also recalled that the whole situation was dealt with very poorly. In particular, she was unhappy with the treatment and rehabilitation facilities that were available to the workers after the incident. A number of the workers did not receive proper healthcare. She thought a lot of people said that they had made many changes, but in reality, that did not happen. The owners might have made some changes because there was so much concern and agitation around the world about this, but in terms of fundamental aspects, she did not think a lot had been achieved.

Accord on fire and building safety in Bangladesh and the Alliance for Bangladesh worker safety introduced

Both the Accord and the Alliance were formed in the immediate aftermath of the Rana Plaza building collapse. The Accord is a five-year, legally binding agreement between global brands or retailers and trade unions. The purpose behind its creation is to ensure a safe working environment in the RMG industry in Bangladesh.[57] It comprises a completely independent inspection programme which is supported by the various brands and involves the workers and trade unions. The signatories of Accord include more than 200 apparel brands, retailers and importers. These parties are from more than 20 countries in Europe, North America, Australia and Asia. In addition, it also includes two global trade unions, eight trade unions from Bangladesh and four NGO witnesses.[58] Some of the main components of the Accord are: the public disclosure of inspection reports of factories along with corrective action plans, an assurance from the brands involved that there will be sufficient funds available for remediation so that the sourcing relationships can be maintained, and the empowerment of workers through providing training programmes and complaints mechanisms.[59] The Alliance is a similar five-year undertaking to improve workplace safety in the RMG industry in Bangladesh.[60] The members of the Alliance represent the majority of North American brands or other retailers that source products from the RMG industry in Bangladesh.[61]

Some of the participants in the owner group were under the monitoring systems of Alliance, some under the Accord, and some were under both. However, there are important structural differences between the two undertakings. The Accord is an agreement between the global brands and retailers and the global and local representatives of their suppliers' employees to coordinate factory safety and it is based on a dedicated governance contract. On the other hand, the Alliance is a commitment between the global brands and retailers to coordinate safety efforts in the factories of their suppliers. The Accord does not include explicit noncommittal language, which the Alliance does.[62] The findings of the study suggest that the Accord and the Alliance have been effective in improving workplace safety in the RMG industry to a great

57 Accord on Fire and Building Safety in Bangladesh, 'About the Accord' (n55).

58 Accord on Fire and Building Safety in Bangladesh, 'Signatories' <http://bangladeshaccord.org/signatories/> accessed 3 July 2017. The full list of the signatories can be accessed on this website.

59 Accord on Fire and Building Safety in Bangladesh, 'About the Accord' (n55).

60 Alliance for Bangladesh Worker Safety 'About the Alliance for Bangladesh Worker Safety' (n56)

61 Alliance for Bangladesh Worker Safety 'Membership' <http://www.bangladeshworkersafety.org/who-we-are/membership> accessed 3 July 2017.

62 For more information on the structural differences see Salminen, J., 'The Accord on Fire and Building Safety in Bangladesh: A New Paradigm for Limiting Buyers' Liability in Global Supply Chains?' (2018) 66 *American Journal of Comparative Law* 411.

extent. This is supported by the contributions of the majority of the participants. For example, Owner 14 commented:

> As I said, as far as the fire safety, building safety and electrical safety is concerned, now we are accountable to Accord and Alliance. And we have to submit our report fortnightly to them. And they are auditing the factory frequently. To see how much improvement has been done, to what extent the remediation process has been completed. So that way it should be done by the government authorities, the offices, they have not done it. But these two companies, Accord and Alliance, due to them, the factory, the industry is now stabilised, in many ways, I believe.

When asked whether they have been effective, Owner 3, who operates under the Alliance, said that they are effective and they are helping the sector. The Alliance evaluates the factories, points out weaknesses, informs them what they have to do and monitors whether they are doing everything properly. So, in his opinion, the Alliance is definitely helping. Nonetheless, he mentions that there are some limitations on its part. It compels the owners to buy certain things from certain companies. He explains that this is not a complaint and acknowledges that these things can happen if people are handling these matters. There is, he thinks, some bias involved. Even so, he thinks that Alliance has been very helpful.

The majority of the participants in the NGO group also thought that the overall impact of the Accord and the Alliance has been positive. NGO 1 mentioned:

> They have been effective in the sense that a lot of factories have been shut down because of them. And in some of the factories, their training has been very productive, in particular, the training that they have done for fire safety and building safety. I have seen the results in factories. It has been very productive.
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> [Translation]

NGO 6 also made similar observations:

> A lot of development has been done because of the Accord and the Alliance. In that regard, their role is definitely notable. They are doing the work. But they should do it in an ethical manner as well. And also, it's not like everything here is bad. Our good aspects should be endorsed as well. But it is true that after the Accord and the Alliance, they are looking at everything very strictly in terms of the workers, worker safety. They don't permit any sort of shortcomings. Human rights organisations are also supporting this.
>
> [Translation]

NGO 7 took the issue further by stating that it might be disrespectful to the country that the responsibility had to be given to outsiders because those responsible for monitoring these issues in Bangladesh had not done it properly. He mentioned that the industry should respect the work that they are doing. The effectiveness of the initiatives was also demonstrated when there were other accidents after the Rana Plaza disaster, but the number of casualties was minimal.

Although the Accord and the Alliance might have been effective in improving the workplace environment in the RMG industry, a number of the owners pointed out that they did not have proper standardised guidelines, and there was a lack of consistency. For example, Owner 5, who was a signatory only to the Alliance, stated:

> The work that Alliance is doing is not consistent. Sometimes, suppose they're working with building safety, they're coming up with new issues. We have been dealing with one engineer but then they replace the person with someone else. Then that person is giving you requirements. This is troublesome for us. They are not being able to set a standard set of guidelines.

This was supported by Owner 9, who said:

> Accord is coming up with different SOPs.[63] Simultaneously, Alliance is coming up with some different SOPs … Well, my company is doing both Europe market and US market. So, at the end of the day, what I really suffer at times is matching both the requirements. So, if the buyers can come up with a uniform SOP, which will be easier for any of our manufacturers and that would give us a breakthrough.

The trouble caused by this lack of standard guidelines was explained further by Owner 18:

> They have been effective in terms of showing the guideline. Telling us what to do. But they have not been very effective implementing it. Okay, I mean let's put it another way … they audit your factory, they said that we have ten problems in your factory, and they say that you have to solve all these problems … Now, in the next audit, when they come, out of ten you cover seven of them, and three of them you say that I'll make it done within next two months. In the next audit they came up, comes up with new let's say ten problems which they didn't cover last time … I understand that this happens because of the lack of experience. This kind of work has not been done before. So, for many factories this has been a big trouble … Sometimes you have to break what you have done and do it again."

63 SOP stands for standard operating procedure.

Owner 2 stated that the idea of the Accord and the Alliance was great, and he supported it, but pointed out that the execution was extremely corrupt. He gave the example of owners being required to change their fire doors multiple times just because they were not bought from prescribed vendors. He thinks the Accord and the Alliance have kept the pressure up, but they could also have kept their integrity intact, which they have failed to do. For these reasons, they lost credibility. This suggests that the way in which the Accord and the Alliance have executed their plans might have been unfair to the owners, who had to invest money for every remedial process and consequently suffered losses when they had to keep changing what they had already done to satisfy new requirements.

Also, the burden of the remediation process seemed to be borne only by the factory owners. There was not much support from the buyers. Owner 6 thought that the standards that they were imposing were not fair in comparison to the price they were paying. He mentioned that immediately after Rana Plaza happened, the government had to agree to everything to ensure that the MNCs would not leave Bangladesh. He claimed that right now it was not a level playing field, as the same standards were not being imposed on the other countries that Bangladesh competes with. These countries were already being paid more in comparison to the prices offered in Bangladesh. Both Owners 13 and 16 also mentioned that the Accord and the Alliance have not been able to create any pressure on the MNCs. Owner 16 stated that in the process of trying to satisfy different requirements at different times a lot of the small factories had shut down. Owner 8 suggested that if they really wanted to help the country, they should not cross certain limits. They cannot help the country and the people by shutting all these factories down. He asked where these workers would go when the factories were shut down.

Owner 2 said that they should not be imposing standards higher than those in other manufacturing countries. He was happy to adopt any sort of regulations which were related to protecting human lives. However, the Accord and the Alliance were going above and beyond to impose standards that were incorporated in North America. Living standards in the United States and in Bangladesh are not the same. This suggests that the standards incorporated by the Accord and the Alliance would perhaps make Bangladesh less competitive in terms of price when compared to other manufacturing countries. This issue will be discussed further later in the chapter.

Contribution of media

The majority of the owners were unhappy with the way the collapse of Rana Plaza was covered by the media. Most of them thought that the coverage had a negative impact on the RMG industry. Owners 1 and 2 both expressed the view that they did not receive fair treatment from the media. Owner 2 asserted that he had to bear the blame for Rana Plaza even though he had nothing to do with it. He owned a standalone, purpose-built factory. The structure of

Rana Plaza was not right for setting up factories. He asked why the government had allowed it in the first place. He claimed that the safety of his workers was his priority, and he would never take a chance with his people. If there were any issues, he would shut down that unit and explain the situation to his buyers. Nevertheless, he lost a lot of business because of the incident. Since he is from Bangladesh, he got branded as Rana Plaza. This was further corroborated by Owner 3. He stated that a number of major accidents happened elsewhere, but they were not dealt with in this manner. The whole RMG industry in Bangladesh cannot be held responsible for the collapse of one building. In his opinion, the incident had been used as a propaganda that harmed the whole sector. However, now that many factories had made improvements, the media was silent. He then went on to give an example of the negative impact. He said that so many factories had been shut down as a consequence. Before this, there used to be advertisements in front of factories that they were hiring people, but that cannot be seen anymore. A lot of the workers had to return to rural areas because so many factories were closed.

Furthermore, Owners 12 and 14 both mentioned that the media should have reported more responsibly. Owners 10 and 18 also added that the media was not very thorough in their reports or investigations. According to Owner 18:

> Media in Bangladesh, I say are very superficial in terms of covering anything. They don't go deep. If you, like, say, listen to news coverage in BBC, Al Jazeera or CNN, they try to go deeper, try to talk with experts, try to find out the real cause, but here, whatever happens is covered heavily, you know, real-time. But then after some time, the follow-up is not there anymore. So during the Rana Plaza, every channel, every newspaper was covering the real-time news but then the achievement that we have done, the work we have done after Rana Plaza, that has not been so much public … After Rana Plaza this Accord and Alliance, because of this Accord alliance, the factories have improved their, let's say, building safety, fire safety drastically. So those were the things that were not really covered after that.

However, Owner 19 thought that even though the media was not helpful initially as it was exaggerating what happened, now the media is more positive. He mentioned that the media has realised that it is more important to show the reality of the situation as they are portraying the country in a certain way.

On the contrary, the majority of the NGOs thought that the contribution of the media was positive and significant in instigating change. NGO 5 explained that it created pressure on the MNCs as well:

> Media played a good role there. The media covered the whole incident continuously … Two things happened as a result of that. First an image has been created internationally. The international media also covered it … So there was a crisis in terms of the image of Bangladesh … But this

> was necessary. Not just nationally, but internationally … So they definitely played a role. The whole time, starting from the rescue work to everything. What was the reason? They tried to identify the reason. Why did it happen? … So this one incident exposed a lot of other incidents. Another thing is, after this incident happened and it was taken up by the international media from our media, the garments owners were shaken up. So was the government. So, everyone was shaken up. So there was a matter of negotiation of the owners and the government. Pressure was also created on the multinational companies.
>
> [Translation]

NGO 7 confirmed this further:

> At the time of Rana Plaza, they highlighted the incident 24/7. What the various difficulties were, what were the issues, how can it be solved or who played what role, inspectors, government, everything was covered well. And at the time BGMEA said that the media is ruining the reputation of the country, the way that they are broadcasting is not good. However, the media fulfilled their duties.
>
> [Translation]

NGO 2 added further that the way the anniversary of Rana Plaza is commemorated every year by the media must also influence the owners by making them feel that such an incident should never happen in their factories. So, the media made a big contribution. In a more neutral account, NGO 1 acknowledged that the media made a positive contribution but admitted that it did have a negative impact on the country as well.

These contributions show that the media had a major impact, regardless of whether it is perceived as positive or negative. The whole world was made aware of what happened in Bangladesh and this forced the MNCs to take action. As the news spread around the world, the reputation of the MNCs that were involved was also affected. Hence, these MNCs failed to maintain a reputation for high standards of business conduct.

Summary and reflection

Since it has been established that development in the workplace environment, in terms of the safety and security of the workers, happened as a consequence of the Rana Plaza disaster, it can be suggested that the concept of ESV did not play any significant role in changing the behaviour of the MNCs based in the UK as far as their international operations are concerned. It can even be argued that since certain MNCs based in the UK were directly involved in the factories in Rana Plaza, it demonstrates that they did not think about the likely consequences of their decisions in the long term, their business relationships with their suppliers, the impact of their operations on the community and

environment, and maintaining a reputation for high standards of business conduct. Section 172 was enacted long before the incident happened. The study confirmed that changes in the industry, which include an increase in monitoring and the imposition of additional requirements on the factories, happened as a result of the Rana Plaza disaster. Hence, it is arguable that the concept of ESV did not make the MNCs in the RMG industry in Bangladesh more socially responsible. It seems that the MNCs were concerned about their reputation; it was the media which played a major role in bringing about change. The majority of the participants in the Owner group seemed to think the media played a negative role, but this was contradicted by the NGO group. Perhaps, the way the incident was covered, which was perceived as negative by the owner group, was what created pressure on the MNCs. It is quite evident that the MNCs became more vigilant and took various initiatives to make their monitoring process more extensive. However, the research discovered that even though the Accord and the Alliance have been quite effective in improving the conditions of the factory, the way the requirements were imposed on the owners might have been unfair. The lack of standardised set of rules was a concern that was raised by a number of owners. A lot of factories were shut down as consequence of the new requirements that were imposed. Even though the MNCs were requiring all these new standards, the owners did not seem to have received much support from them for the fulfilment of the new requirements. It should be noted that Alliance concluded its activity in December 2018.[64] The Accord continued its operations as a Transition Accord until June 2020. Then functions of the local office of the Accord transitioned to the RMG Sustainability Council.[65] This national organisation has been established with equal representation from RMG manufacturers, global apparel companies and trade unions. It is a permanent safety monitoring and compliance body.[66]

The involvement of MNCs

This section seeks to provide insight on the overall involvement and impact of the MNCs in the RMG industry in Bangladesh and explores the need for possible reform based on the data derived from the interviews. The section begins with a discussion on what role the participants believe the MNCs can play in terms of the safety of workers that are employed by their suppliers.

64 Clean Clothes Campaign, International Labor Rights Forum, Maquila Solidarity Network, and Worker Rights Consortium. 'Bangladesh Government's Safety Inspection Agencies: Not Ready to Take Over Accord's Work' (1 April 2019) <https://www.workersrights.org/wp-content/uploads/2019/04/Bangladesh_RCC-report-4-1_3.pdf> accessed 25 June 2020.

65 Accord on Fire and Building Safety in Bangladesh, 'Transition to The RMG Sustainability Council (RSC)' <https://bangladeshaccord.org/updates/2020/06/01/transition-to-the-rmg-sustainability-council-rsc> (1 June 2020) accessed 25 June 2020.

66 Ibid.

Next, it considers the extent of the CSR initiatives and training programmes offered by MNCs. Then, the efficiency of the monitoring processes used by MNCs is discussed. This is followed by the problem of subcontracting or having too many parties in the supply chain. After that, the section reflects on the concepts of fair price and ethical buying. Lastly, the possible impact of holding MNCs liable in their home state for the actions of their suppliers in Bangladesh is explored. It should be noted that since the topics are interrelated, there might be some overlap in the discussions.

Role of MNCs

The participants were asked about the role MNCs play in terms of the safety and security of the workers that work for their suppliers, taking into consideration that sometimes the Bangladeshi government lacks the resources to address such issues or cannot afford to lose foreign investment. It was anticipated that questions on this aspect would shed light on what the parties at the bottom end of the supply chain think the parties at the top of the supply chain can do regarding the safety and security of their workers. This is particularly important because the Bangladeshi government might not have the resources or the incentives to actively monitor these issues. Clearly the government has failed to monitor these issues sufficiently and effectively before, because maybe if they had taken the proper measures, Rana Plaza could have been prevented. Taking this into consideration, the role of MNCs in this regard might be even more important. Furthermore, if the participants believed that MNCs can take a more active role, this would show the need for reform in this area.

According to a number of the participants, the MNCs can play a role in ensuring a safe working environment for the workers if they are willing to offer a fair price for the products. Owner 2 thought that they have to begin with fair pricing first. He mentioned that right now everything was very transparent because of the monitoring systems in place. He could not really do anything without informing the MNCs. This includes the process of pricing. According to him, the MNCs could tell the owners that this was their cost, and they wanted two cents built in the cost for the employees' benefit and other aspects. However, at the moment they were already "squeezing" him on what he had left and asking him to fulfil all these other conditions. He believed it was not fair. This was supported by Owner 9 when he commented:

> Well, they need to increase the prices obviously, of the FOB, what they are paying us. Because every year we need to go to them and what they do, they reduce the prices. And they expect us to increase the efficiency. My efficiency can increase every year up to 5 to 6 per cent but the reduction comes to 10 to 12 per cent at times. But also, there are some clients who really don't focus on price, they focus on quality. So that also puts a pressure on us. I am investing on quality; I am investing on human resource.

