Social contract

The relationship between business and society after the crisis

Summary report of a joint Onward and EY event

ONWARD

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Building a better working world

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About this report

This summary report is a record of a panel event held in June 2021, hosted by Onward and supported by EY.

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Foreword

The lesson from history is that pandemics leave enduring social effects long after the R number has receded. The Black Death ended the practice of primogeniture. Cholera prompted the rise of municipal infrastructure. SARS refocused Asian societies on community self-sufficiency and technological resilience. How will post-pandemic Britain differ from it's pre-pandemic antecedent?

One area where change is inevitable is in the relationship between business and society. The pandemic has shown the best of British business – innovation on vaccines, action on financial support, hand-in-glove partnership with government. But it has also shown frailties, in the form of insecure jobs, ill-judged bonuses and, at the extreme, the defence of vested interest over public safety. We should emerge from the pandemic – therefore – both more convinced of the power of markets to solve society's problems and more expectant that politicians can check any excess. This need not be a contradiction.

As this panel discussed, when government and business work together on shared goals it can lead to faster results, higher trust and lower costs for consumers and taxpayers. When Parliament feels compelled to legislate, it is not just a sign that this partnership has broken down but that action will likely be too late anyway. The consensus was that we need a new contract between business and society built around social voluntarism, not heavy handed legislation. We will need it. The challenges we face after the last year surpass even those of coronavirus during it: net zero, a new technological frontier, extreme interregional imbalances. All will require business and government working together hand in glove – just as they did in the vaccine taskforce and life science laboratories, in the bank branches and supermarkets, over the last year.

Will Tanner
Director of Onward

Introduction

The pandemic has shown that business can be a key part of the solution to global and societal challenges. As leaders look to reframe their future beyond COVID-19, they need to define how their companies will create sustainable value for their employees, investors, customers and society.

Through our own research, both in the UK and across Europe, we have observed how this – still ongoing – crisis has made it critical to reconsider the 'social contract' and reinforced the importance of a long-term value approach: it has increased the expectations of stakeholders – including employees and wider society – that organizations should play a more active role in tackling major societal issues, such as inequality and climate change. CEOs and boards have questioned and changed the role of their organisations in terms of who they are serving, the contribution they can make to society, and what constitutes value. Many have used these uncertain and anxious times to lead with increased purpose – focusing on employee well-being, developing products and services for frontline workers, making financial donations and cutting executive pay.

Businesses are increasingly aware of their environmental impact. Many now recognise that, rather than a trade-off between doing good and making a good return, the two actually align, with Long Term Value the common aim. Or, to put it more simply, leaders are increasingly seeing that there is no such thing as a long-term investment on an unsustainable planet.

As a firm, we encourage a coming together of governments, regulators, local authorities, corporations, investors and financial institutions to set objectives, develop opportunities, and address economic and social challenges as well as examine how corporate governance can enable companies to become more effective in creating value and inclusive growth for the long term, with a focus on initiatives that are within the control of organisations.

The Government's consultation and future work on audit and corporate governance reform could significantly contribute to achieving an ecosystem which better meets society's expectations. We've taken the demands of politicians and society very seriously and are already delivering some of the key elements of audit reform through the establishment of our UK Audit Board and other steps we are taking to create an operationally separate UK Audit practice. But it's crucial that wider governance, reporting and the scope of audit are also addressed.

As Chair of EY I am personally up for change – change we are bringing into effect – but we have always been clear that any reforms, in order to be effective, have to extend to the wider business ecosystem. Robust corporate frameworks support trust and for these to work effectively, there need to be appropriate checks and balances.

I am of the view that greater scrutiny and accountability supports attractiveness for investors – however the Government's key role will be to strike the right balance between new measures and allowing some of the reforms time to prove their merit and impact on the market before introducing additional remedies.

Hywel Ball
UK Chair and UK&I Managing Partner, EY

Summary

This discussion centred around the relationship between business and society, how it should be managed, what needs to be in place for it to work optimally and how the pandemic may have reframed it.

The overriding consensus was that there is a fine balance to be struck between allowing businesses to determine their own corporate behaviour and enacting legislation to decide it for them. It was felt Directors should be empowered to set goals and values for their businesses, and by meeting these they are delivering on their public duty. By upholding the UK Corporate Governance Code which encourages transparency towards stakeholders alongside proper auditing so financial difficulties do not go unnoticed, we can allow consumers to ultimately be the judge of good corporate behaviour. Legislation should therefore not seek to mold or influence behaviour but should instead exist to form the limits of what is acceptable.

