January 2020
A guide to implementation

Case studies from directors on section 172 duties

Contents

Introduction

Purpose

This collection of case studies aims to illustrate good practice application of directors' duties as set out in the [Companies Act section 172.](#)

The objectives are to:

- Highlight factors for consideration on section 172 (directors' duties) and the steps used to make a decision to help get the planning right, so directors are properly thinking through the issues;
- Support directors' judgement and decision-making; and
- Illustrate what good looks like so that individuals can tailor it to their own circumstances.

This guide is not intended to offer a prescriptive approach to decision-making as this will depend on the specific context. It is intended to help shed light and share the experiences of senior board members about how they navigated difficult decisions and the principles they applied to balance different needs and priorities.

Approach

Case studies have been gathered from various CAs in their capacity as board members (both executive and non-executive) in a variety of private and listed companies across a range of sectors.

They are based on a range of actual scenarios and judgements board members have had to apply, but identifiable facts have been changed to preserve anonymity.

The case studies provide an outline of a particular scenario. Only certain aspects have been highlighted for analysis for the purpose of this guide, being to illustrate application of section 172 duties in real life situations. They are not intended to provide a full analysis of the context or decision-making which took place. These case studies aim to offer insights into the key issues which board members had to deal with in real life situations and the most significant aspects of section 172 which they had to consider.

Target audience

This guide is primarily for directors and staff in companies subject to Companies Act requirements and other interested parties.

The Companies Act section 172 – an outline

The primary duty of directors as set out in section 172 is to promote the success of the company. Acting for the benefit of shareholders is not their sole duty and a greater consideration of other factors relevant to a range of stakeholders is encouraged as part of the decision-making process.

The following issues are important for corporates and underpin what 172 is trying to do:

- Building trust in business and demonstrating that business is doing the right thing;
- Anticipating and managing public challenge, reputational impact and scrutiny; and
- Building and embedding wider stakeholder engagement into decision-making, not just relying on a purely shareholders-centric perspective.

Each case study is analysed against the legislation section 172(1) as follows, where relevant:

172 Duty to promote the success of the company

(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.

Extract: Companies Act 2006

Summary and commentary on key themes arising in the case studies

The following themes are considered in the case studies:

a. Managing cost reductions
Balancing financial sustainability of the business with the broader stakeholder impact is explored in case studies 1 – 4. Scenarios include a factory closure, pension deficits and succession planning.

Companies face pressure to protect shareholders, improve cost efficiency and increase returns.

Managing increasingly unsustainable pension costs at a listed company through achieving board and employee understanding of the consequences and subsequently their support for a decision to close future accrual of a defined benefit scheme is illustrated in case study 1.

Succession planning at a private company involves directors navigating a range of challenges to help the company manage a significant pension liability which is threatening their plans to sell the business and its future viability (case study 2).

A private company's efforts to reduce its pension deficit is particularly challenging given the owner's resistance to reducing their dividend (case study 3). In this case, the voice of external parties helped bring added impetus to reform.

A factory closure (case study 4) shows how a board had to step back and think about the wider section 172 issues, going the extra mile to protect those affected by redundancy when the social and reputational impact of closure was high.

b. Investment and growth
Promoting the success of the company and demonstrating responsibilities to investors, wider society and high standards of business conduct is explored.

The acquisition of an overseas business where the political context and international reputation added an extra dynamic which needed to be thought through from a stakeholder's perspective is the subject of case study 5.

Another example during the financial crisis shows how duties to wider society were decided as being more significant than shareholders' return (case study 8) when investments were at risk of default.

Case study 6 shows how a board had to balance its purpose and stewardship duties with values and ethical preferences in an investment decision.

Investment and growth – balancing prudence and entrepreneurial attitudes

A board exercising prudence is contrasted with an entrepreneurial CEO in case study 14. Striking a balance between an entrepreneurial attitude and evidenced based decision-making is one of the board's challenges.

In contrast to the investment decisions in established businesses, such as mergers and acquisitions where a highly evidence-based approach to decision-making is demonstrated, a more entrepreneurial attitude to risk is exemplified in an earlier stage resource exploration company where the board were wary to commit to further drilling given escalating costs, yet the CEO persisted and struck lucky.

The dynamic of an entrepreneurial CEO is often needed to help drive a young business forward. However, this needs to be grounded by a strong board to provide balanced judgement. This emphasises the importance of a controlled environment to provide a counterbalance and avoid the risk of visions tipping over into recklessness.

Themes for the board to navigate include luck versus judgement, setting parameters to mitigate the risk of recklessness and factors taken into account for judging whether the direction is visionary or delusional.

c. Stakeholder and reputation management

Managing the challenges of public inquiry and reputational concerns are demonstrated in case studies 7 – 8.

Insights from a company undergoing a public investigation and how stakeholder needs and reputation were managed across different external and internal stakeholder groups are shared in case study 7. This illustrates how establishing facts and demonstrating an open attitude to learning from mistakes, yet also being mindful of the potential effect on employee morale more broadly was considered by the board.

A narrow interpretation of directors' duties to maximise shareholder return was concluded as being inappropriate in case study 8 when cutting exposure to losses had a negative societal consequence and acting ethically was of greater importance.

d. Supporting longer term success

This theme is at the core of 4 different scenarios in case studies 9 – 12, including:

- How a small company experiencing funding challenges balances going concern with the best interests of members and employees (case study 9). In this example, timing is critical and external advice is sought to inform directors' decisions.
- Managing board challenges to get agreement for sustainable directors' dividends (case study 10). A key challenge for the board was to change the owner director's perspective of the company's purpose as supporting his lifestyle to delivering broader duties and responsibilities in an increasingly complex multi-stakeholder environment. Independent challenge and the addition of external pressure combined to counterbalance a dominant individual on the board.
- Two examples of a business restructure (a listed company and a private company, case studies 11 – 12) follow the decision-making to demerge a division to become a separate company and be better placed for growth, in support of the duty to promote the success of the company for the benefit of its members as a whole. The private company board navigates a conflict of interest in the bidding process, testing its governance controls.

e. Effective governance – managing challenges to exert influence

One of the red flags for boards is when there is an unhealthily close Chair/CEO relationship as this can create barriers and restrain a NED's contribution, or when there is a sole shareholder who is the CEO. These situations can make it difficult for others on the board to exert their influence. Different perspectives are offered in the case studies.

