IoD POLICY PAPER

ESG Priorities for UK Companies

January 2022

Introduction

Environmental, social and governance considerations are increasingly important decision-making criteria for many kinds of organisations – not only as a means of winning the trust of stakeholders but also as barometers of effective business management.

A strong ESG profile is attractive to potential investors, lenders, employees and customers, and helps build the brand of the organisation. Conversely, weak ESG performance is often viewed as a red flag. It may suggest that the company's purpose is not well aligned with the interests of wider society – bringing its longer-term sustainability into question.

For 2022, the IoD has identified a number of ESG priorities for UK companies and organisations. They are applicable to most entities – although the manner in which they are implemented will vary according to the size, complexity and sector of each individual enterprise.

These priorities do not represent a comprehensive list of everything a company must do in order to fulfil its ESG potential. Nor should they be viewed as some kind of regulatory code or systemic set of principles which organisations should benchmark themselves against.

Rather, they are a checklist of issues which the IoD believes are worthy of boardroom discussion in 2022 – and which have been highlighted by recent corporate behaviour, IoD member surveys and advisory groups, and our perception of emerging business norms.[1]

We believe that, by addressing these issues, the sustainable performance of enterprises can be improved. And if widely adopted, they could serve to enhance the reputation of the UK business community.

[1] These priorities draw on the findings of the 'IoD Global Conference 2021 – Connecting the World Tackling our global challenges together'. The conference report can be found here: https://www.iod.com/Portals/0/Images/SCOTLAND/IoD%20Global%20Conference%202021%20-%20REPORT%20IoD.pdf?ver=2021-10-06-094018-037. Conference videos and blogs are also available: https://www.iod.com/events-community/regions/scotland/annual-conference

A Stakeholders and business purpose

The IoD believes that companies should adopt a balanced stakeholder orientation to guide their business activities – rather than a narrow focus on short-term shareholder returns. The doctrine of shareholder value maximisation, which dominated corporate decision-making in the 1980s and 1990s, is increasingly incompatible with current societal challenges, given its tendency to promote short-term decision-making and negative environmental and social externalities.

1. Companies should define a 'purpose' for their organisation which aligns their objectives with the interests of wider society. The business purpose should not be purely concerned with the generation of financial returns. It should provide a clear statement of how the company intends to deliver a positive social and environmental impact.[2]

2. Boards should primarily be concerned with generating long-term value for their organisations. This will involve paying due regard to all those stakeholders that are instrumental in contributing to sustainable success, e.g. long-term investors, employees, customers, suppliers, and wider society. In private sector companies, boards should not prioritise the short-term demands of shareholders over the longer-term interests of other key stakeholders.[3]

[2] This priority draws on the work undertaken by the British Academy as part of its Future of the Corporation Programme – the final report of which was published at the end of 2021. https://www.thebritishacademy.ac.uk/publications/policy-and-practice-for-purposeful-business/
[3] The IoD is a supporter of the Better Business Act Campaign, which is seeking reform of Section 172 of the Companies Act 2006 in order to embed a stakeholder orientation into directors' general legal duties. https://betterbusinessact.org/

B Sustainability

The IoD believes that UK business has a crucial role to play in the transition of the UK economy away from fossil fuels and carbon-intensive business activities. The decarbonisation process needs to be accelerated in order to limit the extent of destructive climate change. But it must also occur in a phased manner – so that business can adjust in an orderly way to the challenges and opportunities of a Net Zero economy.

3. Companies should assess, as a matter of urgency, whether board members and senior executives have the skills, know-how and commitment to oversee the transition of the enterprise to Net Zero. In cases where relevant capabilities are lacking, companies should seek to remedy the situation through board training initiatives or changes to board composition.

4. Companies should assess their current impact on the environment and climate change, and publicly report on it in an appropriate manner. They should not make unjustified, misleading or inconsistent claims regarding their 'green' credentials, i.e. 'greenwashing', in their marketing activities or in corporate reporting.