The pandemic has had a mixed effect on this social contract. On a positive note, it brought public and private interests into the closest alignment in years. Businesses voluntarily put aside everyday operations to respond to the pandemic, regularly at the expense of profit maximisation, and showed their impressive agility in responding to the crisis. In addition it showed the huge value of our industry and supply chains, from getting food on the shelves to supplying the necessary equipment for testing.

It has also brought immense hardship and financial difficulty. This has resulted in businesses being forced to make difficult decisions over keeping staff, honouring offers of employment and staying afloat. Many have focused on the latter at the expense of workers' rights and salaries. As we recover from the pandemic we must be wary of the aftermath of the 2008 financial crisis which allowed many of the temporary measures to become permanent, at the expense of the workforce. It was remarked that this may necessitate greater corporate oversight and regulation, especially given the high levels of debt that businesses will be keen to offload.

Key themes

1. **There is a place for legislation, but only when existing checks and balances fail.**

   There was a strong feeling amongst the panellists that we cannot, nor should we try to, legislate for good corporate behaviour.

This was largely put down to the difficulties surrounding creating and enforcing legislation.

One reason for this was that good corporate behaviour is incredibly difficult to define. Professor Vanessa Knapp OBE, Visiting Professor of Law at Queen Mary University of London, noted this in particular. She raised the concern that creating regulation which can sufficiently address the conduct of FTSE 100 companies alongside small sole traders would be incredibly challenging as it must be able to respond to both extremes. It is also not just a question of size but place, laws must apply to local companies and international ones alike, and therefore ensuring they are appropriate whilst also maintaining Britain's attractiveness is crucial.

As a result of the need for sensitive oversight, the ongoing consultation around structures of corporate governance and auditing was praised. In particular, Vanessa felt that it was important that the statutory powers attributed to the new Audit, Reporting and Governance Authority (ARGA) and the standards it enforces should be decided following proper consultation. It was felt this should then be phased in gradually, starting with larger businesses and then introduced further down the line if successful.

Another concern was raised around the cumbersome process of lawmaking. John Penrose MP cited that the process of passing a law, with various stages of consultation and readings, regularly renders the regulation out of date by the time it is passed. This long process is unlikely to be repeated annually and therefore it is almost certain to be outdated five years after the bill comes into law. Some felt that a better form of oversight is the UK Corporate Governance Code which is updated every year. This makes it well placed to adapt to the behaviour exhibited by businesses, rather than attempting to pre-empt it.

2. **Responsible behaviour must ultimately be championed by Directors and companies themselves.**

Following on from this theme, there was a consensus that where legislation does exist, it should be shaped by how business works in practice rather than in theory. Much more crucial is the Directors themselves who are best placed to balance competing interests and live up to their company commitments. The Corporate Governance Code plays an important role by preserving this practice, as Directors declare their purpose and how this will affect both their stakeholders and shareholders.

To this end, voluntarism has a key role to play. But this cannot happen in a vacuum, maintaining stakeholder relationships is at the centre of corporate governance and only by recognising this can businesses create the greatest value. This is something that Hywel Ball, UK Chair and UK&I Managing Partner of EY, highlighted in particular. He touched on the fact that for stakeholders to truly hold businesses to account, they must be included in decision making. This is where proper auditing plays a very important role, by allowing a high degree of transparency and ensuring conduct is in the public interest. It was noted that whilst audit cannot be a guarantor of success, it can alert customers to when financial difficulties are looming. When such troubles do arise, it must once again be the Directors who balance competing interests.

3. **Business is fundamentally a good thing.**

Directors and employees should be granted sufficient agency to do what is best for their business. There was strong agreement that by trusting them to embody the company values, this is ultimately what will result in the greatest value for all stakeholders.

John Penrose MP touched on this in particular. He pointed to the fact that the private sector is a great thing which we all rely on. The pandemic has shown this greater than ever, by evidencing the importance of supply chains, for example. It was well publicised when testing capacity was limited that it was not because of a lack of individuals to provide tests but due to insufficient numbers of vials – exemplifying the many moving parts needed for a supply chain to work optimally. Outside of the immediate public health crisis, business enriches our lives by providing goods, services and diversity. It is important that businesses feel empowered to do just this. We should not try to separate a business' core purpose from its social value: it is not possible to offset or mitigate social harm through charitable activity. Businesses' should be contributing to society through their core products and services to customers.