Owner 14 agreed with these arguments. He thought the MNCs could definitely play a role, but he was not sure whether they were doing so. After Rana Plaza, some MNCs said that they would assist in the remediation process. For example, if some of the factories could not cope financially, the MNCs said that they would provide support. However, in his opinion, that never happened. He felt that at the end of the day everything depended on money. If the MNCs offered a very low price, that supplier would not have a lot of scope to do something regarding social compliance. So, in that case, the MNCs should increase their contribution margins. He added that if the MNCs believed that the increase in the contribution margin would not be used for what they were asking, they could certainly monitor that. The MNCs could give the suppliers certain targets that had to be met on the basis of the increase in the contribution margin.

Owner 11 remarked that in comparison to the profits the MNCs make, in his experience, he had not seen them make any contribution for the workers. Owner 16 also suggested that if the MNCs wanted to, they could contribute a lot more. He thought that they were getting the benefit from the country but were not paying the proper price for their workers. They wanted shipments on time, good-quality products and adherence to all the compliance issues, but did not provide any financial support. He went as far as saying some of the MNCs could assist by offering loans to the manufacturers with whom they have long-term business relationships with, and there could be an internal agreement that this amount would be adjusted from the payments. However, they were not doing this.

Interestingly, two participants from the NGO group made similar remarks regarding price. NGO 4 stated that it was possible for the MNCs to play a significant role. She said that they also exploited the workers like the owners do in Bangladesh, and also kept the owners under a lot of pressure. In a sense, it was double exploitation. The owners always lost out to the MNCs when it came to negotiating prices. Similar views were expressed by NGO 3 when she said:

> Since the multinationals are getting the big piece of the pie, which is more than 60 per cent, they do have a responsibility. Why are they coming to Bangladesh? Because of the cheap labour. They are not coming here to help us… It should be ensured that multinational companies pay a fair price and do ethical business. Because there will be exploitation if their way of doing business is unfair… But the workers are always the ones who suffer… Consumers are getting products on sale. When I go to Europe or America and I see buy one get one free … but nothing is free in this world. Somebody has to pay. Who is that? Our workers. They are paying the price for this behind the scenes. They are giving their blood and sweat. The multinational companies do not do fair business. They decrease the price after placing one order… But they are asking that the workers' requirements be fulfilled. They are asking for higher standards. So, this means that they are not doing fair business.
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> [Translation]

Some of the participants felt that the MNCs were playing a role in ensuring the safety of the workers through their monitoring systems. Owner 3 mentioned that the MNCs had monitoring systems and the owners were trying to cope with international standards. He admitted that there were still shortcomings, but they were trying to do better. Owner 4 stated:

> It varies from the company to company. But they [major brands] have a guideline. Before placing the order also, they have an evaluation process, as per their code of conduct. And accordingly, if the factory improved according to their code of conduct, only then they start placing the orders. And naturally they have to follow the law of the land as well as international best practices. So, all the brands, these things are being maintained very carefully.

Owner 19 elaborated further on the various audits conducted by the MNCs such as environment audits, safety audits and compliance audits. Owners 10 and 15 suggested that MNCs were playing a significant role now, and talked specifically about the creation of the Accord and the Alliance to ensure that these aspects are monitored properly. Owner 10 stated that the MNCs were playing a major role because of the collapse of Rana Plaza and the Tazreen fire:

> Then buyers became more concerned about this safety and security, what we call LFS, life and fire safety. And now they, the buyers, are gone so deep regarding these issues that they formed two bodies of their association. One is the Accord and another is Alliance. Through those bodies they are investigating all garments [suppliers] working for Europe and USA. They are improving building structure and structural pattern also, fire system, fire safety arrangement and many other things. Compliance is a big subject. As well as the privileges, facilities, legal rights of the worker, these issues are there. In a lot of the cases, they have also stopped buying from certain factories if they have not complied with the rules.

Owner 15 explained further and mentioned that the MNCs are actually exceeding their limits:

> They are playing a significant role actually. The recent development is the introduction of Accord and Alliance. Even before the Accord and Alliance, they were doing the audits and checking the working hours and the health and safety issues. And for the last three years, it has been very stringent. In some cases, I would say that they exceed the limit that they should do or be, the mandate that they have. They bring new things that we were not aware of or that we were not practicing. So, they have a significant role I would say.

However, NGO 6 made a slightly different comment on this aspect. She thought it is also a question of whether everything is actually being disclosed to

the buyers. She recognised the importance of the MNCs in bringing about change after the Rana Plaza factory disaster. Nonetheless, she still felt that there is a need for more transparency. The MNCs need to monitor whether the safety measures are being implemented in the whole supply chain, which includes the factories to which their orders are subcontracted. There would be more development if that happened.

Two of the participants, NGOs 2 and 5, mentioned that ensuring the safety of the workers can be achieved by monitoring from the MNCs, but it also requires that the owners have good intentions. NGO 5 suggested that the MNCs and the owners have to be addressed together. NGO 2 claimed:

> They can play a big role. This is a matter of both their role and the honest intentions of the owners. We are a little opportunistic. We [referring to owners in Bangladesh] try to look for loopholes in the law but we do not think it is inhumane. So we try to get away with using the loopholes. So if I have honest intentions that if my workers are well, my production will be good, and if my production is good, I can maximise my profits. But if my workers are not well and their mental condition is not well, then my factory will not work properly, and my production will not be good. So this depends on, first of all there are some conditions of the buyers, so if the buyers want, they can do a lot of things. A lot has been done because they have forced it, because the buyer's organisations, Accord and Alliance, have forced it. Other than that, the owners also had honest intentions, the owners' association had honest intentions. Otherwise, there would not have been such change … The buyers definitely have a responsibility. This is a matter of them enforcing it. Simultaneously, the owners having good intentions are a big issue as well. If the owners do not have good intentions, then they will violate the rules …"
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> [Translation]

Lastly, NGO 7 also contended that the MNCs can play a major role, and the maximum improvements made in the RMG industry in Bangladesh have happened because of pressure from the MNCs. Nonetheless, the business interest always remains very important. He mentioned that is why the MNCs are also more comfortable in working with factories which do not have unions. They think that their production could be disrupted if there is a union. They do not say outright that they do not accept unions, but they also do not tell the owners to permit the formation of unions.

CSR initiatives by MNCs

A lot of the MNCs flaunt their CSR efforts in developing countries. This was demonstrated by the results of the study on corporate documents in the previous chapter. The participants were specifically asked about the effectiveness and scope of the CSR initiatives taken by MNCs in developing countries. It was hoped

that the responses would demonstrate whether the concept of ESV has promoted or assisted CSR because if the MNCs originating in the UK have taken more initiatives in the last ten years than they used to do before, then the ESV principle might have had an impact.

The study found that there were not many CSR initiatives by MNCs in the RMG industry in Bangladesh. Out of the 26 participants, only three of them, all of whom were owners, mentioned that there many CSR initiatives by MNCS. Owner 1 talked about MNCs supplying machinery to colleges, donating to hospitals and schools and providing expertise to train mid-level managers in the factories. Owner 4 also mentioned that there are some projects and training programmes to which the MNCs contribute. In addition, Owner 15 referred to a programme initiated by an MNC to employ people with disabilities in factories. Under this programme, he has 65 employees with disabilities working in his factory. These comments also indicate a good understanding of the concept of CSR, as the participants seemed to understand that CSR is more than just philanthropic responsibilities.

However, the vast majority of the participants asserted that the MNCs do not really have any CSR initiatives, and even if they do, they are not extensive at all. Six owners mentioned that the MNCs do not have any CSR initiatives in the RMG industry in Bangladesh, or what they do in the name of CSR is very trivial. Owner 2 mentioned that the personnel who handle the pricing and the personnel who are engaged in maintaining CSR are very different groups of people. He suggested that the MNCs need to be questioned on what percentage of their turnover they spend on CSR. They need to be asked what percentage of the profits made from Bangladesh was spent on CSR initiatives in Bangladesh. Owner 5 claimed: "In Bangladesh, in terms of CSR activities, it falls short of what we expect from the buyers. As far as I know, they're not making any mentionable or remarkable contribution to CSR activities here." [Translation]

Owner 13 added that even though the owners might want to help the workers and take care of their health and wellbeing, all of these endeavours will involve costs. They expected that they would be able to get that amount from the contribution margin, but they were not able to.

Twelve participants, including six participants from the owner group and six from the NGO group, mentioned that even though they were aware of CSR initiatives by MNCs, these initiatives were limited. Owner 18 made an insightful observation:

> You see, corporate social responsibility is something which you can look at from two aspects. One is to genuinely do something. And to make sure that you're uplifting the life standard of someone by doing something. You are helping someone by doing so. Or you can do it for the sake of doing it so that you can put in your annual report.

The comments made by the majority of the participants seem to reflect that whatever the MNCs were doing, it was to put it in their annual reports. For

example, Owner 6 mentioned that it was done mostly for show, and the programmes in place were not very effective. Owner 16 added:

> Actually what they're saying, it's very nominal. They are doing this for their benefit. So for example they will conduct a seminar on worker safety one day. What will be the result of just conducting one seminar? Nothing. It is just eye-wash … There are 700 factories in Chittagong. So even if I bring two people from the HR department of every factory, it is 1,400 people. I have to bring 1,400 people from my mid-management. I'll bring them. But is it possible to give guidelines to all these 1,400 people about fire safety, electrical safety, social compliance in one day? They have to come with a long-term thinking, not short-term.

Similar views were shared by some of the participants in the NGO group. NGO 1 stated that such initiatives were quite infrequent and definitely not enough. NGO 2 stated further:

> "By frequent, I mean, if all the buyers of multinational companies took such CSR initiatives, then it would have been a big help for us. Not all the multinational companies take such CSR initiatives. If all the multinational companies ensured that they were engaging in CSR activities, then a lot of work would have been done. As far as I know, there might be some that I don't know about, but not all the multinational companies are taking CSR initiatives. If all of them took such initiatives, then a lot of work would have been done."
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> [Translation]

Taking the argument even further, NGO 3 stated that these MNCs are making profits from Bangladesh while the countries that they are based in are assisting Bangladesh by providing aid. In a way, this is problematic. She said that she does not want aid. She does not want charity. She wants a fair price and what is rightfully hers. Among the remaining five participants, two were not willing to give a clear answer and three said that they did not really know much about the topic. Finally, some of the owners also mentioned that they invest in such initiatives on their own and without any support from the MNCs. For example, Owner 9 discussed investment by his company in a hospital that provided free healthcare for the workers. Owner 11 also mentioned that his company has allocated some funds for providing scholarships to the workers' children and paying for their textbooks.

Training offered by MNCs

There were mixed responses from the interviewees on whether the MNCs provided any sort of training on issues such as workplace safety and workers' rights, but 13 participants clearly stated that they were aware of training

programmes arranged by the MNCs. Owner 1 discussed training sessions on women's empowerment, health and safety issues and quality issues. In particular, the MNCs are likely to offer programmes like this if there is a continuous order from a factory. These programmes are voluntary. If the factory is selected, they have the option to accept or decline. Owner 15 also mentioned that there are many training programmes on the improvement of production, chemical handling, environment handling and human resource management. However, NGO 3 questioned the effectiveness of the training programmes offered to the workers by stating that these programmes are of no use if the workers do not get proper wages and their livelihood is not changed. The advice given in certain programmes is of no use as the workers do not have the means to implement it in their lives.

On the other hand, eight participants stated very clearly that the MNCs did not provide any such training. Owner 7 mentioned that the owners and BGMEA are providing these training programmes. Owner 8, whose factory is currently in transition, mentioned that the company used to hire professionals to provide training on various issues. Owner 12 added that he would welcome assistance from the MNCs, and made the following comment when asked about training programmes offered by MNCs:

> Everything is on us. They should also provide some kind of training. They should also provide us technical advice. You know, we are the third world country. They are the first world country. They should have these kinds of facilities. These are the things that I don't think they even care … They basically come and hunt for orders. They place the orders, whatever the cheapest price they can get, they place the orders and they put them in line and get away. They get the agents to look after it, agents mean QCs.[67] But actually what we require from them, the safety requirement we want to share with them. Because the factory is, maybe I am the owner, but the maximum amount of fabrics and accessories are worth millions of dollars … They also have some responsibilities, they have their products lying in my factory. They have to have the equal rights to the safety measures. But usually they don't get involved with that. I also had an argument with them. I wanted them to come and stay. I wanted them to come and share these things with us. It is always going to be better for us to, you know, take the decision together, buyer and seller.

Monitoring and auditing by MNCs

The study revealed that for the most part, monitoring processes currently put in place by the MNCs were quite extensive and thorough. The majority of the participants believed that the audits were effective as well. A lot of this progress can be attributed to the Accord and the Alliance, as discussed above.

67 Refers to the quality control team.

Owner 1 revealed that the MNCs check everything, starting from building safety to whether the laws of the land are being complied with, before placing orders. Sometimes the MNCs conduct audits through their own representatives and sometimes they hire a third party. They also continue the monitoring process after placing the orders. Owner 18 explained the different types of audits that are conducted when attempting to engage a new MNC. When they want to do business with a prospective buyer, the buyer will visit the factory. There are three audits. The technical audit covers the technical aspects of the factory such as electrical safety, the types of machines being used and whether they are able to make the type of products that the buyers want. Then there is the compliance audit for which every buyer has specific requirements regarding the kind of standards they expect to follow when they start working with the factory. So, the buyers check whether the standards of the supplier meet their requirements or not. The third part is basically to do with building safety, which is handled by the Accord and the Alliance. Only if everything goes well will they start doing development work for the product. Ultimately, if a price can be agreed on and everything else is fine, they will begin production.

Owner 2 also mentioned that the audits are very tedious and extensive, and since he has many clients, his factory is audited three to five times a month. The MNCs that he works with hires third parties to conduct the audits, but he is the one who has to pay for them. Owner 5 also confirmed the extensiveness of the monitoring process when he said:

> Nowadays no work is provided without audits. They do audits yearly … Especially now, the audit by Alliance is very tough. So the buyers that are covered by Alliance, if you do not pass their audit, they will not place an order … There are other buyers who are not members of Accord or Alliance, even they do audits. Audits are a very important part … They will ensure everything and then place the order. Compliance is a very big issue. If you cannot maintain compliance, there will be no orders. So my highest priority at the moment is to make sure that all the investments needed to make my factory compliant are made. Compliance is a cost. There is no scope for any compromise in compliance.
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> [Translation]

Corroborating this statement, Owner 9 added that after the Rana Plaza factory disaster, it was very difficult for him to acquire new orders from MNCs he had not worked with before. The MNCs were sceptical about placing orders with companies they had not dealt with before. It used to be much easier to acquire orders from MNCs. Now, for the compliance audit they have to show the MNCs how much progress they have made based on the requirements of the Accord and the Alliance. One of the MNCs even looked into issues such as whether the workers are working on the weekends and whether the wages for overtime are paid properly. They will only place orders if the factory passes all the audits. If there are any structural weaknesses, they will not even think twice

about leaving. Therefore, from his point of view, the process is very thorough. He thought that this has made Bangladesh a benchmark for such standards. He thought that in places like India and China the safety of the worker was at a higher risk and there was a lot more pressure on the workers. Owner 8, whose factory was in transition at the moment, was currently only working with buying houses.[68] His factory was compliant before, but when more requirements were added his factory did not meet the standards. He was working on setting up a factory that was fully compliant and taking orders from buying houses in the meantime. He admitted that the buying houses did not require the same standards as the MNCs.

On the contrary, the comments made by some participants in the NGO group indicated that despite the extensiveness of the auditing process, some problems remained. For example, NGO 1 pointed out:

> Before placing the orders, they check whether the factories are 100 per cent compliant. Which categories are okay and which categories need to be improved, they look at all these aspects. Whether the worker ratio is correct and whether the working environment of the factory is okay. Factory environment and working environment are two separate things. Factory environment means whether it is safe and secure. If there is fire safety, whether there are emergency exits, are there regular training, how the salaries are given, whether the salaries are being paid … Audits are okay, everything is okay but only if the management abides by it. For example, just to get the order, they comply with everything. But later, they fail to do some things. This does not happen a lot, but sometimes these things happen.
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> [Translation]

NGO 3 stated that the MNCs look into some aspects but most of the time they simply believe the documents that the owners provide. So, as long as the paperwork they are provided with is correct, they do not check whether it is authentic. She gave an example of the union committee. The MNCs do not check whether there is active participation from the workers in these committees. The owners can simply make it up in the paperwork, and the MNCS merely put a tick mark on the checklist. She also mentioned that maternity leave is not provided properly, and fake documents are shown for this as well. This point is supported by NGO 7. He mentioned that MNCs are conducting inspections very carefully in all aspects except for workers' participation committees. He stated:

> I am not saying that the inspections that the buyers do are on paper. I am saying only in terms of whether there is a need to form a PC committee in

68 This refers to intermediary institutions through which MNCs place orders to companies in Bangladesh. Buying houses act as a mediator between the MNCs or retailers and the manufacturers.