5. Companies should thoroughly evaluate the risks and opportunities posed by climate change to their business models and operations. They should then consider how they can report this assessment to stakeholders – such as in their annual report and in other public communications. Where possible, companies should utilise a recognised reporting framework – such as TCFD.[4]

6. Companies should determine how they intend to transition their activities to Net Zero and announce a target date for the achievement of that objective. We encourage them to become signatories to the Net Zero Pledge.[5]

7. Companies should be encouraged to provide more information to customers and other stakeholders around the environmental impact of their individual products, services and operations – in order to facilitate informed consumer purchases and decision-making.[6]

[4] For the largest companies with more than 500 employees and annual turnover above £500 million, the use of the Task Force on Climate-Related Financial Disclosures framework (TCFD) will be mandatory from April 2022. https://www.gov.uk/government/news/uk-to-enshrine-mandatory-climate-disclosures-for-largest-companies-in-law
[5] https://www.pledgetonetzero.org/about
[6] The IoD supports the Rewired Earth initiative, which is building a global data platform aimed at enhancing the transparency of global supply chains in terms of climate impact. https://www.rewired.earth/vision

C Inclusion and Diversity

The IoD believes that business leadership, and directorship in particular, should be open to anyone with the necessary abilities – regardless of their socioeconomic background or personal characteristics. An inclusive approach makes good business sense – both in terms of how the company is viewed by society and through its positive impact on decision-making. When it is lacking, it may signal deficiencies in respect of the underlying culture and leadership of the organisation.

8. Companies should aim to achieve gender balance on their board of directors and in senior executive positions. In cases where the under-represented sex forms less than one-third of board members, the company should describe how improved gender balance will be achieved.[7]

9. Companies should aim to increase the ethnic diversity of their boards and senior management – in order to better reflect the ethnic diversity of the societies and markets in which they are operating. In cases where there are no board members from an ethnic minority background, the company should describe how it intends to improve the situation.[8]

10. Companies should evaluate how they measure and monitor overall levels of inclusiveness and diversity in their organisations. They should consider the extent to which they are providing a level playing field in terms of career development to employees of all backgrounds and personal characteristics. They are encouraged to set targets in respect of relevant metrics of inclusion and diversity, e.g. representation of employees with protected characteristics, narrowing of pay gaps, diversity requirements for recruitment shortlists, etc.

[7] This priority reflects the objectives of the Hampton-Alexander Review, which in 2016 set a target of 33% women in leadership and on boards for the FTSE 350.
[8] This priority reflects the recommendation of the Parker Review, which in 2017 set a target of at least one board member of colour for FTSE 100 and FTSE 250 boards.

D Governance

A key role of any director is to deliver good governance for their organisation. The IoD believes that a robust governance framework is essential in order to promote accountability, effective decision-making and sustain the trust of stakeholders.

11. Large companies[9] should split the role of a Chair and CEO, and include a significant number of independent non-executive directors on their boards. Small and medium-sized companies should appoint one or two independent directors with relevant skills and experience to their boards at an early stage. Where companies have yet to achieve this objective, they should provide a credible justification and roadmap towards improving the situation.

12. Companies should undertake substantive due diligence of their supply chains and business partnerships in order to ensure that they are not inadvertently supporting modern slavery, forced labour, human rights abuses or environmental degradation.[10]

13. Company owners and directors should respect the boundaries between the company and their private interests. They should not seek to exploit their power over the company to pursue their own interests at the expense of other shareholders or stakeholders – but rather seek to benefit from the success of the company as a whole.[11]

14. A chair or board member should not remain in their role for an excessive period of time without a credible justification – given the importance of refreshing board composition and enabling the company to benefit from new experiences and insights.[12]

15. Board members should primarily be appointed on the basis of their ability, personal qualities, training and relevant professional experience, whilst taking account of the need for sufficient independence, diversity and stakeholder perspectives in board composition.

16. Future leadership diversity should be baked into the organisation through meaningful succession planning for both board members and senior executives (including the CEO). A company should not find itself incapacitated if it unexpectedly loses the services of the CEO, Chair or another key individual.

17. Boards should devote time to planning how they can develop the professionalisation of their leadership and boardroom team – through initiatives such as training, coaching and mentoring. In particular, board members and senior managers should be encouraged to begin the journey towards becoming Chartered Directors[13]. Boards should also undertake regular board performance reviews – in order to optimise their functioning.

18. Companies should embrace the need for effective whistleblowing processes, and not adopt a defensive or punitive approach towards whistleblowers.