Where regulation and government have a role, therefore, is fiercely protecting consumers to make sure that products are delivered fairly. This is why bodies like utilities regulators are so essential, not to adjust water and gas provider's purpose or practice, but to ensure the consumer always feels they have the power to make choices in a free market.

4. **The pandemic has highlighted what is possible when the priorities of business and society are strongly aligned.**

   At the height of the pandemic, hundreds of British businesses halted their everyday activities in order to respond to the coronavirus crisis. It was noted by Andrew Griffiths MP that after a couple years where government and business have drifted apart, the health crisis served to bring them much more into alignment. The urgency resulted in a much closer working relationship between ministers and industry: Cabinet ministers were on the phone to CEOs and typical slow timelines were reduced to days.

   Andrew noted that this makes him optimistic for the future, particularly in reaching net zero targets, given the agility shown by industry. It also once again highlights the important role of voluntarism – in the same way that many companies chose to pause regular operations to deliver food packages or manufacture ventilators, the past year has seen a significant rise in companies announcing their own net zero targets. Andrew noted that in November 2020, around 10 FTSE 100 companies had made their own climate pledge, this number has now passed 40. This shows the power of voluntary endeavour and how individual corporate decisions can closely align with public interest.

   The pandemic also allowed companies to exemplify their strong values and loyalty to their staff. In the face of reduced profits and uncertainty, many valiantly retained their staff and honoured offers of employment. Others took extra steps to respond to safety concerns and made shielding possible.

5. **However, the pandemic has also put enormous strain on businesses financially and has led to difficult outcomes for much of the workforce.**

   Whilst for some the pandemic has been an opportunity to prove one's worth in the face of crisis, it has overwhelmingly brought huge hardship on people and businesses. This is something Janet Williamson, Senior Policy Officer at TUC discussed, as she highlighted the scale of job losses and the decay of many workers' rights, particularly those on precarious and zero hours contracts. For example, it was noted that insecure workers were nearly ten times as likely to report they had not been offered sick pay, compared to secure workers, and this also limited the likelihood of isolating as a result. Vanessa Knapp alluded to this too, suggesting that the pandemic has highlighted businesses' need to think about sustainability in the long term, by planning for future obstacles and making sure their workers are properly protected.

It is also important that as we move on from the pandemic, we do not allow workers' rights to be permanently diminished. Janet discussed the instances whereby businesses have asked for their staff to reapply for their current role with lesser pay or lower hours. This may have gone unnoticed during the crisis but moving forward, stronger mechanisms may be needed to protect workers. John Penrose suggested initiating the recommendations of the Taylor review to do this, which have already been accepted by government, meanwhile Janet proposed enforcing the use of the term 'workforce' rather than 'employees' throughout the companies' act.

A number of the panelists reflected on the 2008 financial crisis as a point of comparison, although in different ways. Janet highlighted that following the financial crisis there was a rise in zero hours contracts and poor worker rights as businesses attempted to get a hold on their debts by reducing their outgoings. This cannot be allowed to happen again. Meanwhile others reflected on how many of the changes brought about as a result of 2008 have grown to greatest effect in the last year. Whilst this additional oversight has played a large role, there was a broad consensus that greater regulation and guidance may be needed, particularly necessitated by high debt levels.

Conclusion

This panel discussion presented as an opportunity to reflect on the previous year and the effect it has had on businesses of all sizes. In many ways it was a conversation of two halves, the first discussed what the proper role for government and regulation is in relation to corporate governance, and the second which was how we use this understanding to ensure a just and effective economic recovery.

There was consensus that ultimately it must be Directors and businesses themselves who should be trusted to uphold their values and champion their workers, this is in everyone's interest and many did so valiantly prior to and during the coronavirus crisis. The role for legislation and oversight is to step in when this trust fails, as a precautionary measure, rather than to guide behaviour in the first instance. By getting this balance right, we can ensure that British businesses are working towards what is in the public interest and ultimately create the greatest value for their stakeholders too.

Refreshing the rulebook

The pandemic has made people more aware of the inequalities in society and highlighted the importance of considering the sustainability of our actions. Companies increasingly recognise this and have shown ways to tackle the challenges society faces. It is important that corporate governance encourages businesses to think about how they balance the competing interests of the company, its shareholders and those stakeholders who are affected by how the company behaves.

Recent changes to the UK corporate governance code have encouraged companies to establish their purpose, values and strategy and make sure their culture aligns with them. Directors of large companies must report how they have had regard to stakeholder interests when performing their duty to promote the company's success.