Who do board members turn to when they have a problem? This question arises in various case studies under different themes. Sometimes they have to utilise the views of external stakeholders such as the bank (case study 10), a significant shareholder or the regulator in order to get to the right outcome. In case study 3, the Pensions Regulator was involved and this helped drive change. Without external influence, this board struggled to achieve sufficient influence on its own against a dominant chair and major shareholder.

The experiences of a smaller owner managed business with informal governance arrangements is considered in case study 10. A covenant breach provided the trigger for the bank to add their voice and give impetus to change. Ultimately, it may be that in the last resort a director has to threaten to resign (case study 13).

f. ESG and environmental issues

The push towards a low carbon economy and moving away from carbon investment underlies the need to have stronger arrangements to evaluate the environmental impact and costs. This affects both the business' effect on the environment and costs to adapt to meet targets.

There is increasing investor interest in ESG funds and companies who can demonstrate ESG management and incorporating this in operations to support longer term business sustainability. As well as the reputational and cost impact, there may be a greater risk of not raising required funds if enough attention is not given to this.

There can be huge customer pressure on companies to ethically source their raw materials (case study 15). Supply chains can be complex and challenging to investigate so this can involve a lot of work for the company. In some cases, there may be limited alternative suppliers which can put the company in a difficult position.

Case study 14 offers an example of a business operating within the appropriate legal environmental licences for exploratory drilling yet faced with NGO resistance. Whilst legal and regulatory requirements may be present and require broader consideration of non-financial as well as financial aspects for decision-making, there is increasing public interest in environmental responsibility and a growing sense that adhering to the letter of the law is no longer enough.

Other observations

g. The limits of good practice – what if it still goes wrong?

The board can diligently do everything it can be expected to do but unexpected events still happen and things will go wrong. As long as directors have discharged their duties, ensured appropriate procedures and controls are in place and decisions are based on what could reasonably be known at the time and are well documented, that is all that can be expected. One can only influence what one can control.

h. Similarities and differences between public and private sector boards

Every business manages stakeholders, is subject to directors' duties and increasingly exposed to reputational risk. In essence, boards should be concerned with exercising appropriate judgement on similar key issues and have similar attitudes to applying good practice whatever their size, structure or listing status.

One of the differences observed in board agendas between listed and private companies was the proportion of board discussion time on potential public impact. Public companies are much more conscious of public perceptions. An owner in a private company is exposed to individual reputational risk; for a public company, the impact can affect brand reputation which has been built over many years and this can be high profile. Reputational impact on an organisation can have wide repercussions such as the ability to recruit or agree suppliers.

The culture of the company can also be a factor, with some more risk averse or entrepreneurial in nature. For example, an exploration-based business model inherently involves adopting greater risk to progress than a large established financial services business with consumer protection at its core.

Board commitment

ICAS recognises the important role of all stakeholders in achieving the long-term sustainable success of business and the significant contribution business makes to the economy and society. Building trust in business is crucial.

The increased focus on section 172 through the revised Corporate Governance Code is welcome. We believe this can be amplified and clarified in terms of what it means in practice by the board recording in its preamble to board discussion its section 172 responsibilities and the board's commitments.

To achieve this, we would encourage CEOs to commit to:

- Delivering value to customers
- Investing in employees; treating them fairly and with respect, building diversity and inclusion
- Dealing fairly and ethically with suppliers
- Supporting the communities in which they work
- Embracing sustainable practices
- Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate.

Trust will only be built if these commitments lead to a broader and increased focus by companies on all their stakeholders and they report on how they are meeting them in a fair and balanced way.

Index of case studies

				Act to promote the success of the company for members as a whole, and in doing so have regard (amongst other matters) to:					
No	Case studies	Theme	Business issue	a) The likely consequences of decision in the long term	b) The interests of company's employees	c) The need to foster business relationships with suppliers, customers and others	d) The impact on the community and the environment	e) The desirability of the company maintaining a reputation for high standards of business conduct	f) The need to act fairly as between members of the company
1	**Closing a pension scheme to future accrual**	**Managing cost reductions (pensions)**	Financial sustainability	✓	✓				✓
2	**Managing a pension scheme deficit and business succession planning**	**Managing cost reductions (pensions)**	Financial sustainability	✓	✓	✓			✓
3	**Managing a pensions deficit**	**Managing cost reductions (pensions) and challenges (board)**	Financial sustainability/effective governance	✓	✓	✓			✓
4	**Closure of a factory**	**Managing cost reductions (operations)**	Business restructure and supporting longer-term success	✓	✓		✓		✓
5	**Acquisition of an overseas business**	**Investment decisions (M&A)**	Investment & growth	✓		✓	✓	✓	
6	**Ethical investment**	**Investment decisions**	Investment & growth/ESG	✓			✓		
7	**Facing litigation or regulatory challenge in the public eye**	**Managing challenges – public investigation**	Stakeholder and reputation management	✓	✓	✓	✓		
8	**Investments – responsibility to investors and/or wider society**	**Managing assets at risk of default**	Stakeholder and reputation management	✓			✓	✓	✓
9	**Managing funding challenges and going concern**	**Supporting longer-term success**	Financial sustainability	✓	✓	✓			✓
10	**Managing unsustainable directors' dividends**	**Supporting longer-term success and**	Financial sustainability/effective governance	✓	✓	✓		✓	✓

		managing board challenges							
11	**Demerger of a division**	**Supporting longer-term success**	Business restructure and supporting longer-term success	✓	✓	✓	✓	✓	✓
12	**Selling part of a business and managing conflicts of interest**	**Supporting longer-term success**	Business restructure/managing conflicts & effective governance					✓	✓
13	**Updating executive remuneration arrangements**	**Managing challenges to exert influence (NED)**	Effective governance	✓	✓			✓	✓
14	**An entrepreneurial CEO and navigating environmental concerns**	**Environmental impact and balancing entrepreneurial attitudes to risk**	ESG*/effective governance	✓			✓		
15	**Understanding the supply chain and deciding where to do business**	**Environmental impact**	ESG		✓		✓	✓	

Case studies

1. Closing a pension scheme to future accrual

A company ran two pension schemes in parallel for its employees: a defined benefit (DB) and defined contribution (DC) scheme. For the DB scheme the company bore the financial risk of achieving a sufficient level of capital to pay a guaranteed pension to their employees on retirement. For the DC scheme, the company capped its pension contribution to employees (who also contributed). The final reward that would accrue to employees on retirement was dependent on the performance of the investments made by employees on the funds contributed by both the company and the employees. The financial risk therefore transferred to the employee.