19. Large companies should pay their suppliers within a reasonable timeframe e.g. within 30 days. They should be encouraged to become signatories to the Prompt Payment Code.[14]

[9] For example, companies with an annual turnover exceeding £36 million and more than 250 employees. This reflects the definition of a 'large' company in the Companies Act 2006.
[10] The Modern Slavery Act 2015 requires large companies (with global turnover above £36 million) to publish a modern slavery statement. But the IoD believes that responsible enterprises should go further and undertake substantive due diligence of their supply chains.
[11] In principle, Section 172 of the Companies Act 2006 requires directors to promote the success of the company. However, this legal duty does not apply to shareholders, and the Act conceives the success of the company as synonymous with the success of the shareholder constituency rather than in terms of the company as an organic entity with multiple stakeholders.
[12] This priority is reflected in Provision 19 of the UK Corporate Governance Code.
[13] The Chartered Director programme was launched in 1999 by the IoD. It has since established itself as the 'gold standard' qualification for serving and potential board members. https://www.iod.com/chartered-director/
[14] The Prompt Payment Code was revised in January 2021, and now requires small businesses to be paid in 30 days, with commitments to be made personally by CEOs or Finance Directors https://www.gov.uk/government/news/government-tackles-late-payments-to-small-firms-to-protect-jobs

E Executive remuneration

The IoD believes that senior managers should be rewarded on the basis of performance that they deliver for the organisation and its stakeholders. The nature and structure of executive pay policies can be an important barometer of the accountability (or lack of it) that is being exercised over management by the board.

20. Pay and rewards structures should be designed to align the interests of stakeholders (including shareholders) and management.

21. Companies should be cautious about making large pay awards to senior executives if they have received substantial government support during the pandemic.

22. Companies should not reward management failure – particularly in the context of situations where they have experienced significant reputational or financial damage.

23. Companies should always ensure that they can 'claw back' remuneration from executives if poor performance or inappropriate conduct is discovered after pay awards have been made.

24. Companies should avoid designing pay policies which mainly reward executives on the basis of short-term increases in the share price, and which fail to take account of the company's wider ESG or stakeholder responsibilities or objectives.

25. Executive remuneration should be aligned with the company's progress in transitioning to Net Zero.

26. Companies should avoid unpicking existing performance measurement criteria ('moving the goalposts') in order to secure higher rewards for executives than would otherwise have been achievable based on agreed pay policies.

The Institute of Directors is a non-party political organisation, founded in 1903, with approximately 20,000 members. Membership includes directors from right across the business spectrum – from media to manufacturing, professional services to the public and voluntary sectors. Members include CEOs of large corporations as well as entrepreneurial directors of start-up companies.

The IoD was granted a Royal Charter in 1906, instructing it to “represent the interests of members and of the business community to government and in the public arena, and to encourage and foster a climate favourable to entrepreneurial activity and wealth creation.”

The Charter also tasks the Institute with promoting “for the public benefit high levels of skill, knowledge, professional competence and integrity on the part of directors”, which the IoD seeks to achieve through its training courses and publications on corporate governance.

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About the author

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Dr. Roger Barker is Director of Policy and Corporate Governance at the Institute of Directors (since September 2020) and a member of the IoD Management Team. He is also Honorary Associate at the Centre for Ethics and Law at University College London, and a regular speaker on corporate governance issues at a variety of leading universities and business schools.

Dr. Barker is the author of numerous books and articles on corporate governance and board effectiveness, including a new co-edited volume: ‘The Law and Governance of Decentralised Business Models: Between Hierarchies and Markets’ (Routledge, 2020). Previous books include: ‘Corporate Governance and Investment Management: The Promises and Limitations of the New Financial Economy’ (Edward Elgar, 2017), ‘The Effective Board: Building Individual and Board Success’ (Kogan Page, 2010), and ‘Corporate Governance, Competition, and Political Parties: Explaining Corporate Governance Change in Europe’ (Oxford University Press, 2010).

A former investment banker, Dr. Barker spent almost 15 years in a variety of equity research and senior management roles at UBS and Bank Vontobel, both in the UK and Switzerland. He has a doctorate from Oxford University and taught Politics at Merton College, Oxford (2005-2008). Until January 2020, he served as a UK Member of the European Economic and Social Committee in Brussels.

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