The government is proposing to establish the Auditing, Reporting and Governance Authority as a powerful statutory regulator of companies. There are concerns about the extent and effect of its powers. There are also calls to change directors' duties to make it clearer that they can promote stakeholder interests as well as shareholder interests.

The real question is how to best to encourage good corporate behaviour. Using a corporate governance code is likely to be the best approach. A code is flexible and can adapt quickly to reflect changing expectations. Coupled with an obligation to report publicly, it is more likely to bring about positive change than changing directors' duties. Any action taken now must help the UK remain attractive as a place to do business and be proportionate in its approach.

Professor Vanessa Knapp OBE
Visiting Professor in the Department of Law,
Queen Mary University of London

Evolving economies

For hundreds of years, businesses have transformed our lives for the better by creating wealth, improving living standards, creating jobs, and inventing cool gadgets that make life easier, more interesting and fun. But they can create problems too; if we don't set things up properly, it's easy to leave the door open for monopolies, rip-offs and scams to flourish. And if they do, then citizen-consumers will start to tread a lot more warily, distrusting the system and feeling like we've got to check everything because we aren't sure if it's really on our side.

And that's a serious problem. Partly because all that checking and distrust slows everything down; high trust societies and economies work faster, better and more productively than low ones. And partly because if we think the system is set up for bosses or bureaucrats or cronies rather than us, then we won't care if it crumbles and is replaced by something else. There are plenty of competing creeds that would love to brand profits and businesses as inherently bad or evil activities that constantly have to apologise and atone for some indelible, original sin.

And if they succeed, the legitimacy of our entire liberal, democratic, free-market society is undermined. So it's essential for us to set the system up properly in the first place so it's clearly on the side of the many. That means being clearly and unapologetically on the side of consumers, with strong rules to protect us from scams, cons and rip-offs, plus lots more choice so that we can all find what we want, rather than what some politician or bureaucrat has decided for us instead.

The latest challenge comes from digitisation. It's creating all sorts of brilliant, amazing new things that we all love, but it is also giving fresh legs to new-economy versions of the old scams and rip-offs too. That means we need a new, re-tooled Competition Act so we can deal with digital dodginess just as easily as the more traditional analogue versions, and updated regulators to apply the new laws too. The world won't stop moving and improving, so we can't either.

John Penrose MP
Member of Parliament for Weston-super-Mare,
The Prime Minister's Anti-Corruption Champion

A new deal for workers

The pandemic has shone a new light on the world of work.

We realised which jobs we really depend on, including the supermarket, delivery and transport workers who went out to work while many of us stayed at home. Many of these workers are low paid and insecure. And they're not alone.

Before the pandemic, insecure work in the UK had risen sharply to reach 3.6 million or one in nine working people. Average real wages were still lower than they were in 2008.

If we are to build back better after the pandemic, this must mean a new deal for working people.

Early signs are not encouraging. Nearly 1 in 10 workers have been told to re-apply for their jobs on worse terms and conditions or face the sack. And almost a quarter say their working conditions, such as pay or hours, have been downgraded since first lockdown in March last year.

After the financial crisis, we saw a deterioration in many workers' terms and conditions and the rise of insecure work and low pay. This time we must do better.

Companies must move away from business models based on insecure work and fragmented employment relationships. They must ensure that all the workers who make their products, deliver their services and support their internal operations are employed on secure contracts and paid decent wages.

Best practice is important, but it is underpinned by legal requirements for minimum standards and the incentives created by the regulatory framework, including corporate governance.

The TUC is calling for the word 'employee' to be replaced by 'workforce' throughout the Companies Act. This would broaden the scope of reporting requirements and directors' duties to cover the whole workforce, rather than just directly employed employees.

This would close a loophole that has arisen as when the Companies Act was being drafted, prior to 2006, indirect employment was much less prevalent than it is now, and the word 'employee' was clearly not intended to differentiate between different part of a company's workforce.

The use of the word 'employee' in the Companies Act affects the quality and accuracy of company reporting. Some companies with a large proportion of indirect workers exclude their indirect workers from their annual reports, despite the latter's contribution to the company's products, services and profitability.

This small but significant change has already been reflected in the 2018 Corporate Governance Code and the Wates Corporate Governance Principles for Large Private Companies, which both use 'workforce' throughout.

Primary legislation will be needed to implement the proposals in the BEIS consultation on audit and corporate governance. This provides a vital opportunity that must not be missed to close this loophole and ensure companies take responsibility for their whole workforce.

Janet Williamson
Senior Policy Officer, Trades Union Congress

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