The DB scheme had been closed to new entrants a few years before as it was increasingly expensive. It related to a declining 25% of the workforce. Financially, the company was paying 3 times as much in total pension costs to DB employees compared to DC employees. Pension fund liabilities were increasing and the company was having to make additional lump sum payments to cover the shortfall and this to only 25% of its workforce. Fewer people were costing the company ever increasing amounts in retirement benefit funds, an unsustainable position for the company. This was unfair to the majority of employees who were not benefiting from this funding.

The future outlook indicated that the problem was predicted to worsen, factors included:

- Lower interest rates were expected which would further exacerbate the DB funding problem.
- Decreasing numbers of employees in the DB scheme meant there were less employee contributions to fund the increasing liabilities as they arose. Essentially, the scheme was becoming more risky and less viable.
- Government had communicated proposals for auto-enrolment of employees into a pension scheme. Projections identified this would increase the number of staff enrolled and contributing to the DC scheme. This would further increase the inequality for employees not in the DB scheme and increase overall employer pension costs.

A decision was made to cease future accrual to the DB scheme. Existing accrued pensions would be guaranteed but no new accrual would be allowed. Existing DB scheme members would henceforth be enrolled into the company DC scheme.

Members were effectively offered a hybrid arrangement, i.e. DB scheme members would get the accumulated pension value to date then move to a DC scheme. At retirement they would receive a pension value of the combined hybrid scheme.

Analysis of issues against Section 172

Promoting the success of the company for the benefit of its members as a whole, having regard to:

a. the likely consequences of any decision in the long term

- Financial sustainability – the financial obligations had been calculated and found to be unsustainable over the longer term. The company could not afford to equalise pension benefits by increasing the benefits for 75% on DC scheme to match those on DB scheme so the alternative was to amend the benefits of the minority to equal the majority.
- The size and volatility of continuing these DB payments made it more difficult to plan for the business.
- Some questioned why the company continued to pay dividends to shareholders when the money could be used to protect employees who were DB scheme holders. The judgement was based on what was best for the business as a whole. Paying a dividend was important to secure required levels of equity and debt financing. Any debt funding requires a “base” of equity funding and for that equity funding to be available from the public markets, a dividend needs to be paid on a sustainable basis. The optimum funding balance was important to support longer term growth and health of the business.

- The worsening financial projections made a solution more urgent. This was accentuated by a pending change in government policy to require auto-enrolment. It was concluded that the problem would not disappear and action was essential.
- Obtaining board and employee support – initially most of the board were opposed. Issues for discussion were debated one board meeting at a time, starting with the financial issues to explain the need, impacts on the organisation and equality and fairness for employees. This allowed each board session the time and opportunity to explore each issue in depth and supported challenge. The aim was to achieve a balanced decision for each. Once board acceptance was achieved (the financial argument was quite straightforward, the employee one less so), the concern was how to present this to the employees to ensure understanding, support and successful implementation.

b. the interests of the company's employees

f. the need to act fairly as between members of the company

- A key challenge was to balance the reaction of existing DB scheme members, who would be subject to a certain loss of pension rights with the business' longer-term financial needs; to communicate clearly on the reasons for change and listen to concerns from those affected.
- The DB scheme applied to a declining quarter of employees yet required a payment 3 times greater per employee than those on the DC scheme. In effect this meant inequality of total remuneration for some staff undertaking the same job. It was seen as fundamentally unfair to sustain the expensive pension benefits for a declining few. Whilst equalising the two schemes meant that some employees (i.e. those on DB scheme) would potentially lose out with the withdrawal of their scheme, the longer-term interests of the business and majority of employees needed recognition.
- Shareholders were informed once the decision was made.

Managing the implementation

- Extensive engagement was key to success – to the staff by the board and senior executives. A huge consultation and engagement exercise was undertaken over a year including face to face meetings with employees and their trade union representatives, Q&A sessions and issuing brochures/staff communications to explain the changes, the need for reform, impact and what this would mean for staff. Fairness and equity for all was a key determining factor in the success of this consultation.
- Following the decision to proceed, a transitional, longer term plan to implementation (this took 2-4 years) provided time for building acceptance and a measured approach to planning

2. Managing a pension scheme deficit and business succession planning

A private manufacturing company is owned by two directors who are seeking to retire when the business can be handed over to suitable new owners/management. They have attempted to sell the business in recent years but were unable to find a buyer due to the cost of funding the pension scheme deficit and the associated risk and uncertainty it places on the business' future financial performance.

The company has annual turnover of £30m and profits of around £700k. They run a defined benefit (DB) pension scheme which was closed to new entrants a few years ago but still has significant annual costs for remaining members (£100k). The scheme deficit was recently revalued, increasing from £2m to £3m. Company net assets are reduced to £0.5m after taking into account the scheme deficit.

Cash flow is tight and an overdraft facility is used with annual repayments of £250k per annum. Business is seasonal which creates strain on the company's ability to meet supplier payments and the bank repayment. There is also a commitment to pay £500k per annum towards eliminating the pension scheme deficit over 8 years.

The two directors are also trustees of the pension scheme alongside one member-nominated trustee, the company secretary.