> the factory. So the management did all the proceedings correctly, showed the votes but you see in reality the actual committee is formed of the people the owners like. It is not a genuine committee elected by the workers … Then they conduct meetings monthly or once in three months, take pictures of it, put them in an album and show it to the buyers. In these aspects, the buyers do not really ask about it, but in all other aspects buyers are conducting inspections very carefully.
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> [Translation]

NGO 4 shed light on another problem. She mentioned that workers are being deprived of their rights when the Accord and the Alliance are shutting down factories or the factories are shifting somewhere else. The workers are entitled to a certain amount of compensation if they are terminated. However, some of the factory owners fail to provide this amount. They simply show the letters from the Accord and the Alliance and use them as a loophole to avoid paying the workers. Finally, NGO 6 highlighted the problems associated with factories where orders are subcontracted: "What they do is they don't visit the sub-contracted factories. They only visit the place of the main order. Maybe in places where they have long-term relationships, they might even overlook certain things." [Translation]

Subcontracting

Following on from the previous section, there were contrasting responses from the participants in terms of the current situation regarding subcontracting orders to other factories. The majority of the owners and one participant from the NGO group confirmed that this practice has been reduced, and even when orders were subcontracted, they were given only to compliant factories. Owner 1 mentioned that they do not subcontract orders[69] to other factories anymore, and for the last two or three years they have done everything in-house. This was mainly to ensure the quality of the products. Nonetheless, he disclosed that it was possible to subcontract orders if there was no objection from the MNCs, but in that case the MNCs would conduct audits.

A greater number of the owners disclosed that they subcontract orders only to compliant factories. In referring to orders procured through intermediaries, buying houses or importers, Owner 4 stated:

> You see, in Bangladesh, how our garment sector is running, some factories are directly doing orders for the brands. Other than the brands, importers are also buying from different countries. These importers are actually liable to the brands. When the importers are buying the goods, so at that time, the factory is allowed to give the subcontract. But in that case also, that subcontracted factory must be approved by the buyer. Without buyer's

69 Owners 2, 3 and 18 also claimed that they do not subcontract orders.

> approval if anybody gives subcontract, they can make this order null and void. So this is followed strictly. But … maybe within the year there will be no subcontract business. Big brands already imposed very strict restrictions on that. Even if the same owner has got five factories and five factories are approved by [mentions UK High Street retailer X], even then if A factory got the order, without X's approval they cannot place the order to B factory.

According to Owner 5, about 20 per cent of the orders he received were directly from the MNCs and about 80 per cent were through intermediaries or buying houses. These intermediaries procured the orders themselves and placed them with him. If he could not cope with the size of the order, then he subcontracted it to a compliant factory. According to him, there was no scope for placing an order to a factory that was not compliant, as he could not subcontract it without the consent of the MNCs. Likewise, Owner 7 stated that he subcontracted orders to other factories, but those factories were also monitored by the MNCs he receives the orders from. Owners 10, 11 and 15 made similar remarks. Owner 19 also thought that the MNCs were quite vigilant about whether their orders were being placed to factories that were compliant. Confirming these accounts, Owner 13 claimed that the factories to which he subcontracted orders were also audited by the Accord and the Alliance. NGO 2 corroborated these claims in his account. A statement made by Owner 12 confirmed that those factories were checked by the MNCs, but he also revealed that those factories might not be fully compliant:

> We do subcontracting to the factory that has a little bit of compliance, that has decent amount of, a decent looking factory. And mainly to the person I am giving it to. It is mainly depending on the person I am giving it to. Whether he is there in the factory or he is not in the factory. Or he has got a well-planned manager, production manager, you know, GM, a good supervisor or night supervisor or chief supervisor. These are the key things of placing an order. Because these are the people who are going to work practically in front of the machines. So, like that we do subcontracting.

When asked whether the MNCs ensured if these factories were compliant, he responded:

> Yes, certainly. And before I pay any subcontract or before I give any subcontract to any other supplier or any other factory, I have to ask them and I have to get permission from them. If anything goes wrong, the blame is going to come to me. So we also have to ask the buyer, also have the representative go and check that factory out. And then eventually they agree …

Furthermore, while commenting on subcontracting, Owner 16 said:

> Actually the factories that are under Accord and Alliance, our target is to finish it by 2017. The government's target is 31st June, 2018. Accord and Alliance will not be here anymore. Then ILO, BGMEA and government will look after the issues that Accord and Alliance were looking after. Ultimately, there will not be any subcontracting factories.
>
> [Translation]

Nevertheless, two participants from the owner group and the majority of the participants in the NGO group gave different accounts. Owner 6 revealed that even though most of the time they needed permission from the MNCs, sometimes the MNCs did not permit it directly but turned a blind eye. Owner 17 also admitted that they rarely subcontracted orders but when they did, they generally did not secure permission from the MNC. NGO 1 commented that the situation regarding subcontracting was much better than it had been before, as a lot of these factories had been shut down. Nevertheless, when she was asked whether the MNCs monitored the factories where their orders were subcontracted, she asserted:

> In some cases the buyers check this but in maximum cases they don't, because I see that the condition of the main contract factory and the subcontracted is different. There are structural differences … So I don't think they look in to it completely.
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> [Translation]

She also added that since these factories received their orders from the main factory, the main factory would keep a share of the profit and then give them the rest. Since these subcontracted factories have to make some profit to sustain them, it was not really possible for the subcontracted factories to maintain really high standards. The statement made by NGO 3 was particularly informative. She explained that subcontracting happened in two ways. One was when the owners received a huge order that they could not fulfil. So, they subcontracted to other factories. After the collapse of Rana Plaza and the Tazreen fire, the MNCs became quite attentive to whether their orders were being subcontracted. However, a lot of business was done through buying houses or outsourced through different agents. So these parties had to make their profit in between the MNCs and the owners in Bangladesh. Hence, these parties could not make that profit if they placed orders with the big factories. What happens is that they place orders with noncompliant factories. Therefore, even though there was pressure on the local owners, the international agents or buying houses were getting away with placing orders in noncompliant factories. This was supported by NGO 4 when she stated in her account that the practice of subcontracting had not really decreased. According to her, there were still numerous small factories, and the result of subcontracting was very unpleasant.

She agreed that the regulations got diluted as a result of having so many parties in the supply chain. In addition, NGO 6 also mentioned that as far as the subcontracted factories were concerned, the focus was on aspects such as production time and quality rather than compliance issues.

Lastly, NGO 7 acknowledged that progress had been made in regard to the practice of subcontracting, but some owners still did it secretly. The MNCs paid a lot more attention to this issue than before, but sometimes they ignored certain things if they had a very good relationship with the owner. When asked about whether the MNCs were aware if their orders are subcontracted, he answered:

> What I think is that those who are at the lower level of the organisation, they know to a certain extent and they do not inform those at the higher level about everything. It can also be the case that because they need the products to be shipped urgently so they give their consent by being silent… We had made a complaint that a non-compliant factory was stocking an MNC's production and that order was shipped. There was a level in the factory that was producing the MNC's products. This was a big brand. They accepted it and said that they could not stop it completely right away and they will stop this gradually. So this means that they also consented to a certain extent.
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> [Translation]

Fair price and ethical buying

The concepts of fair price and ethical buying have been hinted at in the previous sections. As these concepts are very significant to demonstrate whether the MNCs are socially responsible, this section specifically addresses the two concepts. Among the owner group, Owners 2, 6, 13, 14 and 15 clearly claimed that they were not getting a fair price, and Owners 8, 9, 10 and 11 expressed the same sentiments without using the term 'fair price'. Owner 2 expressed his frustration in his contribution. He stated that the only reason the MNCs were buying from him was because he was competitive, and they could get a cheaper price. He thought that if he increased the prices slightly, he would lose business. He added that today everything was very transparent in terms of costing. The MNCs were already aware of his profit margin, so they should not ask him to make the products for free. On one hand they ask for cheaper products and more efficiency, but on the other hand they ask for numerous improvements in the factories. This was further highlighted by Owner 14 when he mentioned that the MNCs were definitely not paying a fair price. The MNCs were always giving examples of the availability of cheaper products in other countries, but he doubted whether that was true. To him, the prices that were offered now were simply not sufficient, so many or most of the owners did not really have the opportunity to go beyond running the factory and do much for social compliance. Owner 8 thought that the MNCs were making conflicting demands. They wanted more to be done for the workers, but they demanded cheaper prices.

According to Owner 12, after the collapse of Rana Plaza some of the MNCs made commitments that they would offer support and better prices than what they offered before, when owners improved their factories to a certain standard. He admitted that some of the MNCs were helping, but these were not significant in number. He revealed that what was sold last year for ten dollars now has to be sold for nine dollars.

Owner 10 even claimed that the MNCs were taking advantage of the situation Bangladesh was in after the collapse of Rana Plaza and were reducing the prices even more. The situation now was very different from what it was before. Their expenses had increased a lot, but the prices were being reduced. He elaborated:

> Now you are asking me for the good product, healthy environment and more salary but you are reducing my price. Because they are taking chance like a real capitalist that this country is in awkward situation due to fire and other situation, compliance issues, so let us press them, exploit them. Every buyer has reduced their price. Here, they are not only not transparent, they are irresponsible also. On the one hand, they are asking us to increase our cost. And we have to increase our cost because we are employing hundreds and thousands of people here. Their safety is our primary duty in ethical standard, in legal form, both ways.

Corroborating these accounts, Owner 11 said:

> Actually when we started the business, every year I saw one thing, they reduce the price. When we come, when we visit for the meeting, from the buyer, the first thing, first comment was how much we are offering. This year we are going to reduce 20 per cent, 10 per cent, 5 per cent, whatever. It was the starting of the meeting. So, in my life, I never saw the prices increase. Always, I saw the decrease. Always. But now, the situation is very bad. Because in terms of investment, the bank interest, the production cost and the buyer's price, it doesn't match. But we are thinking that this is a buyer's market. This is not a seller's market. We hope that if we can develop our total sector in Bangladesh, once it will become a seller's market, then we will bargain on this.

Surprisingly, as well as the owners, NGOs 1 and 4 also mentioned the pressure from the MNCs to reduce the prices. Commenting on this, NGO 1 also said that MNCs were hesitant to increase the price even by one cent.

Accountability of MNCs

The participants were questioned on whether there is a need to hold MNCs liable in their home states, where the regulations are much stronger, and the legal systems are far more efficient. It was anticipated that the answers to these

questions might highlight a need for change. Also, if holding the MNCs accountable in their home states would be beneficial, then perhaps the ESV principle could be reformed or changed to achieve that. An overwhelming majority of the participants believed that it would be beneficial if the MNCs could be held accountable in their home states for any legal breaches. Before discussing the various responses, it is worth mentioning that the idea seemed very novel to a number of the participants. The question had to be explained further using examples.

Out of the 26 participants, 17 participants clearly agreed that the MNCs should be held liable in their home states. This included 11 owners and 6 NGOs. Owner 2 claimed that he did not want them to be held responsible in Bangladesh because they could get away with murder there. He wanted the MNCs to be held liable in their own countries. This was supported by Owner 4 when he mentioned that it would be fair if the MNCs shared the responsibility as the factories were manufacturing their products. In his response, when asked if the MNCs should be held liable in their home state, Owner 5 stated that they should be held liable. His customers, or the MNCs, had benefitted from doing business with him for many years and made a lot of profit. However, in troubled times he would not get any support from them, and that should not be the case. Owner 8 also supported this idea but was worried that if the MNCs were held liable for the actions of their suppliers in Bangladesh they might stop placing orders there and place them in other countries. When it was clarified that the question concerned whether they should be held liable in their home state for the actions of their suppliers anywhere in the world, his response was positive.

Moreover, Owner 14 asserted that the MNCs should be held liable in their home states, and he would also encourage them to take a more active role. Yet, he expressed his concern:

> Yes, but again, again, when you are talking about business, if, I don't know, if we make all state-of-the-art factories, everything comes with a cost. So, if we make everything state-of-the-art, or to certain level, the level where we can compete as far as the safety matters are concerned, we took the factories up to that level, the industry up to that level. And then, because of that, the prices have gone up. Then, people are now going to Africa. And I doubt how much compliant factory they will have in Africa. And if they get cheaper garments from there, they will buy it from there. Overall perspective, if we are not competitive anymore by doing, by upgrading the factories, to certain level to meet their safety requirement. Not only safety, so many CSR issues, and then there is no work, I really don't understand. I don't know how to proceed further.

As mentioned above, the majority of participants in the NGO group also thought it would be helpful to hold the MNCs accountable. NGO 1 said that the impact would be good. She also pointed out that taking an active role was

not enough. The MNCs had to be supportive in making arrangements for implementation as well. She gave the following example:

> For example, I have an exit that is six feet long. You are telling me to make it 12 feet. To do that I will need space, or if I have to assign a certain space for that, it will decrease my space for something else … To do so, my expenses will increase from 50 taka to 100 taka. Where will that come from? So they need to think about it.
>
> [Translation]

Furthermore, when she was asked whether she was trying to say that the MNCs did not think about it, she confirmed that they did not. They are not willing to increase the production cost even by one cent.

Similar remarks were made by NGO 6:

> So if it is happening here, they are placing the order in Bangladesh. They usually place the orders after visiting the factories, checking everything and reviewing their policies. They always have a close supervision or monitoring to see if all these things are being maintained properly. So … if an accident happens, they should also be liable to a certain extent because they should have also looked at it … If this factory was set up in their home country, then they wouldn't be able to use these products. The production cost will increase by 100 or 200 times. So this sort of mentality is needed for a win-win situation, to reach a middle point in terms of profit.
>
> [Translation]

NGO 4 agreed that it would help and mentioned that the MNCs would not stop placing orders in Bangladesh as they were getting them at such cheap prices. She then continued to elaborate on the problem of low wages and the suffering of the workers. She thought that workers were dying in two ways. One was through the accidents in the factories. Another was because of the illnesses caused by the excessive workload. She went on to give an example:

> I went to Europe … I discussed garments. They were talking about the chemicals that are used for jeans and the impact on the environment. I couldn't explain to them that someone who is starving will not think about the environment. Now we are talking about the environment, but in a very minimal capacity … They showed us some clothes from [mentions an international retailer] and said that there is some smell coming from these clothes … So, think about the condition of workers who actually manufactured those clothes. But the situation is, someone who doesn't have enough to eat is not thinking about the diseases he might be acquiring. Even though it should be thought about, it is not happening."
>
> [Translation]

Three of the owners thought that maybe the MNCs should be held accountable, but the responses were uncertain and not very definitive. For example, Owner 13 gave the following response:

> If something goes wrong because of the price, then definitely the buyer should be held responsible. If fair price is given, or almost fair price is given, in Bangladesh nobody is giving fair price, but still whatever they are giving, say, survivable price, I am not saying fair price but survivable price, if it is a survivable price and the factories do something wrong, then definitely factory has to be responsible.

Owner 18 explained that there were different levels of businesses that placed orders in Bangladesh. There were MNCs, and there were some importers, wholesalers, etc. There were also different levels of factories in Bangladesh. He said that an importer could not buy products from his company because it would be too expensive for the importer. So, these importers and wholesalers sought out the smaller factories that were not that compliant. He thought that the bigger brands would not place orders with these factories. So, he said that not all the businesses should be held responsible, but the big ones definitely had a responsibility to buy ethically.

Nevertheless, there were three owners who thought that the MNCs should not be held liable for the actions of their suppliers. Owner 1 said that it was his responsibility to maintain the standards in his factory. The MNCs should be not responsible for the actions of their suppliers in Bangladesh. He wanted the MNCs to monitor the factories and offer fair prices. When asked why he thought the MNCs should not be held liable, Owner 15 explained that it was not always possible to keep track of everything because of so many parties in the supply chain. He said:

> See, the supply chain, the customer, the buyer will give you the order and the production that is taking place in Bangladesh, in between, there are a lot of stages. Lots of departments are working. So, the person who is giving you the order should not be, cannot be held responsible … Because if you have got too many agents, you cannot keep track of it. And once the prices become less, so does the intention of going to cheaper factories, noncompliant factories come up.

Owner 19 simply thought it would not be workable. He believed it was more important to establish trust between the MNCs and the owners. It would be more helpful if they could come to a position where everyone was in a win-win situation. Finally, four participants, including three owners and one NGO, did not provide or did not want to provide a clear answer.

Summary and reflection

The study revealed that the CSR initiatives of MNCs in the RMG industry in Bangladesh are quite inadequate. This might even be indicative of the limited impact, if any at all, of the concept of ESV on CSR in an international context. Even though the monitoring processes of the MNCs, implemented directly or through the Accord and the Alliance, are quite extensive, there is evidence that there are still deficiencies. For example, in cases where orders are placed through intermediaries or buying houses and are subcontracted to other factories, the same standards are not always maintained. Additionally, the comments made by a significant number of the participants show that the MNCs do not have an ethical buying practice. Conflicting demands are made when, on the one hand, the MNCs are imposing stricter regulations which require a lot of investment from the owners, and on the other hand they are reducing the prices that they are paying. It was even claimed that the MNCs are taking advantage of the reputation of the RMG industry in Bangladesh after the Rana Plaza factory disaster. Again, this indicates that the ESV principle did not have much of an impact on the CSR practices of MNCs that originate in the UK and operate in the RMG industry in Bangladesh.

It should be noted, however, that this is not representative of all the MNCs. There are some MNCs that are ethical in the way they conduct business. They are providing training programmes and other forms of support to assist their suppliers. Some are investing in CSR initiatives. However, the number of MNCs in this category seems to be low. Also, each MNC can have both positive and negative aspects. Nonetheless, the findings suggest that there is a need for reform in this area. Lastly, a considerable number of the participants thought it would be helpful if the MNCs could be held accountable in their home state for the actions of their suppliers in Bangladesh.

Other factors

In addition to the impact of the MNCs and their operations, along with the impact of the collapse of Rana Plaza, there are a number of other factors that potentially have an effect on the workplace safety and the rights of workers in the RMG industry in Bangladesh. In this section, consideration will be given to three factors: the role of the Bangladeshi government, the attitude of the owners in the industry, and the influence of multilateral organisations.

