Fair weather friends

Wider stakeholder interests are left unprotected should a business fail.

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The introduction of section 172 of the Companies Act 2006 reflected growing public acceptance that it isn't just shareholders that have a stake in the outcomes and outputs of businesses and other organisations. The statutory requirement was an acknowledgement that companies are part of a symbiotic ecosystem comprising employees, customers, suppliers and providers of capital, as well as the communities in which they operate. All of these, as well as the natural environment, can be impacted by a business and its activities, and businesses depend on these stakeholders to exist, innovate, trade, grow and make a profit.

For those working in boardrooms today, the emphasis on other stakeholders is increasingly evident. Directors often proactively query the impact of proposals on other groups or the environment in a way that was previously unlikely to have been the case. In the UK, new Better Business Act proposals are intended to move the debate on even further, reflecting the growing consensus that shareholder interests are not necessarily the only ones that should be taken into consideration. Under s172, the default position remains one of shareholder primacy. Under the Better Business Act, that default position would no longer apply and directors would have greater freedom to prioritise other stakeholder interests above those of members.

Whatever the pros and cons of s172 and the future of the Better Business Act may be, the interests of wider stakeholders are at least recognised as important. And it is true to say that the concept of enlightened capitalism is increasingly being embraced by institutional investors who recognise, and are more often willing to act upon, the need to drive more responsible business behaviours. Guided by the Stewardship Code, major shareholders are now frequently to be found challenging boards on their approach to remuneration, supply chain practices or environmental stewardship.

While wider stakeholder interests have been accepted as a core principle of good governance, at the other end of the spectrum, when a business approaches failure and company law dictates that the interests of shareholders are superseded by the interests of creditors, such enlightened attitudes are immediately required to take a back seat.

The protection of creditors in insolvency plays an important role in keeping the wheels of industry turning. Without creditor protection, the willingness of creditors to allow a company to be indebted to them would quickly evaporate, creating damaging barriers to trade. But there are numerous recent examples where the interests of smaller suppliers, pensioners and employees have been sacrificed on the altar of this fundamental principle of insolvency law. In such unfortunate circumstances, the law affords no wriggle room to embattled boards who must take a cautious approach to protecting creditor interests if they are to keep themselves safe from wrongful trading claims. And in an ironic twist, it is often the best protected and most influential institutional creditors – those who could often most easily absorb a loss but who are least likely to need to do so – that must be favoured.

It is at this precarious point in the life cycle of a business – when the potential for negative impact on their wider stakeholders is likely to be greatest – that company law withdraws support for all connected parties other than those who are owed money. Pension fund members and pensioners, employees and smaller suppliers, all of whom can be almost entirely dependent on the business for their financial wellbeing, are often poorly protected. Investment management colleagues at many banks will be signatories to the Stewardship Code which urges them to adopt a purpose, culture, strategy and beliefs that enable them to create 'sustainable benefits for the economy, the environment and society.' Yet within the same firms, those who offer capital in the form of institutional debt facilities, rather than as equity, will have no equivalent responsibility to consider any alternative options that may be available for a struggling business, even if those alternatives offer a good chance for the lenders to recover their money alongside improved outcomes for other creditors, employees, pension funds and suppliers.

A degree of mismatch between how wider stakeholders are supported in the good times versus the bad is, no doubt, inevitable, but recent corporate collapses have shown that the current position is no longer in sync with societal expectations. Directors, for whom wider stakeholder interests are now an accepted part of their debate, can be left wholly powerless to help those other stakeholders at the most critical of moments. Perhaps, alongside the Better Business Act, insolvency law should also be reconsidered.

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