Analysis of issues against Section 172

a. the likely consequences of any decision in the long term

Continuing the DB pension scheme is creating pressure on the business' sustainability which is becoming more acute as the directors seek to achieve a solution to enable retirement.

Managing the deficit through scheme closure could improve the financial position of the business and its marketability to third parties. It would also support the directors in meeting their own retirement plans.

For existing members, closing the scheme to future accrual would mean that they cease to earn benefits. For the business it would reduce its exposure to a heavy financial liability and the risk and uncertainty around future pension scheme liability remeasurement would also diminish. However, advice is needed to prepare a full cost appraisal of the options and evaluate the impact.

Actuarial advice would help confirm any funding implications of ceasing future accrual and the investment strategy would need to be reviewed by trustees. For example, less risky investments may be more appropriate for a closed scheme as member contributions cease.

Legalities also need to be considered to inform the decision. The company will need to establish what legal powers exist to close a pension scheme, for example, in the scheme's trust deed/rules and the terms of the members' employment contracts, consultation duties, etc. They will also need to seek advice on how to progress and what consents are required.

Timescales are important as depending on what option is selected, it could vary and there may be a need to factor in additional steps, e.g. analysis, advice and communication plans. For example, a programme to communicate to staff the business need, preferred option and impact assessment, consultation period etc. Timing may affect what option is feasible depending on the latest date the directors decide to retire or sell the business.

b. the interests of the company's employees

For individual employees on the DB scheme, a decision to close the scheme to future accrual would mean a reduction in their pension rights and a loss in value of their future pension. On the other hand, at a company level, there is a risk to the business' longer-term continuation and jobs.

Employers must be prepared to demonstrate the business need for the closure of a defined benefit pension scheme and implications of the preferred option.

The scheme's trustees have a duty to safeguard the interests of its members so they will need to assess commercial and financial reasons and any alternatives with the employer as well as assurance that the pension obligations will be met in the long term. An insolvency would see the scheme enter the Pension Protection Fund's assessment period and this would impact the benefits available to members.

The directors face a conflict in their role as directors versus their role as trustees and therefore decided to resign from the role, appointing a third-party independent trustee company.

c. the need to foster the company's business relationships with suppliers, customers and others

The pressure on cash flow has triggered a review of terms for suppliers' payments and customer debt to manage cash flow. The business has strong reliance on high quality and reliable suppliers so is keen not to undermine their good supplier relationships.

f. the need to act fairly as between members of the company

The continued viability of the company is ultimately a better outcome for other shareholder and scheme members than any potential insolvency. Directors decided to explore the following options:

- An adjustment to the agreed recovery plan that would see annual deficit contributions halved and the deficit eliminated over a period of 16 years. The rationale for this is that the company's ability to continue meeting its obligations to lenders is improved, as is its marketability to third parties.
- The potential "buy-out" of scheme liabilities by an insurance company. This option would involve selling the company's trade, assets and operating liabilities generating funds which could be used to buy-out the scheme liabilities and leave a balance that can be paid to the owners of the business.

3. Managing a pensions deficit

Trustees of a pension scheme for a family owned private company submitted 3-yearly actuarial valuations for its defined benefit (DB) pension scheme to the Pensions Regulator. The Trustees received a response from The Pensions Regulator (TPR) that its latest actuarial deficit fell outside acceptable parameters and would be subject to inspection. The company was required to put in place a 10-year deficit recovery plan and strengthen governance arrangements.

The scheme deficit was measured at £35m and the required recovery contributions were agreed at £3.5m per annum.

Regulatory focus was given to the remuneration and dividends paid to the owner and family directors. Governance improvements were required both at the company and the pension fund. The chairman of the company, a family member, was a dominant personality.

At the same time, the company had other challenges and the employer was going through a number of changes including:

1. Amending bank covenants.
2. Reducing/restricting dividends.
3. Closure of the DB scheme to future accrual as there were concerns it was not financially sustainable.
4. Business restructure comprising the sale of a subsidiary to help with renegotiation of bank covenants (point 1 above).

Challenges included obtaining board consent for reducing dividends given resistance and opposition from the chairman (a controlling shareholder).

Analysis of issues against Section 172

a. the likely consequences of any decision in the long term

The DB pension scheme was unsustainable financially. Renegotiations focused on achieving a balance between the shareholders' need for a return and maintaining the financial health of the company over the longer term.

A quarterly payment from the business to contribute to the deficit was agreed and a proposal to restrict dividends was ultimately accepted. Approval and support were needed from the chairman to drive through the business changes required. Pragmatically to achieve agreement, all parties received something and there was an element of compromise for all (as for many restructuring scenarios).

A proposal for closing the DB scheme to future accrual was also implemented.

b. the interests of the company's employees

The TPR had highlighted concerns that the DB scheme was not being treated fairly by the employer as it operated at an unsustainable deficit with dividends coming before deficit recovery contributions.

The trustees and employer agreed to establish a recovery plan and agreed appropriate deficit recovery payments to protect employees who were saving in and relying on this scheme for their retirement.

Whilst employees in the business may be working for shareholders, shareholders also need to do the right thing for employees.

c. the need to foster the company's business relationships with suppliers, customers and others

The business reforms, such as renegotiation of bank covenants, could only be satisfactorily achieved with agreement from funders.

The voice and presence of external parties (funders and TPR) helped to add force and urgency for change to meet regulatory requirements. In this example, of a family owned company with significant majority shareholder influence over the board, it may otherwise have been difficult to generate enough impetus to drive through the changes using only internal drivers.

f. the need to act fairly as between members of the company.

Progressing a deficit recovery plan to maintain both a healthy pension scheme for employees and a financially successful company achieved greater equality of interest across both majority and minority shareholders.

The Trustee Board for the pension scheme was changed. Family members were replaced by new independent and professional trustees to strengthen the level of challenge.

4. Closure of a factory

A manufacturing company which founded its business decades ago and was still located in its original premises and town had to make a commercial decision on production facilities. It had grown considerably over the years and now had an international presence with various premises across the country. The original location had become a small part of the manufacturing process. The company had undertaken a business and cost review. This identified the need to upgrade premises, consolidate sites and reduce costs through a redundancy programme. Consultations were undertaken for a high impact restructure as a commercial decision was made to close the factory and move to new premises in a different part of the country.