Role of the government

The comments made on whether the Bangladeshi government addresses human rights issues in this industry were contradictory. In particular, there was noticeable contrast in what was claimed by the owners and what was suggested by the NGOs. The majority of the owners seemed to think the government

was playing a positive role, and thought the employment laws were properly implemented, but most of the participants in the NGO group disagreed.

According to Owner 1, the role of the government was to implement laws, and the government was doing a good job. Owner 3 mentioned that after the collapse of Rana Plaza the government was monitoring everything as well, and agreed that human rights issues were being addressed properly through employment laws. It was confirmed by Owner 4 that the government had increased the capacity for the monitoring of factories after the Rana Plaza factory disaster.

Likewise, Owner 5 also mentioned that the government was quite careful and concerned about protecting human rights, and agreed that the current employment laws were adequate. These accounts were further supported by remarks made by Owner 11:

> Whatever happened in past, after Rana Plaza disaster, the government has took very good initiative, very serious initiative. The government has zero tolerance on this issue, basically safety issue, basically salary issue. The government has a special team to follow up on this thing. Every day they follow up. They have a labour team, labour department. They have a commerce department. They have an industry department. And they have a law enforcement department. They work together. Whenever there is any kind of festival, the government, within one or two month, they give us notice to pay the salary before the festival … The government also had a committee with ILO, BGMEA, and Ministry of Commerce, Ministry of Health, Ministry of Labour and Ministry of Finance. So, there is a committee, those who monitor regularly. And every month we had a meeting with this committee. So, government is very much serious about this. Government does not allow any kind of irregularities, any kind of unsafe, unhealthy practices, never. So, we are also facing big pressure from the government.

Nevertheless, Owner 2 admitted that even though the rights of the workers were well-protected in most of the factories, there might be deficiencies in a very small number of factories. In giving a slightly different response, Owner 15 stated:

> The implementation phases are being checked more than the government by the brands. We need to show them how much working hour we have, how much hour we have worked in the last month or last week, certain period. They do the periodical audits. Sometimes if we have, if the factory has violated, the factory has worked more, the factory has to give them a remediation plan. That they will reduce it and how they will reduce. They have to give a plan and it's been monitored. So, I would say that all these things are monitored by the brands more than the government.

NGO 2 was the only participant from the NGO group whose account matched the information provided by the owners. He also thought that after Rana Plaza and the Tazreen fire, the government had hired many factory inspectors to monitor these issues. The situation was much better than what it used to be. In regard to implementation of laws, he said that there might be some minor deficiencies, but in general there had been considerable improvement.

In contrast to the contributions of the owners, NGO 1 commented that the laws were not always implemented properly. She gave the example of not allowing the formation of workers' committees. NGO 3 pointed out the problem of corruption in Bangladesh. She added that the labour laws were not being implemented properly. In order to bring change, they needed to be enforced throughout the supply chain. The problem of corruption in the system was also hinted at by NGO 7:

> I think they should be able to do it, 100 per cent. But because of the tendency of the employees, who are responsible for this, to be biased towards some people, the process required to fix it is not followed … Suppose I am a poor worker who has made a complaint against a big factory owner. Even if a proper enquiry is made against the owner, if the owner group can influence that employee or provide someone else's reference to influence them, they dispose the matter in other ways. We have seen this happen in a lot of places. So, if they want to, they can follow the procedures strictly. Even though those at the top level of the government have the right mentality, there are many shortcomings and weaknesses at the lower level. As a result, our workers are very far away from getting justice.
>
> [Translation]

He added that he was not satisfied with the enforcement of the labour laws. In NGO 4's contribution, she explained that if the government could have ensured the safety and security of the workers, then intervention from outside organisations would not have been necessary. This was in reference to the Accord and the Alliance. According to her, the government favoured the owners and gave them all the incentives. Rana Plaza and Tazreen were shining examples of the laws not being implemented properly.

Attitude of the owners

As might be expected, the majority of the owners denied that their focus was solely on profits, although some of them admitted that it was the end goal. Conversely, it was rather surprising when some of them expressed the importance of considering stakeholder interests in order to make profits. Owner 1 accepted that the main reason to do business was to generate profits. He mentioned he started with 300 workers and now he employs 27,000 workers. This would not have happened if he did not treat them properly and if he had

failed to maintain the proper standards in his factories. He claimed his main goal was to keep his workers happy and maintain the standards in his factories. Owner 3 also revealed that he should only think about making profits after ensuring everything else. He confessed that there were some owners who were unethical, but the majority of the owners in Bangladesh were fair. Owners 14 and 15 highlighted this further. Owner 15 stated:

> If some, I agree. If you say some of the factory owners I agree. But if you look at the industry, I would say that our industry is much more matured, much more sustainable nowadays. The way the industry is growing which is in a sustainable manner and that is very much commendable. The good practices of the international, the good practices are being followed. So the basic statement that we only work for profit is incorrect. But if you talk about one, two, three or five factories, of course. I would say, the majority is, the idea is that sustainability is very important. Of course, profit is the primary concern but not at the cost of ethical practices.

Furthermore, in Owner 4's elaborate response to the question, he demonstrated a very good understanding of why it was important to think about the long term and stakeholder interests. He said that the owners did not focus solely on profits because if they did, they would not have decided to operate an industry. Someone who chooses to do so knows that it is a long-term project. He also added that currently the profit margins were low due to the investment that the owners have had to make to satisfy the requirements of the Accord and the Alliance. In conclusion, he emphasised the importance of the workers in the RMG industry. He claimed that the owners know very well that this industry cannot run without the workers. The machines would be useless if there were no people behind them. The statement that the owners did not care about the workers was incorrect. Owner 18 also emphasised the importance of thinking in the long term. He said that if he focused only on profits, he would not have invested so much money in making improvements in his factory. It was more important to him that he had a good reputation, long-term relationships with his customers and a sustainable business. He thought that at the end of the day, the workers were the game changers. If he did not treat them properly, he would not have a good workforce. In the end, this would affect his production.

While commenting on the attitude of the owners, Owner 5 explained the various challenges he faced in running his business:

> The factory owners that are there today have to maintain international standards in their factories, but in terms of pricing they are paid according to the standard of Bangladesh. We don't get international prices. But when can I think of profit? When my pricing will be high. Every year if I invest 10 million taka only on compliance issues, which is a new and different issue, and I have to set international standards in my factory, I should have

> also gotten international pricing … In China, the government provides various incentives. The government of Vietnam provides it. The workers' salaries are a bit higher there. So since it is a bit higher there, the government gives them incentives so that they can remain competitive. But I'm not getting those in-house protections to that extent. So how will I maximise profit? I am setting international standards in my factories but I'm not getting international prices, so how will I maximise profit? … After facing so many challenges, a garment factory owner will do business only for making profits? I don't think so. If there was this sort of mentality in Bangladesh, this business could not have grown or flourished. So, I think it is a wrong conception because we have to face many challenges."
>
> [Translation]

Most of the participants in the NGO group contradicted what the owners said, because they felt that the majority of the owners still focused solely on profits, although some of them acknowledged that there were a small number of owners who had a different attitude. NGO 1 mentioned that in many cases the owners still focused their attention purely on profits, but they claimed that they did not make enough profits and they could not achieve much with the payment that they received from the MNCs. NGO 3 commented that all the owners just thought about making profits. This was demonstrated by the returns on their investment in the factories, whereas the living conditions of the workers remained unchanged. Giving an example of this profit-oriented mentality, NGO 4 stated the following:

> Except for one or two owners the majority of the owners focus only on profits … For example, during Eid, we have participated in a lot of protests against factories failing to pay wages during Eid, but they [referring to the owners] have gone to Singapore for holidays. So their luxury has reached at such a level. And because of this overly profit-oriented mentality, a lot of our people are losing their lives … It is why Rana Plaza happened. The workers of Rana Plaza had said the day before the incident that they would not enter, but they were forced to do so. And then the next day, such a big disaster happened. So this is ingrained in the character of the owners. There are two or four owners, who think about the workers and maintain the standards, but they are scarce."
>
> [Translation]

NGOs 5, 6 and 7 also gave similar responses.

NGO 2 was the only participant in the NGO group who gave a different account. Putting forward a more positive response, NGO 2 remarked:

> Actually, someone as a businessman will always want profits but I will not want profits at the cost of my workers' lives. I wouldn't want money that

> has the blood of my workers on it. I think right now the mentality has changed a lot in comparison to what it was before.
>
> [Translation]

Multilateral organisations

When it comes to regulating the operations of MNCs in developing countries, the tendency has been to promote a soft law approach. Companies and countries ratify guidelines and adopt codes of conduct. The participants were asked if they are aware of the UN Guiding Principles on Business and Human Rights and whether they have been effective. It was also inquired whether intervention from multilateral organisations and agencies have any impact. By "multilateral", the author is referring to organisations that obtain their funding from various governments and use that funding to conduct projects in different nations.[70] The majority of the participants were unable to comment in detail on the impact of multilateral organisations and their guidelines. It is submitted that this lack of knowledge suggests that their impact is probably quite limited. Among the various organisations, the ILO seems to play the most prominent role as most of the participants recognised that its presence in Bangladesh was significant. For example, Owner 4 mentioned that the ILO is very active in Bangladesh and is playing a major role in the development of the RMG industry by providing training programmes and finding donors. Owner 5 also discussed the contribution of the ILO along with GIZ (Deutsche Gesellschaft für Internationale Zusammenarbeit):

> ILO plays a good role. Their work involves creating awareness for human rights here. Additionally BGMEA, BGMEA is the association of the owners in Bangladesh. The ILO works jointly with this association. Especially the factories that are under BGMEA, ILO works very closely with these factories. ILO works for improving the workplace environment. GIZ also does some work. Various NGOs also operate. But among them, ILO and GIZ do remarkable work regarding the improvement of workplace environment as well as human rights awareness among the workers. They address these aspects really well. They coordinate with the management as well as the workers. They work mutually with both the groups. I think they help us. We have been benefited by their helping attitude. If we want to set a standard we have to use the experience of an organisation like ILO. So to gain that experience, I think ILO has contributed a lot."
>
> [Translation]

While putting forward a different opinion, Owner 10 asserted that he had not noticed any direct impact of the ILO, but referred to the work done by the European Union. Then again, Owner 14 said:

70 For example, the United Nations.

> Again the one thing comes always. It's the price. What price the customer is offering and at what price we are working here. If that comes into consideration, then all these NGOs, ILO, they have no place there. They do nothing. They are doing nothing being there. They only ask about safety and compliance and legal issues and human rights, fantastic, lovely. But as I said, everything comes with a cost. That has to be given to them first.

NGO 2 pointed out that these organisations were effective because they pressurised the MNCs to respond promptly after what had happened. Finally, NGO 6 made the following remark while referring to international guidelines and policies:

> These are sufficient but we will only be able to implement them properly when the Bangladeshi government will bring it in their policies, rules and regulations and they will make a proper plan for national implementation. If there isn't a strategic plan at national level for implementation, then nothing is possible. There are a lot of policies internationally. Bangladesh becomes a signatory to these but there is a need to integrate these in the national planning. The human rights-based organisations can act as pressure groups to ensure that these are integrated.
>
> [Translation]

To sum up, the interviewees could not provide information on the impact of multilateral organisations and international guidelines in great detail. Perhaps this reflects that, with the exception of the ILO, these organisations and guidelines do not have a significant impact on the industry as a whole.

Summary and reflection

The study revealed that even though according to the owners the government was playing a positive role in addressing human rights issues relevant to the RMG industry, the majority of the NGOs disagreed. Unlike the majority of the owners, they were dissatisfied with the implementation of the law. As anticipated, most of the owners denied that they were only focused on generating profits, but the participants in the NGO group gave contradictory accounts. Nonetheless, some of the owners seemed to understand the importance of giving consideration to stakeholder interests to ensure that their businesses thrive in the long term. However, in light of the responses from the NGOs, it may be argued that the owners made those comments because they have a vested interest. Hence, it is extremely important that the MNCs continue to stay actively involved and continue their monitoring processes. It is also uncertain whether the recent developments that were made after the collapse of Rana Plaza will last as the terms of the Accord and the Alliance have come to an end. As far as the impact of multilateral organisations and international guidelines are concerned, the participants were unable to give detailed

responses as to their effectiveness. This leads the author to contend that, with the exception of the ILO, the impact seems to be trivial.

Current problems in the RMG industry

Only the participants in the NGO group were asked what they thought were the top three problems in the garment industry. The responses were a combination of problems directly associated with the industry itself and other issues which related more to the lives of the workers outside the workplace. Only the responses relating directly to the workplace are considered, as the other issues are not related to the aims of the study.

The study found that one of main problems in the industry was still workplace safety. NGOs 4, 5 and 6 mentioned that the safety of the workers continued to be a matter of concern. NGO 6 made the following remark:

> And if I talk about workplace safety, compliance is not being maintained everywhere. In Chittagong, there are more than 400 garment factories. A lot of them do subcontractor work. We provide health services in a lot of these factories which do subcontractor work. So we see that in those places the way safety measures should be maintained, maybe they do so when someone comes for a visit, but I would not say that it is maintained all the time.
>
> [Translation]

However, as mentioned before, NGO 2 stated in his contribution that the situation was much better in comparison to what it was before.

The study found that another major problem in the industry was the extremely low wages. When asked about the problems in the RMG industry, NGO 4 said:

> The wages in this industry are very low, very low. This industry has reached new heights in the last 30 to 35 years. In that place, I mean, now, in the 80s there was one garment factory called Desh Garments … Now there are more than 5,800 factories. If you calculate the factories that do subcontractor work, it will be even more. So this is such a big industry, but the reason that they have so much work is that they have cheap labour. So there is a lot of exploitation here. So cheap labour, and the quality of the work of Bangladeshi girls is really good. Their handiwork is such … that they can do this sort of sewing work really well. So in comparison to the work that they do, they don't get the wages that they deserve. So this is the number one point.
>
> [Translation]

This assertion was supported by NGO 3 and further highlighted by NGO 7, who stated:

> Actually the first thing that always comes up for our workers is wages. The difference in their wages and what they need to survive in a city, that

> difference is their biggest problem. Right now due to international compliance, the kind of environment the workers have in the factory is very different from the environment they have at home. So for that reason the first thing that we will say is that their wages are very low compared to what they need.
>
> [Translation]

Four out of the seven participants in the NGO group also felt that there was a threat to the freedom of association, or, in other words, the freedom to form trade unions. This concern was raised by NGOs 3, 4, 5 and 7. NGO 3 pointed out that the problems would never be solved if the formation of unions was not permitted in factories. The right to form a union is a fundamental right. The workers have the right to sit at the table and solve their own problems. They have the right to participate in negotiations. People think that the girls who work in these factories are empowered because they have jobs, but they fail to see the other side. These workers live in poverty. They are unable to eat properly. Their children do not get access to proper education. While sharing similar observations, NGO 7 added that the attitude of the owners against the formation of trade unions might be a result of the history of trade union movements in Bangladesh. However, the garment industry was completely different from those institutions. He mentioned that the owners use their power and influence to convince the government that if trade unions were allowed then it would lead to a destructive path. According to him, the government also inclined to side with the owners due to the importance of the RMG industry. Lastly, the participants also mentioned other areas of concern such as the excessive workload on the workers, the absence of proper employment contracts and sexual harassment.

Conclusion

This chapter discussed the methodology and presented the findings of an empirical investigation conducted to examine whether implementing an ESV approach has had or could have any impact on the CSR practices of MNCs that are based in the UK and operate in developing countries. This case study has presented evidence as to what is happening in an industry based in a developing country, with which a number of MNCs based in the UK are involved. The results from this case study could be representative of suppliers in other developing countries.

The study has shown that the ESV principle as implemented through section 172 of the Companies Act 2006 has not had much of an impact on the CSR practices of the MNCs that are based in the UK and are operating in the RMG industry in Bangladesh. First, the Rana Plaza collapse itself, along with the involvement of British companies with those factories, is proof that the MNCs did not think about the consequences of their decisions in the long term, did not consider the need to foster relationships with their suppliers and failed to

maintain a reputation for high standards of business conduct. The MNCs came under a lot of pressure after the incident, which led them to make changes in how they operate. Therefore, the changes were a result of the pressure on MNCs from the media, human rights organisations, their consumers, etc. The concept of ESV did not seem to play a part in this. The monitoring of the factories improved and the owners in the country were forced to make numerous changes to fulfil the new requirements imposed by the MNCs and two organisations, the Accord and the Alliance. Obviously, this required factory owners to make huge investments. The ones who were able to do so survived, but a significant number of factories had to shut down. However, the MNCs did not increase the prices they were offering before the improvements were made.

The owners and even some of the participants in the NGO group claimed that the MNCs did not practice ethical business and failed to offer fair prices. The MNCs were also accused of taking advantage of the vulnerability of the industry after the collapse of the Rana Plaza. The number of CSR initiatives taken by them was limited as well. In addition, despite the extensive monitoring process the study revealed that there are still some deficiencies, especially when orders are placed through intermediaries and buying houses. The issue of subcontracting orders continues to remain a problem as well. There is definitely a need for reform in the way MNCs operate. The results of the study show that the majority of the MNCs operating in the RMG industry in Bangladesh are not socially responsible. The study has also shown that it might be beneficial if MNCs could be held accountable in their home states. The final chapter will reflect further on the results of the two empirical studies presented in Chapter 4 and Chapter 5 and explore suggestions for reform.