Analysis of issues against Section 172

a. the likely consequences of any decision in the long term

The business and financial case for closure was clear. It was not beneficial for the business to invest further in a small and increasingly costly factory when more efficient and modern manufacturing was centred elsewhere.

b. the interests of the company's employees

d. the impact of the company's operations on the community and the environment

f. the need to act fairly as between members of the company

At a global level, the impact on the business of the restructure in its place of birth was not financially significant. Financially and operationally, the scale of this decision would not normally be a matter for the board. However, the social and reputational impact was high particularly given the heritage associated with the brand. The matter was therefore escalated to the board to focus on the wider implications of the decision. The board involvement reflected a recognition of its responsibility to do the right thing. Respecting the local community and the company's heritage were judged to be highly important.

The social impact of making a significant number of employees redundant in the local area was considered. There were a limited number of alternative businesses to move to, so the company agreed to donate to a local enterprise fund combined with other support for redundant staff to help find them alternative jobs.

Legal responsibilities regarding redundancy were identified and followed.

5. Acquisition of an overseas business

A financial services company was seeking to increase its footprint in an emerging market. The board were reviewing an opportunity to buy a business in a country where the projected business outcome was good, but the region was subject to political uncertainty and had received some international criticism.

The board assessment of the foreign acquisition included strategic fit, projected return, financial and reputational risks. The following factors were considered:

- Alignment with strategic objectives and business plan.
- Whether the proposal was consistent with stakeholder expectations.
- The company's ability to execute the transaction, manage the integration and risks.
- Achieving understanding of the domicile and ascertaining the probability of whether it might be systemically risky for the business to invest in the location.
- Assessments of affordability, contingency levels and capacity for a write-off if the investment went wrong, including whether the loss of capital and follow-up costs could be borne financially by the business without impacting any other business area.
- Testing of assumptions.

The board accepted the business and financial analysis but were evenly split on whether this was a country they were comfortable doing business with, given the political environment.

The board achieved a unanimous decision. The approach which the board used to exercise its responsibilities and deal with uncertainty was as follows:

- Additional time was allocated and the decision was debated over various board meetings.
- Importance was attached to ensuring everyone clearly understood why they made the decision. Effort was made to provide all the facts they needed and to gather any additional information to inform board members on their areas of uncertainty. The aim was to keep clarifying and assessing the facts until everyone had the information they needed to make a decision.
- Future events and the expected outcome may change yet individuals can only make a decision based on the facts available at the time. Whatever the outcome, individuals need to be comfortable with their own part in the decision.
- An inclusive/team approach sought to gather a broader view and obtain support from board, staff and customers. No attempts were made to force a decision, each board member was to make their own decision and achieve a collective final agreement.

Analysis of issues against Section 172

a. the likely consequences of any decision in the long term

As well as managing financial risk, the political environment of the overseas business brought an additional layer of uncertainty and potential for media headlines/public criticism should events occur in areas inconsistent with the company's values.

The board sought to achieve understanding of the domicile and ascertain the probability of reputational risks which would draw stakeholder criticism.

c. the need to foster the company's business relationships with suppliers, customers and others

Understanding supply chains and compatibility (or otherwise) with group standards and statutory requirements.

For example, the Modern Slavery Act 2015 sets out a range of measures on how modern slavery and human trafficking should be dealt with in the UK. In particular, section 54 entitled 'Transparency in supply chains' impacts the corporate sector and requires many businesses to disclose a 'slavery and human trafficking statement'.

d. the impact of the company’s operations on the community and the environment
The potential for policy differences in ESG matters and potential impact on the business’ reputation and performance.

e. the desirability of the company maintaining a reputation for high standards of business conduct
The company sought to gather assurance that group standards for business conduct and internal control would be reliably achieved and upheld in the overseas business.

An evidence-based approach was applied to achieving a collective decision. No decision would be based on instinct. Evidence and additional information were the basis for a balanced and researched conclusion. This supported accountability as the rationale and basis could be clearly and openly explained to stakeholders, reinforcing credibility.

6. Ethical investment

A research company received a substantial donation. The board had to decide how to invest £1.5m in a fund which could grow the capital and help the organisation meet its objectives. Fund managers were invited to present on an appropriate investment strategy.

The investment options were to invest in either:

- A multi-asset fund with a successful track record, or
- A new ethical fund with the ability to tailor holdings according to investee company preferences and avoid particular industries. However, there was a very limited track record available for this new fund.

Analysis of issues against Section 172

a. the likely consequences of any decision in the long term

d. the impact of the company’s operations on the community and the environment
The board had to decide how to prioritise its duty of stewardship and balance it with the objective of growing funds to support organisational objectives through ethical investment.

The lack of a track record for the ethical fund increased the risk of uncertainty around the ability of the ethical fund to achieve investment objectives. The limited availability of investment performance information also showed high volatility which was inconsistent with the Trustee’s risk appetite. It was decided that the stewardship duty was the greater priority. The board acknowledged that it is not always possible to fulfil every objective (at the same time). An ethical investment could be made with more assurance once the fund had established a track record.

A policy can help to articulate the principles and issues for consideration and support consistent decision-making. Over the longer-term, moving towards ethical funds was cited as an example of how organisations can play a part to help to encourage positive business behaviour.

7. Facing litigation or regulatory challenge in the public eye

A financial services company discovered a regulatory breach and was subject to investigation by the regulator. The incident was also publicly reported.

In this example, when the breach was discovered, the board requested that a holistic review be undertaken to establish the facts, what learning points could be derived and to inform how they should respond. This included identifying what went wrong, the scale, i.e. whether the incident was isolated and if not, how widespread it was. The review sought to understand how the breach arose, whether an individual knowingly went beyond their remit or if it was an inadvertent breach.

Analysis of issues against Section 172

a. the likely consequences of any decision in the long term
The potential for reputational damage to the business was identified and managed by the board. A thorough review was undertaken to establish facts and learning points.

b. the interests of the company's employees

- Care is needed not to present an unfair or inaccurate picture which may undermine the value and good work of the many for the sake of a few to appear appropriately contrite to external parties.
- Corporate loyalty and protection will be expected by innocent staff/those not involved. Ensuring recognition of good work and valuing employees is important to maintain a sense of pride in the organisation.

c. the need to foster the company's business relationships with suppliers, customers and others
Striking the appropriate balance in responding to this can be highly challenging, particularly when matters are aired in the public arena. Everything will play through internal and external stakeholders so potential perceptions and how one responds is critical. Engagement and communication across all stakeholders must be carefully navigated to maintain reputation and trust.

The case needs to be handled proportionately and cognisant of the interests of a wide variety of stakeholders:

- Regulator and public – if a breach has been identified, there is a clear duty to cooperate fully and openly with the regulator. All parties need to be assured that the issue is being dealt with diligently and fairly. Any matters raised must be taken seriously – there is no smoke without fire and underplaying the incident may appear flippant. There can be a tendency to bend over backwards to avoid public censure and gain brownie points – a balanced and accurate response is sought.
- Investors – providing assurance that matters are being dealt with appropriately and thoroughly so that no additional problems are being missed helps to maintain credibility, confidence and maintain focus on the long term.
- Customers and suppliers – how the company responds is important for maintaining trust and a reputation for quality.

> *"This is not an opportunity to win points. The best one can hope for is a scoreless draw."*

d. the impact of the company's operations on the community and the environment
Demonstrating professionalism, independence and objectivity as part of the wider duty to support the integrity of and trust in the capital markets.

The larger and more systemically important the business is (particularly in highly regulated industries), the greater the level of regulatory oversight and public communication requirements. Managing broader considerations and public perceptions is inherently a far more significant content of board agendas for listed than private companies.

8. Investments – responsibility to investors and/or wider society

A financial services organisation held significant exposure to US household mortgages during the sub-prime crisis. This company had a high level of mortgage products at risk of default. There was pressure from a particular group of investors to threaten to cut the impacted subsidiary loose as a way of forcing its debt providers to share the pain.

The board considered the different arguments and concluded that the wider stakeholder perceptions were much more significant. It was decided that a narrow interpretation of directors' duties to maximise shareholder return was inappropriate in this context.

Analysis of issues against Section 172

Legally it would have been possible to withdraw support from the group company which would have led quickly to its bankruptcy. Such action would have forced losses onto bondholders and the effect of a rapid withdrawal from the market would have been detrimental to a large number of householders and extremely high profile. It was believed that this was likely to generate considerable longer-term reputational damage with the public, government, customers and the company's own employees, who may have ethical concerns with an action which prioritised short-term financial return over social impact. This was inconsistent with the values of the business.

a. the likely consequences of any decision in the long term

The board considered the likelihood of a longer-term detrimental effect on the business to be more significant than shorter-term financial gain. The longer-term negative consequences risked undermining the business' values, reputation and performance.

d. the impact of the company's operations on the community and the environment

The impact of a bankruptcy of the mortgage lender was expected to compound the financial strain on exposed householders. The broader societal impact and negative reputational implications were a significant part of the decision-making process.

e. the desirability of the company maintaining a reputation for high standards of business conduct

Practising good business ethics – the reputational benefits of being seen to "do the right thing" by customers, employees and wider stakeholders was believed to have a positive impact on performance supporting longer-term business success and sustainability.

f. the need to act fairly as between members of the company

The proposal to threaten to force losses as a negotiating tactic to achieve some debt mitigation was the view of a particular group of shareholders (group A) but it was not necessarily representative of wider shareholders and stakeholders. The board was required to consider their statutory director duties. Group A, who were not subject to the same broader duties, were driven by different priorities. This difference in perspective was acknowledged and the board came to a balanced decision that overall, disregarding broader responsibilities for short term financial gain, was inconsistent with their duty to *"promote the success of the company for the benefit of its members as a whole…"*.

9. Managing funding challenges and going concern

A private technology company with a bright future was in a start-up state, not pre-revenue but loss making. It was equity funded using angel and venture capital investment. Without profits, bank debt finance was not available. The funding was sufficient to match the cashflow forecast when, through increased orders and sales, profits and cash would be generated. Once the cashflow became positive further funding would not be required unless the business decided to expand.

However, orders and revenue were slower to materialise than forecast and the business started to see another potential funding gap. The appetite for a further equity injection depended on how much progress has been made on orders and revenue. This created valuation issues as a further equity issue would have a dilutive impact on existing shareholders. There was no appetite for further equity funding from the shareholders and the directors had to take action. This included professional insolvency advice, as the board wanted to continue to trade to the point where sufficient orders and revenue were generated. Action also included cost-cutting to give the business the optimum possible chance to continue to operate.

Orders and revenues were usually higher than planned yet variable; cash was tight and careful management of working capital on a frequent basis was critical. A company is insolvent when it is unable to pay its debts[1] either because it:

- cannot pay bills when they become due
- has more liabilities than assets on its balance sheet.

It is difficult to judge when this point is reached. Directors reviewed a range of information to inform their decision of whether it was still reasonable to conclude the business is a going concern. This included historic and forecast cashflows, assumptions were checked and a reasonable contingency for variations between actual and forecast cashflow was set.

Directors frequently monitored progress and checked if any assumptions were failing. They met in-between board meetings as monthly board meetings were too infrequent for the needs of a dynamic ongoing issue.

Directors engaged external advisers (insolvency practitioners and lawyers) to offer an external, independent expert view to evaluate assumptions and assess whether their approach and judgements are reasonable and in accordance with the law. The insolvency practitioner was also able to offer practical advice on next steps and how to sustain the business when cash is tight.

Analysis of issues against Section 172

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

f. the need to act fairly as between members of the company

The business had a viable business model which attracted investors however capital requirements for a technology business were high. It relied heavily on long-term, patient finance and this created pressure on working capital. The directors had identified the issue and were managing it.