6 The scope for reform

Introduction

In the previous chapters, there were discussions on the two main theories of corporate governance along with CSR, the ESV principle, a theoretical analysis of whether ESV promotes or assists CSR including an empirical study on corporate reports, and the methodology and findings of the case study. This chapter draws together the discussions in the previous chapters in order to fulfil the overall objective of this book, which is to assess whether the concept of ESV is capable of promoting or assisting CSR, and to propose suggestions for reform. By combining the outcomes of the doctrinal, theoretical and empirical research considered in the previous chapters, this chapter seeks to provide concluding thoughts on the impact of ESV on CSR and then considers the need for reform in this area. While considering the need for reform in this area, the chapter also provides final thoughts on whether companies in the UK are offered the legal-institutional conditions to support and nurture a purposeful conception of ESV. Some proposals or suggestions for reform that might facilitate the enhancement of the impact of section 172 on stakeholder interests are discussed. It is suggested that the adoption of one or more of these proposals might increase the impact of the section in practice, which will strengthen the position of stakeholders and consequently promote CSR. This is followed by a final conclusion.

Reflections on the impact of ESV on CSR

Before considering whether the concept of ESV is capable of promoting or assisting CSR, it is essential to summarise the reasons why it has been argued that the two concepts are connected. The doctrinal and theoretical research on the concept of CSR and the analysis of the ESV principle demonstrated that the ESV principle as incorporated in section 172 resonates with the concept of CSR. The factors that the directors are obliged to have regard to in section 172 are the same aspects that a company needs to pay attention to in order to be socially responsible. First of all, under section 172 the directors have to think about the consequences of their decisions in the long term. CSR also promotes

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thinking that secures the company's future in the long term and ensures sustainability. Second, the duty requires the directors to take the interests of the employees in account, and considering the interests of its employees, which is a primary stakeholder group, is a crucial part of a company's commitment to CSR. Third, the section highlights the need to foster the company's business relationships with suppliers, customers and others, and to be socially responsible, companies have to be considerate about their impact on their suppliers, customers and other stakeholders. Under the section, the directors have to manage relationships with these stakeholders in a way that reaps benefits for the company in the long run. CSR also acknowledges the importance of these stakeholders to make sure the manner in which a company is operating is sustainable. Moreover, prima facie companies are now being held accountable for the actions of their suppliers, and customers are concerned about the brand image of companies. Fourth, the provision compels directors to have regard to the impact of the company's operations on the community and the environment, and the various definitions of CSR that were discussed earlier in Chapter 2 emphasise the significance of focusing on environmental, social and economic goals at the same time. Lastly, maintaining a reputation for high standards of business conduct is a common element of both section 172 and CSR.

The findings of the empirical study on corporate documents, presented in Chapter 4, also confirmed that there is a clear link between the two concepts. As mentioned earlier in Chapter 4, Kingfisher plc actually mentioned CSR, referring to it as CR, and the duty under section 172 together in its Corporate Responsibility Summary Report 2007/08. It was mentioned in the report that the new Companies Act introduced a requirement for directors to give consideration to social and environmental factors when they make business decisions. It asserted that it enables its directors to meet this requirement through its Corporate Responsibility management processes. These processes outline clear lines of responsibility, starting from the Board level of the holding company all the way down to each of the operating companies. It was also stated that the requirements of the Act on Corporate Responsibility were fulfilled by the inclusion of progress on Corporate Responsibility in the Business Review.[1] The rest of the companies did not connect the two concepts together overtly, but it seemed that all the companies thought that being socially responsible meant giving consideration to the factors and stakeholders mentioned in section 172. The material published on CSR in CSR reports or CSR sections in annual reports was focused on the stakeholders mentioned in section 172, and a number of examples of this were provided in Chapter 4. In particular, the connection was very evident in the manner in which Next plc described what corporate responsibility means as it was very similar to what the ESV principle

1 Corporate Responsibility Summary Report 2007/08, at p. 4, available at: <https://www.kingfisher.com/content/dam/kingfisher/Corporate/Documents/Sustainability/Reports_publications/Archive/Kingfisher%20CR%20Report%2007_08.pdf> last accessed 31 January 2018.

seeks to promote.[2] It seems like that those responsible for the preparation of the statements were actually making sure that the factors mentioned in section 172 were included in the description of corporate responsibility. In light of the findings of this study, it is proposed that there is a clear connection or link between the concepts of ESV and CSR.

Since it has been confirmed by the arguments presented in the previous chapters that there is a link between the concepts of ESV and CSR, it can now be considered whether the concept of ESV is capable of promoting or assisting CSR. This has been done by reflecting on the analysis of the concept of ESV as incorporated in statutes, the results of the previous empirical studies, and the findings of the study on corporate reports. An analysis of section 172 has shown a number of problems that hinder its impact, and consequently it can be contended the section does not go as far as anticipated in protecting the interests of stakeholders and promoting CSR. The lack of any enforcement mechanisms for the stakeholders mentioned in the section is a major difficulty. There is a lot of confusion and lack of any guidance regarding a number of the terms used in the section. 'Success', 'have regard', 'long term' and 'community' are vague terms, and this ambiguity also plays a role in hampering the impact of the section. The positions of the various stakeholders appear to remain the same as they were before the enactment of the section.

The absence in practice of any significant impact on promoting or assisting CSR is also confirmed to a certain extent by the results of previous empirical studies. In the study conducted by Peter Taylor,[3] only around a quarter of the respondents thought that the Act would cause directors to have higher regard for the listed factors. Even though this might suggest that ESV is capable of promoting or assisting CSR in some companies, the majority of the participants gave a negative response. In the larger study commissioned by the BIS,[4] the findings demonstrated there was high level of awareness about the codification of directors' duties in general, the requirement of the Business Review and the specific duty under section 172. Nevertheless, the majority of the participants believed that the changes related to the directors' duties did not affect the way in which directors fulfilled their duties. When the officers of companies that were aware of section 172 were asked if they had an impact on the behaviour of directors, the majority stated that they did not. Even though this indicates that the duty under section 172 did not have a significant impact in practice nor did it bring about the cultural shift desired by many, it is worth mentioning

2 Corporate Responsibility Report 2010, at p. 4, available at <http://www.nextplc.co.uk/~/media/Files/N/Next-PLC-V2/documents/cr-reports/cr-2010.pdf> accessed 31 January 2018.

3 P. Taylor, 'Enlightened Shareholder Value and the Companies Act 2006' (unpublished PhD thesis, May 2010), Birkbeck College, University of London.

4 Department for Business, Innovation and Skills (August 2010) 'Evaluation of the Companies Act 2006, Volume One' <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31655/10-1360-evaluation-companies-act-2006-volume-1.pdf> accessed 14 March 2017.

that there were some companies that thought that it had an impact on how directors behaved. Therefore, on the assumption that the impact mentioned by the minority was positive, it can be deduced that the section is capable of promoting or assisting CSR but only for a very limited number of companies. For the majority of the companies, the section did not instigate the behavioural changes that were anticipated by many. The reasons for this might be that some of the companies were confident that they had instilled the right culture already.

Similarly, the overall results of the study on corporate reports suggested that the concept of ESV did not promote or assist CSR, even though the results did establish a link between the two concepts. This observation has been based on a number of factors. As discussed before, seven of the eight companies had ultimate objectives inclined towards stakeholder interests, while only one company had a shareholder approach. The companies that were more focused on stakeholder interests acknowledged the importance of shareholder interests and vice versa. An examination of the corporate documents and websites showed that section 172 made little or no impact on what the companies claimed were their ultimate objectives or goals. Since it is evident that the enforcement of section 172 did not make companies more concerned about stakeholder interests, it can be asserted that it did not promote or assist CSR. Moreover, the study showed that the enforcement of section 172 did not make a lot of difference to how companies reported on their various stakeholders or CSR. There was no substantial improvement or change in that regard. The various stakeholders listed in section 172 were being considered before its enactment. Information on customers, employees, suppliers and the impact of the company's operations on community and environment was already being provided. The companies also acknowledged the importance of focusing on the long term and sustainability. There might have been some difference in the degree of detail with which stakeholders were reported on, but they were mentioned. Hence, this demonstrates that the ESV principle did not really have an impact on how and what information companies provide in relation to their stakeholders. Considering the fact that information on stakeholders was frequently mentioned in the CSR sections of annual reports or separate CSR reports, it is argued that the ESV principle did not have much of an impact on how companies reported on CSR. There was no real change in the way companies reported on CSR that could be credited to the implementation of the ESV principle. Therefore, the results derived from this study show that the concept of ESV did not promote or assist CSR. However, this does not mean that the companies were not being socially responsible. In fact, in a way it reaffirms the results from the BIS study that a lot of the companies seem to portray that they had the right culture already.

The previous chapters also aimed to address whether the concept of ESV is capable of promoting or assisting CSR in an international context. This involved examining whether the concept of ESV had an impact on the CSR practices of MNCs that are based in the UK but also operate in developing countries. As it was not possible to examine the overseas operations of all the

MNCs originating in the UK due to time constraints, the author chose to focus on an industry in a developing country with which MNCs originating in the UK are involved, and specifically a major incident that happened in that industry. It was hoped that the findings of this case study would be representative of the situation in other developing countries. As mentioned earlier, even though the concept of ESV has been the subject of a great deal of scrutiny and discussion, the possibility of it having an impact internationally has not received much attention. However, the factors listed in section 172 can easily be interpreted as covering operations overseas. The consequences of decisions in the long term can be the consequences of decisions made regarding operations in other countries. For example, the UK companies that had provided contracts to suppliers in the Rana Plaza probably failed to have regard to the consequences of their decisions in the long term. MNCs have suppliers and customers overseas and there is a need to foster relationships with them as well. The employees of their suppliers are part of their supply chains; it is even arguable that the employees of their suppliers should be treated as de facto employees as they are producing goods or providing services for them. Having regard to the impact of the company's operations on the community and environment can include the impact of the operations of the MNCs on communities and environment of other countries. Finally, the desire of the company to maintain a reputation for high standards of business conduct can definitely include international operations. If an MNC fails to maintain high standards of business conduct while operating in other countries, its reputation may certainly be affected. Again, the Rana Plaza disaster serves as an example here. Therefore, the stakeholders and factors mentioned in section 172 can include stakeholders overseas. Given the dearth of literature available on the international impact of the ESV principle, it was contended that the best way to address this aspect was to conduct a case study that would reveal the reality of the situation and generate results that might be illustrative of the situation in other developing countries. The findings of the case study have been discussed in depth in the previous chapter, but the findings will be briefly addressed further now in order to reflect on the impact of ESV on CSR in an international context.

It was suggested in the previous chapter that the involvement of British companies with the factories in the Rana Plaza in itself shows that the ESV principle has not really assisted or promoted CSR, since the incident happened after the enactment of section 172. The particular MNCs involved in the incident had placed orders with these factories without thinking about the long-term consequences of doing so. Perhaps they were getting products at a very cheap price and making profits at the time, but providing business to factories that were structurally unstable had catastrophic results. It can be argued that they prioritised generating profits in the short term and failed to consider the consequences of their decisions in the long term. The need to foster relationships with suppliers was also ignored. If these MNCs were truly concerned about developing relationships with these suppliers, their monitoring processes

would have been more efficient. They would have focused on building relationships with suppliers who at least had a safe working environment, instead of giving contracts to suppliers whose factories were structurally unstable.

The MNCs also ignored the interests of the employees who were making their products. The incident was reported on extensively by the national and international media, and links were made in the media to the MNCs, which led to bad publicity for these companies. So, these MNCs could not maintain a reputation for high standards of business conduct. The way they placed orders and dealt with their suppliers in Bangladesh was unethical. They were either unaware of the unethical practices in their supply chain, which means their monitoring processes were flawed, or they chose to ignore these issues as long as their requirements for price, quality and delivery time were being met. As the news of their involvement spread, their actions might have enraged their customers as well, which means it could have also affected their relationships with their customers. The liability of the MNCs was also highlighted by some of the interviewees. Owners 6 and 18 mentioned in their responses that the MNCs were responsible for the incident. Owner 18 claimed that Rana Plaza would not have happened if the MNCs had not asked their suppliers to reduce the prices over and over again. He also questioned their decision to place orders with factories that were not structurally stable in the first place. However, these observations can only be made regarding the companies that had placed orders with the factories in Rana Plaza. The case study on the industry as a whole generated results that are arguably more representative of the operations of MNCs, including those that originate in the UK, which operate in the RMG industry in Bangladesh.

The case study revealed that the collapse of Rana Plaza instigated major changes in the RMG industry in Bangladesh. There was considerable development in terms of the workplace environment, the safety of the workers, the rights of the workers and the monitoring processes of the MNCs. However, all these changes were a consequence of the Rana Plaza incident. The concept of ESV failed to make a difference in how the MNCs were conducting their operations in the RMG industry. It did not make the MNCs more socially responsible, and the directors had hardly any regard for stakeholders. It seems that after the incident, the MNCs, the government of Bangladesh and the owners in Bangladesh were under enormous pressure to make changes to ensure the safety and protect the rights of the workers. Both the national and international media made a huge contribution towards creating that pressure. This is also evidenced by the outrage of a lot of the participants in the owner group towards the national media, while most of the participants in the NGO group made positive remarks about the role of the media. The way the incident was reported was also detrimental to the reputation of the MNCs, and it seems like it led them to be more concerned about what happens in their supply chains. Therefore, it is submitted that the concept of ESV did not promote or assist CSR in an international context. This conclusion is also supported by other observations. For example, the responses of the interviewees in the case study regarding the CSR initiatives of MNCs were mostly negative. It was

surprising that in an industry with which a great number of MNCs are involved, the presence of CSR initiatives seems to be very low. Some of the participants even went as far as stating that whatever is done by the MNCs is only window-dressing, done so that they can mention it in their annual reports.

After Rana Plaza, there was remarkable improvement in the monitoring processes of MNCs in comparison to the situation before. The audits conducted seem to be very extensive. The formation of the Accord and the Alliance was also very effective for the most part. Nonetheless, there are still some issues that need to be addressed. First, problems relating to subcontracting remain. Even though a lot of progress has been made in this regard, the standards imposed on the factories get diluted if orders are placed through intermediaries rather than directly by the MNCs. A lot of the owners mentioned that even if they subcontract orders, they are only given to factories that also comply with all the requirements. On the other hand, participants in the NGO group revealed that there are many differences between the main factories and the subcontracted factories. It is not possible for the subcontracted factories to maintain the same standards as they have to make some profits too. Concerns were also raised about the over-reliance of the MNCs on the paperwork provided by the suppliers, rather than checking the authenticity of it. The suppliers also suffered due to the lack of standardised guidelines from the Accord and the Alliance. Initially they were asked to invest in certain equipment and facilities which were changed later on. As a result, some of the suppliers suffered some financial losses. It appears that as a result of the collapse of the Rana Plaza, the suppliers had no bargaining power. They had to accept whatever they were asked to do even if it was unfair. Lastly, the MNCs imposed various additional requirements on their suppliers but did not provide any form of support in the fulfilment of those requirements. The suppliers who had the financial capacity to meet those obligations were able to continue, but a lot of factories had to be shut down. The suppliers had to make a lot of investment for the remediation process but the MNCs did not increase the prices.[5] The suppliers also mentioned that this put them at disadvantage as their competitors in other countries did not have to follow the same standards. In light of these issues, it is contended that the ESV principle has not assisted or promoted CSR in an international context. There are still deficiencies in the monitoring systems of MNCs, and there does not seem to have been much change in the attitude of the MNCs in terms of building relationships with their suppliers. This brings us to the discussion on ethical buying.

A number of the participants mentioned that the MNCs are not offering fair prices and their buying practices are unethical.[6] It was mentioned by one of the owners that the whole process of receiving a contract and production is very

5 For a brief discussion on the remedial process, see T. Iqbal, "Pitfalls of Industry-Led Private Governance Regimes in Promoting CSR in Global Supply Chains: Evidence from the RMG Industry and Impact of COVID-19" (2019) 26 *International Trade Law & Regulation* 231.

6 Owners 2, 6, 13, 14 and 15.

transparent. The MNCs are aware of how much the owner is making, but they still insist on reducing the prices.[7] Another owner expressed his frustration at the situation he is in. On one hand he has to spend a lot to satisfy the additional safety requirements, but on the other hand the MNCs keep asking for cheaper prices.[8] It was also claimed that after the Rana Plaza disaster some of the MNCs had given assurances that they would provide support and increase prices once the improvements in the factories were made, but most of the MNCs did not follow through on those assurances.[9] Interestingly, these remarks by the owners on the pressure for reducing prices were corroborated by some of the participants in the NGO group as well.[10] Since transparency, fair prices and ethical buying are very important aspects of being socially responsible, it is asserted that the concept of ESV has not promoted or assisted CSR in an international context.

The need for reform

It has been established that section 172 has had limited impact, if any at all, on how companies operate in practice. It has not made much difference regarding the degree of consideration given to stakeholder interests and the consequences of decisions made in the long term. Consequently, its capability to promote or assist CSR is limited as well. However, it has also been established that the two concepts are connected. The analysis of the concept of CSR and section 172, along with the results from the empirical study on corporate reports, established a clear link between the two concepts. Therefore, if only the ESV principle could be implemented properly, there is a chance that it could promote or assist CSR. As discussed in Chapter 2, the case for CSR or protecting stakeholder interests is supported by both financial and normative reasons. These reasons include financial benefits such as attracting and retaining employees, gaining a competitive advantage by maintaining good corporate reputations, appealing to consumers, reducing costs and attracting capital. There are also normative reasons such as the fostering of ethics, altruism, fairness and the argument that companies operate under a social license and should be considered social enterprises. Due to the detrimental impact of corporate operations on human rights, the significance of ensuring CSR in a global context and supply chains cannot be overlooked. Hence, there is a need for change.

Moreover, the findings of the case study also suggested that there are still some deficiencies in the monitoring processes set in place by the MNCs. As long as these problems are not dealt with, the safety of the workers will always be at risk. In addition, a number of the interviewees claimed that a lot of the MNCs are not ethical in the way they conduct business in Bangladesh. The

7 Owner 2.
8 Owner 8.
9 Owner 12.
10 NGOs 1 and 4.

participants in the NGO group expressed their dissatisfaction with the implementation of the local laws by the government. Furthermore, the participants were unable to provide a lot of information on the impact of international guidelines and multilateral organisations, which indicates that their impact has been insignificant. So, considering the relative inefficiency of international codes and guidelines along with the ineffective enforcement of local laws, there is a need to ensure that the MNCs are being compelled to pay attention to stakeholder interests and be socially responsible. The majority of the interviewees also agreed that holding the MNCs accountable in their home states for the actions of their suppliers in Bangladesh would be beneficial. For example, NGO 5 stated when a MNC gives contracts to suppliers in Bangladesh who fail to maintain the required standards, it should be held accountable. Owner 5 said that it does not seem fair that the MNCs generate great profits by doing business in Bangladesh and do not have to take any responsibility if something goes wrong. Therefore, the findings of the case study also strongly suggest that there is a need for change in this area.

Before the proposals for reform are advanced, it is important to consider briefly whether currently companies in the UK are offered the legal-institutional conditions to support and nurture a purposeful conception of the ESV principle. Historically, shareholder value orientation has been deeply embodied in the UK. The contemporary era has been primarily driven by the definite political project of neoliberalism. Neoliberal thinking, as a discipline-shaping phenomenon, influences the role and expectations of most shareholders and also the corporate organisation and the architecture of company law.[11] Even though it is expected in the UK and Europe that shareholders should be behave in a responsible manner,[12] neoliberalism provides shareholders the freedom to have short-term, profit-maximising goals which lead them to pursue the highest returns in a global economy.[13] This legal myopia hinders the moral choice of harmonising the interests of the shareholders with the interests of stakeholders.[14] An examination of the legislative reform process for directors' duties will have to take place against this ideological framework which promotes shareholder value as the overriding corporate objective, even though this has been asserted as the cause for catastrophic problems in the global financial system in the recent decades.

11 D. Attenborough, 'The Neoliberal (Il)Legitimacy of the Duty of Loyalty' (2014) 65 *Northern Ireland Legal Quarterly* 405 at 407, 409.

12 A. Dignam, 'The Future of Shareholder Democracy in the Shadow of the Financial Crisis' (2013) 36 *Seattle* University Law Review 639 at 690.

13 L. Talbot, 'Why Shareholders Shouldn't Vote: A Marxist-progressive Critique of Shareholder Empowerment' (2013) 76 *Modern Law Review* 791 at 793. On corporate short-terminism, also see M. Moore and E. Walker-Arnott, 'An Alternative View of Corporate Short Termism' (2014) 41(3) *Journal of Law and Society* 416.

14 Attenborough, 'The Neoliberal (Il)Legitimacy of the Duty of Loyalty' (n11) at 407–408.

While addressing the requirement that "the board should establish the company's purpose" in the revised Corporate Governance Code,[15] Kershaw and Schuster have also provided an account of certain important legal-institutional barriers to change in this regard and highlighted the pro-shareholder ecology of UK law. The UK company law provides a shareholder-rights-focused regime that supports shareholder interests and amplifies value pressures. This is highlighted in the features of distribution of corporate power between the shareholders and the board of directors. Corporate power originates with the shareholders in general meeting. Then it is transferred from the shareholders to the board through the company's articles of association. The senior managers of the company are appointed and empowered by the board. Company law provides no inherent managerial power and no adequate protection from removal for those managers.[16] Under section 168 of the Companies Act 2006, shareholders in general meeting can remove directors, without having to give a reason for removal, by an ordinary resolution. Interim meetings to exercise such removal rights can be requisitioned by 5 per cent of the shareholder body.[17] These features are either fundamental to the origins and structure of power in a company in the UK or they are mandatory.[18] Other company law rules, such as rules on the issuing of shares and the waiver of pre-emption rights, allow other forms of shareholder control over corporate development.[19] Shareholders enjoy considerable formal and informal power due to these rules, which ensure that their interests are the most important aspects in decisions to raise finance to fund projects or to grow the company through acquisitions.[20] The significant transaction rules for premium listed companies, that requires shareholder approval for greater than 25 per cent value transactions,[21] and the Takeover Code's non-frustration rule[22] also amplifies the shareholders' power.[23] Lastly, the pro-shareholder balance of power is demonstrated in the optional rules found in most companies' articles of association; consider the seldom used but existent shareholder instruction rights in company articles.[24] It is also reflected in some of the recommendations in the Code; note the

15 See UK Corporate Governance Code, Principle B of Section 1. This will be considered later in the chapter.
16 D. Kershaw and E. Schuster, 'The Purposive Transformation of Company Law' (2019). LSE Legal Studies Working Paper No. 4/2019, Forthcoming, American Journal of Comparative Law, Available at SSRN <https://ssrn.com/abstract=3363267> accessed 20 December 2019.
17 See sections 303–305 of the Companies Act 2006.
18 Kershaw and Schuster, 'The Purposive Transformation of Company Law' (n16) at 20–25.
19 Ibid. Also see: Sections 549–551, 561–566 of Companies Act 2006.
20 Ibid.
21 Listing Rule 10, FCA Handbook, Listing Rules.
22 Rule 21 Takeover Code.
23 Kershaw and Schuster, 'The Purposive Transformation of Company Law' (n16) at 20–25.
24 See Article 4 of the Model Articles for Public Companies.

recommended one-year board term.[25] If these rules are considered to be unavoidable, it is simply impossible to create a legal zone of insulation for the directors in which they will have the freedom to consider stakeholder interests without prioritising shareholder interests. In companies that have a diversified shareholder base, are subject to strong shareholder rights with a high probability that such rights will be exercised formally or informally, and are exposed to market pressures to conform to shareholder interests, it is likely the board of directors will always have to prioritise shareholder interests.[26]

It has been established that persistence of shareholder value orientation in corporate governance in the UK can be credited to historical, political and cultural arrangements of the UK national model. In addition, the deep-rooted self-regulation legal culture in the UK has been offering enough autonomy for the fast growth of market activities, and therefore, amplifying the prosperity of the market-based economy and the primacy of shareholders' interests. The various key features of the UK corporate governance system, such as the dispersed ownership and ultimate shareholder decision rights, the one-tier board structure, the external monitoring system, the liquid market and the dynamic market activities are all determined by and complementary to the ultimate objective of maximising shareholder value. The shareholder maximisation ideology has been solidified by eternal socio-economic institutional elements, such as the historical recognition of a company as a shareholder value maximisation economic entity, the role of the law in promoting trade freedom, discipline forced by the political policy to enhance competition and the market for corporate control.[27] These barriers mean that fundamental reforms are needed to enable UK company law to provide a legal ecology in which stakeholder interests can be prioritised if required.

Proposals for reform

In this section, some proposals or suggestions for reform that might facilitate the enhancement of the impact of section 172 on stakeholder interests are advanced. Some of the suggestions presented here have been put forward previously by scholars in relation to promoting stakeholder interests in general or for promoting the interests of the company in the long term but have not necessarily been discussed in relation enhancing the impact of section 172 on promoting stakeholder interests. These include the introduction of enforcement mechanisms, clarity in the terms mentioned in section 172 along with well-defined guidance on the fulfilment of the duty, reforms to give meaning to purposeful companies and the creation of stakeholder advisory panels. It is

25 UK Corporation Governance Code, Provision 18.
26 Kershaw and Schuster, 'The Purposive Transformation of Company Law' (n16).
27 S. Wen and J. Zhao, 'Exploring the Rationale of Enlightened Shareholder Value in the Realm of UK Company Law – The Path Dependence Perspective' (2011) 14 *International Trade and Business Law Review* 153.

contended that the adoption of one or more of these proposals might increase the impact of the section in practice, which will strengthen the position of stakeholders and consequently promote CSR.

Enforcement mechanisms

The lack of any enforcement mechanism in relation to section 172 for groups other than shareholders is a significant problem that affects the impact of section 172 in practice. Two ways through which the proper enforcement of section 172 might be achieved are derivative claims and the increasing the power of the FRC.

Under the current framework, only shareholders can bring a derivative claim on behalf of the company for breach of directors' duties. Therefore, even though section 172 might appear to give rights to stakeholders, they do not have any way to enforce this right. It was mentioned by the CLLS that unless the existing framework for enforcement is changed, any other changes made regarding the statutory duty might not have the desired outcome.[28] The possibility of broadening the range of parties who can bring an action for breach of section 172 should be considered. Keay has argued that the legislation should provide that an application for a derivative claim could be made by "anyone who appears to the court to be interested in the company".[29] He had suggested this in order to use derivative action as a way to enforce the entity maximisation and sustainability model.[30] It is submitted that a similar approach can be taken to provide stakeholders with a mechanism to enforce section 172. Shareholders might not be the appropriate group to be relied upon to bring an action against directors ignoring stakeholder interests, as they might not be interested in doing so, or it might even conflict with their own interests. As shareholders are often unaware of what is happening in a company, broadening the range of parties who can bring an action might be better for protecting the interests of the company. Employers might be in a better position to be aware of the directors' activities, and therefore might play a better role in monitoring their activities than shareholders. This is evidenced by some employees who sometimes chose to disclose the unethical practices of the directors.[31] Dean has

28 Response of the City of London Law Society Company Law Committee to the Green Paper (February 2017), at p. 2, available at <https://www.citysolicitors.org.uk/storage/2017/02/CLLS-Response-to-the-Green-Paper-on-Corporate-Governance-Reform.pdf> accessed 15 August 2017.

29 A. Keay, 'The Ultimate Objective of the Public Company and the Enforcement of the Entity Maximisation and Sustainability Model' (2010) 10 *Journal of Corporate Law Studies* 35 at 58.

30 The Entity Maximisation and Sustainability Model (EMS) "focuses on the company as an entity and proposes that the object of a company is to foster entity wealth, which will involve directors endeavouring to increase the overall long-run market values of the company." See A. Keay, *The Corporate Objective* (Cheltenham, Edward Elgar Publishing Ltd, 2011) for a detailed explanation of the model.

31 Keay, 'The Ultimate Objective of the Public Company and the Enforcement of the Entity Maximisation and Sustainability Model' (n29) at 57.

also mentioned that "there seems to be no a priori reason why others [besides shareholders] should not enjoy similar access to the courts to protect the company from harm, under a regime of judicial supervision similar to that envisaged to 'manage' shareholder actions."[32]

Keay has suggested that in order to convince the court that a potential claimant has an interest in the company, they should be able to demonstrate either "a direct financial interest in the affairs of the company or a particular legitimate interest in the way that the company is being managed".[33] This interpretation can potentially provide the various stakeholders mentioned in section 172 with the means to bring a claim in the event of a breach of the duty. Some of these stakeholders might even have more resources to bring a claim or much better access to information than the shareholders. It is even arguable that shareholders can simply chose to sell their shares and invest in a different company, but some of the stakeholders might not have similar options to engage with other companies. They might be more dependent on that particular company. In such a situation, these stakeholders have a greater stake in ensuring that the company is being managed properly. Hence, they might be better monitors than the shareholders.

Some might argue that broadening the range of parties who can claim would open the floodgates for litigation. It has been proposed that courts could be given discretion to judge whether a particular claimant falls within the scope of the suggested category. If the current permission procedure in the Companies Act 2006 and the criteria for assessing proceedings could be continued, it would not open floodgates in terms of applications made.[34] The courts would act as gatekeepers and ensure that the procedure was not being abused. Nonetheless, it is expected that there will be a great deal of resistance from businesses against proposals to broaden the range of parties that are allowed to bring derivative proceedings.

Chiu has also stated that both shareholder and stakeholder groups are interested in holding directors liable for breach of their duties, even though the interests of these two groups might not always coincide. In her opinion, even though the company should remain the primary person to bring actions against directors to enforce their duties, the derivative action should be reformed to allow shareholders or stakeholders to sue if there are situations that prevent the company from doing so. This is essential, as shareholders cannot always be relied on to ensure that there is enforcement in all the cases that are relevant.[35]

There are other jurisdictions that allow a broader range of individuals to bring derivative claims. Section 238(d) of the Canada Business Corporations

32 J. Dean, *Directing Public Companies: Company Law and the Stakeholder Society* (London, Cavendish, 2001) at 155.

33 Keay, 'The Ultimate Objective of the Public Company and the Enforcement of the Entity Maximisation and Sustainability Model' (n29) at 58.

34 Ibid.

35 Chiu, 'Operationalising a stakeholder conception in company law' (2016) 10 *Law and Financial Markets Review* 173 at 185.

Act allows any proper person in the discretion of the court to bring proceedings. A very similar approach is taken in Singapore. Under section 216A(1)(c) of the Singapore Companies Act, the range of persons who are allowed to bring a claim includes any person who is considered a proper person in the discretion of the court. As this approach has been workable in other jurisdictions, the proposal to broaden the range of individuals who can bring derivative claims is worthy of serious consideration. This option has the potential to improve the impact of section 172 in practice as the stakeholders mentioned in the section will have the opportunity to bring claims in the event of a breach. This will improve the position of the stakeholders along with promoting long-term thinking and enabling section 172 to promote or assist CSR.

Furthermore, it should be considered whether the potential applicants could include stakeholders in other jurisdictions. As discussed earlier, a vast majority of the interviewees in the case study confirmed that it would be useful if there was a way to hold MNCs liable in their home states for the actions of their suppliers in Bangladesh. Stakeholders in other jurisdictions can also have a direct financial interest or a legitimate interest in the way the company is being managed. In order to protect shareholder interests, companies frequently organise themselves in group structures for the purposes of partitioning assets and sharing the responsibility for any liability.[36] This leaves many victims of corporate wrongdoing or externalities with limited ways to seek redress.[37] It is extremely difficult to impose a duty of care on the parent company of huge corporate groups.[38]

In its response to the Green Paper on Corporate Governance Reform when considering the way boards take stakeholder interests into account, the CLLS mentioned that there is a need for clarity on whether the concern is restricted to stakeholders in the UK or whether it should be a more global approach. It mentioned that the majority of large companies have operations in more than one country. The focus in the Green Paper seemed to be on stakeholders based in the UK. However, for large companies with global operations, limiting attention only to stakeholders based in the UK might be inadequate.[39] MNCs have international operations, and thus limiting the focus on stakeholders in the UK should not be acceptable, as doing so would exclude the numerous stakeholders these companies have all around the world. It would be difficult to ensure that MNCs act responsibly in the way their supply chains are managed without extraterritorial liability. As mentioned earlier, this assertion is supported by the findings of the case study. Nevertheless, even if stakeholders in other

36 See H. Hansmann and R. Kraakman, 'Organizational Law as Asset Partitioning' (2000) 44 *European Economic Review* 807.

37 Chiu, 'Operationalising a stakeholder conception in company law' (n35) at 173.

38 However, note the decision in *Vedanta Resources PLC and another (Appellants) v Lungowe and others (Respondents)* [2019] UKSC 20 which is addressed later in the chapter.

39 Response of the City of London Law Society Company Law Committee to the Green Paper (n28) at 2.

jurisdictions could be considered to have an interest in the company for the purpose of a derivative claim, and the fact that they are not UK residents would not prohibit them from bringing proceedings against a company in the UK, there will be issues relating to whether there is a cause of action against a UK company allowing for proceedings to be taken in the UK, and this might prevent stakeholders from bringing an action against a parent company in the UK if their interest lies mainly in subsidiaries that are based in other countries. MNCs often use smaller subsidiaries to venture into risky operations overseas so that the larger companies of the group can be protected from any losses or liabilities faced by the smaller subsidiary. Also, in the UK it is very difficult to hold the parent companies liable through the process of piercing the corporate veil.[40]

However, there are companies in developing countries that contract directly with UK companies, and surely the interests of the employees of those companies should be a matter of concern. The landmark judgment in *Vedanta Resources PLC and another (Appellants) v Lungowe and others (Respondents)*[41] shows some progress in terms of forms of redress being made available to stakeholders overseas. This case concerned a claim brought in England by 1,826 villagers in Zambia against a subsidiary based in Zambia (Konkola Copper Mines plc) and its parent company based in the UK (Vedanta Resources plc). The claim was brought regarding environmental pollution caused by a copper mine in Zambia owned by the subsidiary. The judgment from the UK Supreme Court means that the claim can proceed to a trial of the substantive issues in the English courts and is a significant development in corporate accountability for human rights and impact on environment.

The idea behind giving wider stakeholders enforcement powers also relates to the notion of board accountability and CSR. Much of the literature related to CSR focuses on forms of disclosure and the rights of stakeholders, but there is also a need to examine the responsibilities of the boards and the mechanisms that provide accountability for the acts of corporations.[42] The fiduciary duties of the directors require them to use good judgement, and they are also under a duty to make decisions with reasonable skill and care. Zhao argues that there is a real normative opportunity here provided by corporate law to deal with irresponsible behaviour by corporations. This is done through various requirements for disclosure, dialogue, questioning and liability. In order to cater to the dynamic nature of the needs of various stakeholders, board accountability needs to go beyond the legal accountability incorporated in laws addressing specific stakeholders, such as employment law or consumer protection law. These laws

40 See *Adams v Cape Industries plc* [1990] Ch 433.

41 *Vedanta Resources PLC and another (Appellants) v Lungowe and others (Respondents)* [2019] UKSC 20.