Timing is critical and directors are responsible for getting this right. Giving up on the business too early is not in the best interests of members yet too late can risk trading insolvently.

Taking appropriate external advice at an early enough stage helped to provide assurance that directors were undertaking their responsibilities in a proper manner and doing all they could in the circumstances to keep the business a going concern and maintaining jobs.

Managing working capital requirements involved negotiating payment terms with debtors and suppliers to help improve a positive cash flow and ensure sufficient funds were available to stay solvent.

10. Managing unsustainable director's dividends

A profitable private company has a sole owner director and shareholder who has a high level of personal spending needs. He is accustomed to withdrawing from the director's loan account and maximising his dividend payments. The company currently has an overdrawn director's loan account. The director has been advised by the accountant to address this as a matter of urgency.

[1] https://www.legislation.gov.uk/ukpga/1986/45/section/123 & https://www.gov.uk/government/publications/options-when-a-company-is-insolvent/options-when-a-company-is-insolvent

The cumulative effect of cash withdrawals from the business have placed a strain on the overdraft limit. The bank covenant terms also require net assets to be at a certain level. Despite interim profits, the company is now in breach of this requirement.

The following interim measures are considered:

- Cost savings, e.g. ceasing employee overtime.
- Working capital management, (e.g. delaying payments to suppliers and HMRC).
- Assessing potential for increasing income and positive cash flow.

The company recognises that its ability to service its customers' needs is key to its long-term sustainability. There is a significant volume of unfulfilled orders in the order book. Cash flow projections and sensitivity analysis help to identify that adding one additional employee to clear these orders will help generate a net cash improvement over the next quarter resulting from profits from the additional sales less salary costs.

The projections show that the company needs a further cash sum which the director agrees to reinject back into the company. He also agrees to limit drawings from the business to a sustainable level.

Analysis of issues against Section 172

a. the likely consequences of any decision in the long term
The continuation of cash withdrawals from the business via dividends without sufficient regard to affordability and consequences for the business and its growth plans is unsustainable.

b. the interests of the company's employees
The cessation of employee overtime is unpopular with the company's small workforce, many of whom have come to see this as part of their core package.

It does not address the root cause of excessive withdrawals and the irresponsible actions of the director.

There is a heightened risk of resignations and diminishes the company's ability to meet customer demands.

c. the need to foster the company's business relationships with suppliers, customers and others
Managing working capital through delaying payments to suppliers is unfair and potentially damaging to the business' relationship with them and reputation.

It is a breach of directors' duties, unprofessional behaviour and inappropriate to treat suppliers and government as involuntary creditors. This exposes the company to penalty payments and raises concerns about the business' competency.

The director, having started and grown the business, has been accustomed to withdrawing cash from the business as needed without challenge. As personal circumstances developed and cash withdrawals escalated, the consequences on the business have broadened to bring in other stakeholders. The breach effectively acted as a check and balance to the director's actions. Although the accountant had told him about this, it was the introduction of external forces which helped to initiate change. This demonstrates the importance of independent challenge to counterbalance a dominant individual on the board (in this case the owner), particularly in smaller companies where governance arrangements may be less developed.

e. the desirability of the company maintaining a reputation for high standards of business conduct

The implications of a breach of the Companies Act 2006 section 830 regarding distributable profits[2].

f. the need to act fairly as between members of the company
The sole owner director had developed a habit of supporting his growing personal spending demands from the business. One of the challenges for the board was to change the director's perspective of the company supporting his lifestyle to broader duties. It took a trigger point of breaching a bank covenant and subsequent discussions with external advisers – an accountant and the bank, to help change this and achieve a better balance between business needs and director's drawings.

11. Demerger of a division

The future strategic focus of a Group is on 2 divisions in a company with a total of 4 divisions, each responsible for different activities in the business.

Divisions A & B are both capital hungry and good businesses with a bright future. Both required further capital for growth.

Division A delivered a higher return on invested capital than division B. Division A was therefore able to win a greater share of company funding, Division B fared less well in the limited capital allocation which impacted its ability to grow. Increasing pension fund liability payments across the Group, including Division B, intensified the pressure to compete for capital resources and the increasing squeeze on capital allocation by the company was increasingly unsustainable for Division B .

A strategic demerger of Division B from the company was decided. It would be set up as a separate listed public company owned at day one.

The aims were to:

- Enhance access to funding for Division B and allow public shareholders to purchase shares and raise bond funding to improve future access to capital.
- Enable greater focus on the strategy of Division B (much of the company focus had been on the higher performing Division A).
- Offer greater choice and freedom to future board, directors and shareholders on the future strategy, capital planning and investment.
- For the remaining Group, this would help to simplify its capital allocation decisions on the higher return business, demerge a portion of pension fund assets and liabilities, support financial sustainability of the remaining Group and help support their future investment strategy.

Analysis of issues against Section 172

a. the likely consequences of any decision in the long term
If a company is unable to provide sufficient capital to one of its divisions, it is likely holding back a business – this is not equitable in the long run for employees or shareholders.

Improving the strategic focus and financial sustainability of the business better positioned it to meet its potential.

b. the interests of the company's employees
A healthy growing business would help to create a better environment and future for employees.

Promoting the success of the company for the benefit of its members as a whole
One of the key considerations for directors is that a new business will have greater chance of survival if it is not over-burdened with debt and liabilities. This needs to be balanced against the Group's desire to offload a portion of pension fund liabilities. Sometimes the stronger business partner will need to keep a higher portion of liabilities (even if not strictly their own) to support the sustainability of the new

[2] https://www.icas.com/technical-resources/distributable-profits-guidance Distributable profits guidance ICAS ICAEW

business. This is fundamental to the decision. Unless the proposal creates a viable business in the demerged entity then the demerger will not work or be approved. In a demerger (for a listed company) there is a full prospectus, working capital report and the new directors of the new company will have separate legal and financial advice on what responsibilities they are taking on.

There is a trade-off taking place of what assets and liabilities get transferred across. The shareholders of both entities are identical so a viable solution for both companies must be found, or the demerger does not take place.