42 J. Zhao, 'Regulation of Corporate Social Responsibility Through the Lens of Board Accountability and the Case of China' in J. J. du Plessis, U. Varottil and J. Veldman (eds), *Globalisation of Corporate Social Responsibility and its Impact on Corporate Governance* (Cham, Springer International Publishing, 2018) at 129.

lay down the rights, responsibilities and legal accountability only at a minimum level. If accountability towards various stakeholders is left to voluntary CSR and these legal forces at minimum level, it will not have a substantive impact on the decision of directors.[43]

Zhao has proposed a notion of board accountability that, accompanied with corporate objectives which include the wider community, seeks to hold companies and boards liable when their actions have a detrimental impact on society and the environment. It aims to give victims of abusive practices the power to claim remedies, and motivates legislators to give more consideration to the idea of implementing stricter regulations to hold boards and companies liable for damages done to stakeholders. This wider understanding of board accountability will then be in line with the dynamic nature of CSR.[44] This wider notion of board accountability, which can be referred to as corporate social accountability, will actually move beyond the voluntary nature of CSR and give it some teeth by regulating the behaviour of corporations and compensating stakeholder groups that have been wronged. By introducing the idea of corporate social accountability, the current CSR framework will become more systematic and enforceable. This will help prevent corporations from acting irresponsibly.[45] It is submitted that this notion of corporate social accountability can be achieved by broadening the range of parties who can bring a derivative action against the directors for breach of section 172. This will provide a way for various stakeholders who might be affected by corporate actions and decisions to hold the wrongdoers accountable.

The second suggestion relating to enforcement is increasing the power of the FRC. The FRC had sought wider powers so that it can investigate and bring actions for breach of duty under section 172 by any director.[46] In the report by the Business, Energy and Industrial Strategy Committee of the House of Commons, the following recommendation was made in this regard:

> We recommend that the Government brings forward legislation to give the Financial Reporting Council the additional powers it needs to engage and hold to account company directors in respect of the full range of their duties. Where engagement is unsuccessful, we would support the FRC in reporting publicly to shareholders on any failings of the board collectively or individual members of it. If companies were not to respond satisfactorily to engagement with the FRC, we recommend that the FRC be given authority to initiate legal action for breach of section 172 duties. Given the

43 Ibid at 129–130.
44 Ibid at 129–130, 133.
45 Ibid at 134–135, 144–145.
46 Financial Reporting Council, Response to the Department of Business, Energy and Industrial Strategy Corporate Governance Reform Green Paper (17 February 2017) <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/FRC-Response-to-BEIS-Green-Paper-consultation-on-C.pdf> accessed 15 August 2017 at 5.

> broader powers we have recommended in this Report, the Government should consider re-establishing, renaming and resourcing appropriately the FRC to better reflect its expanded remit and powers.[47]

If stakeholders are not given the power to bring derivative proceedings for a breach of section 172, giving additional powers to the FRC to prosecute in the event of a breach might be a good alternative. It will not have the same effect as stakeholders having the power to enforce their interests, but at least the directors will be accountable to a supervisory body. This might deter directors from ignoring stakeholder interests in their decision-making. There are a number of arguments in favour of public enforcement. Since a public authority, unlike the shareholders, will not have an interest in the company, it is more likely to be objective in deciding whether an action should be brought against a director. This does not necessarily have to result in a legal proceeding, as the public authority might indicate to the director in question that a breach has occurred and he or she needs to rectify the situation. This will be more cost effective and act as a stronger deterrent in comparison to an action being brought by shareholders. Lastly, as mentioned before, since shareholders might not always be interested in bringing an action in relation to directors ignoring the factors listed in section 172, permitting public enforcement might provide the constituents listed in the section with some protection and redress. The wronged stakeholder or stakeholder group will have the option to make a complaint to the public authority in the event of breach, and the public authority might be willing to act on it.[48]

Formulating a model that will provide such powers to the FRC would obviously require a great deal of thought on appropriate procedures that might be put into place. It should also be anticipated that there might be a lot of resistance from businesses for this proposal. Furthermore, due to recent corporate failures, the FRC has been subject to severe criticism, and in 2018 the Government commissioned three separate reviews of the audit profession. Three key reports[49] on the future of audit and accountancy professions have been published, which put forward recommendations to reform audits and the way in which they are regulated. This includes replacing the FRC with a new regulator with enhanced powers. Even though the reviews are focused on audits, one of the most controversial recommendations was that regulator's enforcement powers should be extended to company directors of public

47 Business, Energy and Industrial Strategy Committee, Corporate Governance, Third Report of Session 2016–2017, HC 702, 5 April 2017 at p. 21, para 42.

48 A. Keay, 'The Public Enforcement of Director's Duties: A Normative Inquiry' (2014) 43 *Common Law World Review* 89 at 107–109.

49 These are the Independent Review of the FRC by Sir John Kingman which was published in December 2018; The Competition and Markets Authority's study of competition in the audit market, which was published in April 2019; and the Independent Review into the quality and effectiveness of audit, by Sir Donald Brydon, published in December 2019.

interest entities. It was recommended that the regulator should set out relevant requirements or statements of responsibilities in relation to auditing and corporate reporting so that directors are held individually accountable for their roles.[50] This clearly gives rise to a number of concerns, but at this stage it remains unclear how the Government will approach progressing the recommendations and the time it will require.[51]

Clarity of terms

One of the major factors that hinders the impact of section 172 is a lack of clarity. As mentioned previously, terms such as, 'success', 'have regard', 'long term', 'suppliers' and 'community' remain vague and cause confusion. Therefore, the directors, shareholders and stakeholders do not have clarity regarding what having regard to the listed factors really means. This seems to be the view espoused in much of the literature written on section 172, as well as in the reports of organisations. Even though it has been many years since the duty was put into force, there is no substantial guidance from existing case law on the fulfilment of the duty. The courts have neither discussed nor provided any explanation for the factors listed in the section. This was discussed in detail in Chapter 3. The scarcity of case law on section 172 also suggests that shareholders who might have wanted to bring a claim for breach of the duty are confused about what the duty requires and are uncertain about the approach the courts will take. Therefore, they might be hesitant to bring any claims.

It was also indicated in the results of the BIS study that there was uncertainty regarding what 'having regard' to the factors entails.[52] It was stated in the feedback for areas of improvement that there was a need for more clarity and guidance in order to increase awareness and to improve the understanding of section 172 and to instigate change in behaviour.[53] The CLLS had mentioned in their response to the Green Paper that it would be helpful if there was increased guidance from the FRC or BEIS on what section 172 requires.[54] Again, this indicates that there is uncertainty regarding what the duty entails and how section 172 should be applied. As discussed in Chapter 3, the FRC has published an updated

50 See Recommendations 36 and 37. Independent Review of the Financial Reporting Council (December 2018), available at <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf> accessed 15 July 2019.

51 A. Lidbetter and J. Wood, 'The FRC and enforcement action – what next?' (Herbert Smith Freehills LLP, 2020), available at <https://sites-herbertsmithfreehills.vuturevx.com/20/21553/landing-pages/2020-02-05–audit-regulation-article—final-update.pdf> accessed 30 September 2020.

52 Department for Business, Innovation and Skills (n4), at 163.

53 Ibid at 15.

54 Response of the City of London Law Society Company Law Committee to the Green Paper (n28) at 2.

guidance on the Strategic Report,[55] and this includes detailed guidance on the application of the requirement under section 414CZA to include a section 172(1) statement as part of the Strategic Report. However, it is clearly stated that the guidance is provided to companies "to determine the appropriate reporting to meet the requirements of the section 172(1) statement. It is not intended to interpret how the section 172 duty should be met."[56]

Various cases, including *Shepherd v Williamson*[57] which has perhaps provided the most consideration of the factors, have made it rather clear that the dominant feature of section 172 is the good faith of the directors. It is contended that directors should be obliged to engage in a balancing exercise so that the interests of the stakeholders are not grossly neglected. It is appreciated that balancing the different interests of the various stakeholders is a difficult task. However, the adoption of shareholder primacy in company law diminishes the importance of other forms of productive capital that companies use for the success of their businesses. This includes various forms of tangible and intangible resources, such as the "human capital of employees, reputational capital conferred by the corporation's community, financial markets, media, etc.," loyalty capital committed by dedicated suppliers and other forms of capital.[58] The law does not need to take the extreme stand of only promoting shareholder rights and power in the context of company law.[59] As it been demonstrated in previous chapters, this imbalance has permitted exploitative practices. Also, taking stakeholder interests into account is not always avoidable anyway. Winkler argues that there are many mandatory legal rules which are enacted for the protection of stakeholder interests that limit the discretion of directors. These rules in other areas of law such as employment or labour law, consumer protection law and environmental law cannot really be evaded through choice of form, because all corporations are subject to these laws.[60] Considering the interest of the stakeholders does not necessarily require a shift to pure stakeholder theory. The focus can still remain on promoting the success of the company, but not at the cost of ignoring stakeholder interests. The updated guidance provided by the FRC also states that

> the success of a company is dependent on its ability to generate and preserve value over the longer term. Companies do not exist in isolation; they

55 Financial Reporting Council, Guidance on the Strategic Report, at 16, available at <https://www.frc.org.uk/accountants/accounting-and-reporting-policy/clear-and-concise-and-wider-corporate-reporting/narrative-reporting/guidance-on-the-strategic-report> accessed 10 July 2020.

56 Ibid at 59.

57 *Shepherd v Williamson* [2010] EWHC 2375 (Ch) [103].

58 Chiu, 'Operationalising a stakeholder conception in company law' (n35) at 174.

59 Ibid.

60 A. Winkler, 'Corporate Law or the Law of Business?: Stakeholders and Corporate Governance at the End of History' (2004) 67 *Law and Contemporary Problems* 109 at 110–111.

> need to build and maintain relationships with a range of stakeholders in order to generate and preserve value.[61]

Again, this is stated in relation to the meeting the reporting requirements and the guidance is not intended to be used to interpret how the section 172 duty should be met. Also, it is clearly stated that the one of the objectives of the Strategic Report is to provide information to enable shareholders, not stakeholders, to assess how directors have had regard to stakeholders and other matters when performing their duty under section 172. This is also reiterated in the Corporate Governance Code.[62] Therefore, the focus remains on providing the shareholders relevant information, and not the stakeholders.

After receiving the responses to the Green Paper, the Business, Energy and Industrial Strategy Committee of the House of Commons stated in a report that:

> We do not believe that weaknesses in corporate governance arise primarily from the wording of the Companies Act, in particular section 172. We nonetheless recognise that the requirement for directors to "have regard to" other stakeholders and considerations is lacking in clarity and strength and is not realistically enforceable by shareholders in the courts, even if they were minded to take action against their own company directors. However, with negotiations on leaving the EU about to begin, now is not the time to introduce uncertainty to UK markets by seeking to reframe the law.[63]

Even though this suggests that it is unlikely that clarity on section 172 will be provided, in the government's response to the Green Paper consultation it is mentioned that the government admits that it would be more helpful to have guidance on how the ESV model as incorporated in section 172 should operate in practice.[64] The government then invited the GC100[65] group of the biggest corporations to publish guidance on how section 172 is interpreted in boardrooms. It was anticipated that this would instigate more debate about the understanding of and flexibility provided in the current wording of section 172.[66] This guidance has now been published, and it aims to provide practical assistance, instead of formal legal advice, to directors on their performance of

61 Financial Reporting Council, Guidance on the Strategic Report (n55) at 16.
62 The UK Corporate Governance Code.
63 Business, Energy and Industrial Strategy Committee, Corporate Governance, Third Report of Session 2016–2017 (n47) at p. 17, para 29.
64 Department for Business, Energy and Industrial Strategy, Corporate Governance Reform, The Government Response to the Green Paper Consultation, August 2017 at 34, para 2.45.
65 The GC100 is the Association of General Counsel and Company Secretaries that are working in FTSE 100 Companies.
66 Department for Business, Energy and Industrial Strategy, Corporate Governance Reform, The Government Response to the Green Paper Consultation (n64) 34–35, para 2.46.

the section 172 duty, and there is a case study that can be helpful.[67] It is questionable whether this has resulted in any improvement in the position of the stakeholders. The guidance states that how the directors address both the interests of the members as a whole and the stakeholder considerations, is a matter for them, in good faith.[68] Since it simply states that balancing the factors should be determined by the directors' good faith judgement, it will not really change the position of the stakeholders. Similarly, it does not change the position of shareholders who want to hold directors accountable for ignoring the interests of the company in the long term or stakeholder interests. The guidance also does not provide clarification in regard to the various terms in the section. It states that

> for most commercial companies long term value creation is their strategic goal, but value creation and the success of the company needs to be considered in each company's particular context. For some companies, short term measures or goals may either at times or consistently be their priority. For others, for example in declining markets or facing stronger competition, successfully managing as best they can that declining market or those challenges might be the key goal.[69]

Therefore, the meaning of 'long term' and 'success' is still vague as it would vary according to the company, continuing to provide the directors' with unfettered discretion.

In light of these arguments, it is submitted that added clarity on the fulfilment of the duty under section 172 and the various terms mentioned in the section might enhance its impact. Guidance on the fulfilment of the duty, which includes clear definitions for the various terms, would surely be welcomed by the relevant parties. Lastly, it is suggested that any future guidance should indicate that 'employees', 'suppliers', 'customers', 'community' and 'environment' can have international reach. For example, suppliers should not be limited to suppliers in the UK. Considering the fact that the operations of a number of the MNCs based in the UK are in other countries, many of their stakeholders are outside the UK, or at least there are parties outside of the UK who can relate to the factors listed in section 172. Therefore, limiting the scope of the section to the stakeholders in the section would exclude the numerous stakeholders that public companies have in other countries. This could act as an opportunity for public companies to ignore their stakeholders in developing countries and the impact of their operations on the communities and environment of their operations in developing countries. Hence, it is strongly recommended that the explanations or definitions of the terms should have international reach.

67 GC100, 'Guidance on Directors Duties: Section 172 and Stakeholder Considerations' (October 2018).
68 Ibid.
69 Ibid at 13.

Purposeful companies

As mentioned earlier, Kershaw and Schuster have argued that the deployment of 'company purpose' in the Revised Corporate Governance Code, through its requirement that "the board should establish the company's purpose, values and strategy and satisfy itself that these and its culture are aligned",[70] is a potentially transformative event within UK corporate law. Even though 'company purpose' is not defined in the Code, they have established that it is best understood as the company's mission-purpose, an animated idea of why a company exists. It has been argued that purpose is key to corporate and economic success. According to Big Innovation's Purposeful Company Project, "great companies are enabled by the pursuit of clearly defined visionary corporate purposes, which set out how the company will better peoples' lives".[71] Purposeful companies are also considered to be a means of generating wealth through a more inclusive form of capitalism,[72] because a purposeful focus motivates a rearranging of corporate priorities, towards important stakeholders such as employees, customers, and suppliers and away from an ever-present primacy for shareholders.[73] If company purpose could be enabled to evolve into a meaningful concept, it could promote and protect stakeholder interests.

It is not possible to consider purposeful legal ecology and the reforms required to achieve this in detail in this chapter, but a brief summary of the arguments presented by Kershaw and Schuster is provided.[74] UK corporate law and regulation are not fit for corporate purpose because of a structural power balance that undermines taking corporate purpose seriously.[75] This was highlighted earlier in the previous section on the need for reform. Therefore, corporate law and regulation should adopt the optionality required to support corporate purpose by a taking a legal and regulatory neutral position on whether or not a firm's corporate legal ecology should provide the board with insulation from shareholder value pressure.[76] It has been suggested that to support purposeful companies to implement their purpose, state action is needed to remove legal non-compliance risk and the impression of undermining the spirit of the rule. This would enable purposive directors and managers to operate on a level playing field if they try to

70 See UK Corporate Governance Code, Principle B of Section 1.
71 Purposeful Company Project, The Purposeful Company Interim Report (2016), at 4, available at <https://www.biginnovationcentre.com/wp-content/uploads/2019/07/BIC_THE-PURPOSEFUL-COMPANY-INTERIM-REPORT_15.05.2016.pdf> accessed 30 June 2019.
72 C. Mayer, *Prosperity: Better Business Makes the Greater Good* (Oxford, Oxford University Press, 2018).
73 Kershaw and Schuster, 'The Purposive Transformation of Company Law' (n16) at 2.
74 For detailed discussion on purposeful legal ecology, suggested reforms and criticisms, see Kershaw and Schuster, 'The Purposive Transformation of Company Law' (n16).
75 Ibid.
76 Ibid.

persuade their shareholders of the advantages of a purposeful legal ecology. An introduction of clearer ecology optionality in UK corporate law will allow individual companies to select the preferred nature and extent of the zone of insulation.

Some of the recommended options provided are

> opt-ins to staggered boards with weaker removal rights, such as higher voting thresholds (for example, a simple majority of the outstanding shares, or a special resolution) or with-cause removal rights; and opt-outs of the non-frustration rule, the Listing Rule's prohibitions on proportionate voting arrangements and significant transactions, and the pre-emption rights regime.[77]

This availability of options could be arranged into to a variable rule-menu giving more legitimacy to the selection of these options. It could be organised for ease of use into shareholder-focused rules, or shareholder-stakeholder focused rules. Thus, a neutral position should be taken in corporate law and governance regarding the shareholder rights and board insulation debate, and a neutral position should naturally map onto the varying needs of different companies, with diverse mission-purposes, in different industries, at different times in their life cycle.[78] Companies subject to inflexible regimes are likely to underperform,[79] and more choice in company law could make a significant difference.[80] Corporate law and regulation should be neutral in not biasing the ownership and governance of firms. As suggested in the Purposeful Company Project's Policy Report:

> Listing, takeover, board rotation and rights issue rules should be scrutinized to ensure that they do not discourage firms from committing to their purposes through preventing companies from adopting share structures, takeover defences, board tenure and equity raising that may in some cases be justified and critical to the fulfilment of their purposes.[81]

Hence, the recommendations regarding providing more optionality could assist in protecting stakeholder interests.

Stakeholder advisory panels

Other than strengthening the reporting requirements regarding the engagement of stakeholders, which was addressed in Chapter 3, the Green Paper published

77 Ibid at 29.
78 Ibid.
79 Ibid.
80 See E. Ferran, 'Corporate Mobility and Company Law' (2016) 79 *Modern Law Review* 813 at 834.
81 Purposeful Company Project, The Purposeful Company: Policy Report (2017), at 32–33.

by the BEIS in late 2016 had proposed three other options that would strengthen the voice of stakeholders and which would also assist in ensuring that section 172 is understood and applied properly.[82] One of those options was the creation of stakeholder advisory panels.[83] The Green Paper proposed that stakeholder advisory panels could be created by company boards, so that the directors could hear the perspectives of their main stakeholder groups directly. These panels could function in different ways. The views of the panel could be sought on certain issues as they arise, and then these views could be given consideration in board meetings. Alternatively, the members of the panel could even be invited to join the board meetings to share their views when discussion on certain matters is scheduled. The panel could also start discussions on issues that are of importance to them and invite directors to attend their meetings to respond to any queries they have.[84] For example, a stakeholder panel could be formed of companies that are in the supply chain and which could give suggestions to the board in respect of relationships with suppliers.[85] These panels can be very flexible. The composition of the panels could be adapted to meet the needs of the particular company and their key stakeholders. They could also be modified over time in line with the main concerns the company has at any given time.[86] The Green Paper acknowledged that even though the representatives of the stakeholders will not have direct input into decisions made by the board, there will be more transparency regarding whether a company is attending to the concerns of its stakeholders. Instead of discussions on stakeholder issues taking place within the walls of board meetings, there would be a dialogue between the board and the panel.[87]

It is very likely that the creation of stakeholder advisory panels would assist in promoting the interests of the stakeholders and potentially enhance the impact of section 172. If there is a dialogue between the panels and the board, there would be greater transparency in that regard and how stakeholder issues are being considered. The directors would also be more aware about the concerns of the stakeholders, which will hopefully enable them to make more informed judgements. The CLLS also agreed that such panels could play a role in assisting directors to obtain views from their stakeholders, but suggested strongly that any mechanism put in place should have a very flexible approach in terms of the number of groups formed, the composition of the groups and the matters on which their opinions would be sought. Companies should have the freedom to form the panels according to their own circumstances. It highlighted that it might be inappropriate to consult with stakeholders for some

82 Department of Business, Energy and Industrial Strategy, Corporate Governance Reform, Green Paper, November 2016 at 35, para 2.14.
83 Ibid at 38–39, paras 2.15 to 2.18.
84 Ibid at 38, para 2.15.
85 Ibid at 38, para 2.16.
86 Ibid at 38, para 2.17.
87 Ibid at 39, para 2.18.

decisions because of issues such as time constraints and confidentiality.[88] Even though there should be a degree of flexibility allowed so that the groups are formed according to the type and size of the business, the panels formed should be representative of all the key stakeholders of any given company. If companies are allowed complete freedom on the creation of the panels, then problems associated with lack of clarity and the board having complete discretion over the creation of the panels will arise. These were two of the main factors that hindered the impact of section 172. If companies are given total freedom regarding the creation of the panels, it is unlikely that the panels would fulfil their purpose. Therefore, proposals for the requirement of forming stakeholder advisory panels will have to strike the right balance between giving companies too much freedom and being too rigid.

The Law Society of England and Wales made an interesting point while suggesting that it would be useful to know whether the intention of the government is mainly to strengthen the voices of the stakeholders in the UK. It acknowledges that for the purposes of section 172, a company with global operations would have stakeholders all around the world, whose interests would need to be taken into account. Therefore, the representation of the stakeholders in the UK would vary from these stakeholders in other countries whose interests need to be taken into account by the board to fulfil its statutory duties.[89] This remark is interesting as it acknowledges the possibility of section 172 having international impact. Fulfilling the duty requires paying attention to the stakeholders based outside the UK as well. This supports the arguments made in this book about the possibility of section 172 having an impact on the international operations of MNCs. Hence, it is also suggested that proposals for the formation of the stakeholder advisory panels should also include the key stakeholders of companies which are based outside the UK. Excluding them from the panels would give companies the opportunity to ignore their concerns. For example, companies with elaborate supply chains could be required to include in their panels representatives from the companies in their supply chains.

After considering the responses to the Green Paper, the Business, Energy and Industrial Strategy Committee of the House of Commons also suggested that the stakeholder advisory panels could be quite useful to create a dialogue with all stakeholders.[90] In the government response to the Green Paper consultation, it was mentioned that the government will invite the FRC to discuss the development of a new Code principle that will establish the significance of promoting the voice of stakeholder interests at board level as an important

88 Response of the City of London Law Society Company Law Committee to the Green Paper (n28) at 9–10.

89 'Law Society Response to the BEIS Green Paper on Corporate Governance Reform' February 2017, at para 40. <https://www.lawsociety.org.uk/policy-campaigns/articles/green-paper-on-corporate-governance-reform-response/> last accessed 30 March 2017.

90 Business, Energy and Industrial Strategy Committee, Corporate Governance, Third Report of Session 2016–2017 (n47) at p. 25, para 54.

factor in running a business that is sustainable. It stated that the following action will be taken in this regard:

> As a part of developing this new principle, the Government will invite the FRC to consider and consult on a specific Corporate Governance Code provision requiring premium listed companies to adopt, on a "comply or explain" basis, one of the three employee engagement mechanisms: a designated non-executive director; a formal employee advisory council; or a director from the workforce.[91]

As far as stakeholder engagement mechanisms are concerned, the focus of the government seemed to be primarily on employees, as it was deliberating on requiring certain companies to adopt employee engagement mechanisms on a "comply or explain" basis. The exclusion of other stakeholders from this deliberation is a matter of concern, because if companies are not required to do the same for other stakeholders, they might not make an effort to engage with them. The revised Corporate Governance Code provides that the board should understand the views of the company's other key stakeholders. It should describe in the annual report how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making. The board should also keep engagement mechanisms under review so that they remain effective. In regard to engagement with the workforce, it is suggested that one or a combination of the following methods should be used: a director appointed from the workforce, a formal workforce advisory panel and/or a designated non-executive director. If the board has not chosen one or more of these methods, it should explain what alternative arrangements are in place and why it considers that they are effective. So, even though engagement with other stakeholders is strongly encouraged, in regard to creating advisory panels, the focus remained on engagement with the workforce. In addition, in the government response to the Green Paper consultation, it was stated that it would ask the ICSA (the Governance Institute) and the Investment Association to finish their combined guidance on the ways through which companies can get involved with their stakeholders at board level.[92] This has now been published.[93] However, this also does not take the matter very far.

The idea of stakeholder advisory panels is not entirely novel. Many organisations have already established frameworks for stakeholder engagement that can be studied further and possibly adopted.[94] For example, a standard for

91 Department for Business, Energy and Industrial Strategy, Corporate Governance Reform, The Government Response to the Green Paper Consultation (n64) at 4–5.

92 Ibid.

93 See ICSA and IA, 'The Stakeholder Voice in Board Decision Making: Strengthening the business, promoting long-term success' (September, 2017) <http://www.wlrk.com/docs/secure.pdf> accessed 10 October 2017.

94 Chiu, 'Operationalising a stakeholder conception in company law' (n35) at 178.

stakeholder engagement has been developed by Accountability.org.[95] Another stakeholder engagement framework can be found in the ISO's stakeholder engagement framework.[96] So if companies are willing to engage with stakeholders, they have various means and existing frameworks to assist them in identifying their key stakeholders and to provide guidelines on the process of engagement. The updated guidance on the Strategic Report by the FRC also suggests that companies will probably include some information in the section 172(1) statement about the main methods the directors have used to engage with stakeholders and understand the issues to which they must have regard. It is encouraged that information on the outcomes of the company's engagement with key stakeholders and the impact on the board's decision making is provided. Directors need appropriate information to make informed decisions to discharge their duty under section 172, and it is mentioned that this information is likely to involve stakeholder engagement. This could be through day-to-day business interactions or through any specific process, structures or channels established for engagement.[97] So, the creation of stakeholder advisory panels would also be very beneficial to the board of directors to demonstrate engagement.

If proposals are put forward for the introduction of formal and permanent stakeholder advisory panels for all key stakeholders, other than just for employees, they will need to ensure that companies are given enough flexibility to tailor the panels to their particular business, but at the same time there would need to be some guidelines that ensure that there are panels for all the key stakeholders of each company, and that the panels do play a worthwhile role. Giving companies complete freedom in this regard will defeat the purpose of the panels. Based on the company's size and operations, the advisory panels would have to be provided with a clear operational mandate. A requirement to create stakeholder advisory panels can be a step forward in recalibrating corporate culture if the engagement could be linked into the boardroom and to decision-making. It is a relatively flexible and easily adaptable solution that can ensure that the board has the appropriate information to be able to consider the interests of stakeholders in its decision-making process. Companies which have a genuine willingness to listen to stakeholders and consider their interests are likely to benefit from this in the long run.

Conclusions

This book began by querying the impact of the concept of ESV, as incorporated in section 172 of the Companies Act 2006, on CSR. Section 172 is arguably the most controversial provision that was introduced by the Act, and it is no surprise

95 This global stakeholder engagement standard is called AA1000SES and is available at <http://www.accountability.org/standards/> accessed 10 October 2017.

96 ISO, 'Guidance for ISO national standards bodies: Engaging stakeholders and building consensus' <https://www.iso.org/files/live/sites/isoorg/files/archive/pdf/en/guidance_liaison-organizations.pdf> accessed 10 October 2017.

97 Financial Reporting Council, Guidance on the Strategic Report (n55).

that it has been the topic of numerous debates, both before and after its enactment. It has been submitted that the concept of ESV shares many similarities with the concept of CSR, and this book has examined whether or not section 172 is capable of promoting or assisting CSR both in a domestic and international context. By analysing the concepts of CSR and ESV, it has been established that there is a link between the notions of ESV and CSR. The ESV principle is similar to the concept of CSR because CSR also promotes long-term sustainability, and it recognises the significance of considering various stakeholder interests in achieving that objective. The analysis of section 172 in Chapter 3 demonstrated that the concept of ESV has not gone far enough in protecting the interests of non-shareholding stakeholders, which was expected by many that it would be able to achieve. Consequently, its impact on CSR is also very limited. The various weaknesses of section 172, such as its lack of clarity and guidance, the absence of enforcement mechanisms, difficulty in bringing derivative claims and inadequate reporting requirements, have prevented it from having any substantial impact on companies. The position of stakeholders remains the same, and hence its ability to promote or assist CSR is also limited. However, a link between the two concepts has been clearly established, since the research on what CSR means and the analysis of section 172 show that the concepts resonate and address very similar ideas.

The possible impact of ESV on CSR in a domestic context was also examined through a discussion of previous empirical studies and by conducting an empirical study on corporate documents. The results of the empirical study of corporate documents have shown that the ESV principle has not made much difference in practice. Previous empirical studies have reached similar conclusions. Nonetheless, the findings of the study also established a clear link between ESV and CSR. Therefore, it was proposed that if the impact of section 172 could be enhanced, the ESV principle will be capable of assisting or promoting CSR. Successfully enforcing the ESV principle would result in companies becoming more socially responsible. After analysing the situation in the UK, the focus of the book shifted to the possible impact of ESV on CSR in an international context. It was argued that the duty under section 172 could have international implications for companies that originate in the UK and operate in other countries, for a number of reasons. Chapter 5 presented the findings of the case study on the RMG industry in Bangladesh, showing that the ESV principle as implemented through section 172 did not have any discernible impact on the CSR practices of the MNCs that are based in the UK and operate in Bangladesh. It was concluded that the ESV principle does not promote or assist CSR in an international context, and it is contended that the results from this study might also be representative of the situation in other developing countries. The results from the empirical study on corporate documents, previous empirical studies and the case study on the RMG industry in Bangladesh, indicated that there is a need for reform in this area. The world is now facing an unprecedented challenge owing to the coronavirus (COVID-19) outbreak. The business responses to the pandemic in relation to global supply chains

and its impact on the CSR policies of MNCs have highlighted the deficiencies and the need for reform in private governance regimes even further.[98]

Some proposals for reform that might improve the current situation have been put forward in this chapter. In spite of the limited impact of section 172 in practice, it is contended that it continues to have educational value for directors. It shows the importance of considering stakeholder interests and thinking in the long term in promoting the success of the company. It might also serve as a protection to those directors who want to take stakeholder interests into account but may be afraid to do so. Therefore, it might be too harsh to assert that section 172 has not added anything to corporate governance in the UK.

Finally, there is scope for further research in this area. The study on corporate documents was based on the retail industry alone, and conducting a study on companies involved in other industries might provide additional valuable insights. It would be interesting to compare the results from this study with studies on companies in other globalised industries such as mining, petroleum or banking. Furthermore, after a few years, conducting a study on the impact of the new requirement for a section 172(1) statement would also be beneficial to demonstrate whether the enhanced reporting requirement has brought about the changes that were hoped for. With regard to international impact, case studies might be conducted on other industries in foreign countries where British companies have a strong presence. It is hoped that the research presented in this book will inspire future academic enquiry and debates on ESV and CSR.

98 For detailed discussion on this, see Iqbal, 'Pitfalls of Industry-Led Private Governance Regimes in Promoting CSR in Global Supply Chains: Evidence from the RMG Industry and Impact of COVID-19' (n5).

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Annex

List of corporate reports analysed for each company

Company	*Annual Reports*	*CSR Reports*	*Website*	*Section 172 (1) Statement*
Associated British Foods plc	Annual Report and Accounts 2006, Annual Report and Accounts 2008, Annual Report and Accounts 2010, Annual Report and Accounts 2012, 2015 Annual Report and Accounts	Corporate Responsibility Report 2010, 2015 Corporate Responsibility Update	✓	Annual Report and Accounts 2020
J Sainsbury plc	Annual Report and Financial Statements 2006, Annual Report and Financial Statements 2008, Annual Report and Financial Statements 2010, Annual Report and Financial Statements 2012, Annual Report and Financial Statements 2015	Corporate Responsibility Report 2006, Corporate Responsibility Report 2008, Corporate Responsibility Report 2010, 20 x 20 Sustainability Update November 2012, Closer to Customer Report 2015	✓	Annual Report and Financial Statements 2020
Tesco Plc	Annual Report and Financial Statements 2006, Annual Report and Financial Statements 2008, Annual Report and Financial Statements 2010, Annual Report and Financial Statements 2012, Annual Report and Financial Statements 2015	Corporate Responsibility Review 2006, Corporate Responsibility Review 2008, Corporate Responsibility Report 2010, Corporate Responsibility Review 2012, Corporate Responsibility Update 2015	✓	Annual Report and Financial Statements 2020

Company	*Annual Reports*	*CSR Reports*	*Website*	*Section 172 (1) Statement*
Morrisons Supermarkets plc	Annual Report and Financial Statements 2006, Annual Report and Financial Statements 2008, Annual Report and Financial Statements 2010, Annual Report and Financial Statements 2011/12, Annual Report and Financial Statements 2014/15	Corporate Social Responsibility Report 2007 (as no report published in 2006; their first CSR report), Corporate Responsibility Review 2011/2012, Corporate Responsibility Review 2015/16	✓	Annual Report and Financial Statements 2019/20
Kingfisher plc	Annual Report and Accounts 2005/06, Annual Report and Accounts 2007/08, Annual Report and Accounts 2009/10, Annual Report and Accounts 2011/12, Annual Report and Accounts 2014/15	Corporate Responsibility Summary Report 2006/07, Corporate Responsibility Summary Report 2007/08, Corporate Responsibility Group Performance Report 2009/10, Corporate Responsibility Group Performance Report 2011/12, Net Positive Report 2014/15	✓	2019/20 Annual Report and Accounts
Marks and Spencer Group plc	Annual Report and Financial Statements 2006, Annual Report and Financial Statements 2008, Annual Report and Financial Statements 2010, Annual Report and Financial Statements 2012, Annual Report and Financial Statements 2015	How we do business report 2008, How We Do Business Report 2010, The key lessons from the Plan A business case, Plan A report 2015	✓	Annual Report & Financial Statements + Notice of Annual General Meeting 2020
Next plc	Annual Report and Accounts January 2006, Annual Report and Accounts January 2008, Annual Report and Accounts January 2010, Annual Report and Accounts January 2012, Annual Report and Accounts January 2015	Corporate Responsibility Report to January 2006, Corporate Responsibility Report to January 2008, Corporate Responsibility Report to January 2010, Corporate Responsibility Report to January 2012, Corporate Responsibility Report to January 2015	✓	Annual Report and Accounts January 2020

Company	*Annual Reports*	*CSR Reports*	*Website*	*Section 172 (1) Statement*
Travis Perkins plc	2006 Annual Report and Accounts, 2008 Annual Report and Accounts, 2010 Annual Report and Accounts, Annual Report and Accounts 2012, Annual Report and Accounts 2015	None	✓	Annual Report and Accounts 2019

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