12. Selling a business and managing conflicts of interest

A manufacturing company decided to sell a business following successful development of the products and proving them in the market.

A board director, who was also representative of a significant shareholder intended to bid for the company.

Analysis of issues against Section 172

Promoting the success of the company for the benefit of its members as a whole, having regard to:

e. the desirability of the company maintaining a reputation for high standards of business conduct

f. the need to act fairly as between members[3] of the company
The director's potential conflict was disclosed as per the Companies Act 2006 section 175. Duty to avoid conflicts of interest and section 177. Duty to declare interest in proposed transaction or arrangement.

The board identified the following risks:

- Significant conflicts of interest and unethical behaviour.
- Insider knowledge of the bid process impeding the duty to act fairly between members of the company (shareholders).
- Reputational impact and presenting a poor perspective to other bidders of an insincere process.

The board ensured that steps were taken to ensure independence of the analysis and decision-making process and minimise the opportunity for a single board member/shareholder to benefit. This reflected their duty to act fairly between members.

When the conflict of interest was identified, the board sought legal advice on how to proceed. The company's approved process for sale as outlined in its Articles of Association included a provision to enable the board to exclude directors from board meetings for agenda items where there was a conflict.

A board resolution was passed to exclude the individual board member from the meetings and any related activity, e.g. review of bids, due diligence and decision-making. Arrangements were set up to keep lines of communication separate.

Former board papers were reviewed to identify if any commercially sensitive information was included which could have given the director an advantage. It was concluded that the only advantage remaining was that the director had earlier notification of the plans to sell the business.

[3] Members of a company defined in Companies Act 2006 section 112 as subscribers – see also definition of subscriber

13. Updating executive remuneration arrangements

A new Chair was appointed to the company's Remuneration Committee. She believed that the approach for remunerating executives needed tightening. This included making long-term incentive plans (LTIPs) more demanding and simplifying the general approach to remuneration, aligning it more closely with company plans for the next 3 years.

She met with remuneration consultants to discuss options for a new scheme then presented the proposal to the CEO. The CEO was a strong character and disagreed with Remco Chair's decision to take responsibility for driving forwards the change. The Remco Chair persisted and the CEO raised with the Board Chair who supported the CEO. The latter two had worked together a long time and were of a similar mindset. There was little independence of thought demonstrated. The options for the Remco Chair were to stay and not deliver proposed change or resign.

Analysis of issues against Section 172

Principles for remuneration practice are an element of the UK Corporate Governance Code 2018[4] (the Code).

a. the likely consequences of any decision in the long term
The principles of aligning remuneration with the company strategy and supporting long-term sustainable success are part of the Code[5].

b. the interests of the company's employees

f. the need to act fairly as between members of the company
The Code principles[6] state that "directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking account of company and individual performance and wider circumstances".

The scope of the remuneration committee has also been expanded in the latest Code to include reviewing workforce remuneration, demonstrating engagement with the workforce and alignment with wider company pay policy. The expectation is that a broader perspective is taken which includes a consideration of perceived fairness when setting executive remuneration.

e. the desirability of the company maintaining a reputation for high standards of business conduct

Effective governance
Good practice for listed companies (public interest entities) governance arrangements includes establishing a remuneration committee. The Board Chair and independent non-executives are meant to offer an independent perspective. The Remuneration Committee should have delegated responsibility for determining the policy for executive director remuneration and setting remuneration for the chair, executive directors and senior management.

Resistance from the CEO and Board Chair prevented the Remuneration Committee from carrying out its responsibilities as the Chair saw it, therefore reducing the independence and effectiveness of the role and undermining the governance structure.

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[4] Scope of application – see page 3 of the Code
[5] Principle P – The UK Corporate Governance Code 2018 (the Code) principles include:
• "remuneration policies and practices should be designed to support strategy and promote long-term sustainable success" and
• "executive remuneration should be aligned to company purpose and values and be clearly linked to the successful delivery of the company's long-term strategy".
[6] Principle R

Reputation risk and stakeholder expectations

The potential impact on personal reputation of going along with a board decision which is incompatible with one's own principles needs to be considered. By fronting the decision at the AGM and answering questions, it would likely damage the reputation of both the company and the Remuneration Committee (Remco) Chair if it appeared she did not fully support the decision. The expectation externally would be that the Remco Chair would drive the process, not remuneration consultants and certainly not the CEO. She believed that she had to take ownership of and believe in, the proposals the company would be presenting to shareholders. If questioned and challenged at the AGM it would be very difficult to defend a scheme she did not own.

The Remco Chair knew that media attention was focused on remuneration and that the time was ripe for a review to update the remuneration policy and LTIPs to reflect wider public and investor perceptions.

Independence of mind

The CEO and Board Chair having worked together for several years and sharing a similar viewpoint, were not welcoming challenge and change, yet introducing greater challenge was one of the reasons for setting governance standards on independent non-execs and chairs.

The Remco Chair was not comfortable in a role which restricted her ability to exercise judgement and promote change as she saw fit. How she reacted to this scenario would influence the rest of her tenure on the Board. Enacting the responsibilities and achieving ownership of the role at the start would set the tone. The challenge was how to break the stand-off.

A formal independent and transparent process for determining remuneration is a principle of the UK Corporate Governance Code 2018[7].

Outcome

The Remco Chair decided to offer her resignation as the Board Chair and CEO were not supportive of her exercising her responsibility as she saw fit. This was rejected as the Board Chair was aware that such a resignation would be announced publicly and would need to be supported by a reason. Exposing a fundamental disagreement at this level would have generated awkward questions.

This tool to break the standoff is more powerful in a listed company which is required to make public announcements and it was this potential reputational threat which brought the Board Chair around.

In a private company, which is not bound by the same rules around public announcements, there is not the same driver and a different approach may be more effective. One can only ensure that views and decisions are carefully documented although depending on the shareholder base it may be that as in a public company they have to be considered.

Impact of NEDs

NEDs are there to provide the check and balance. It can take time to build confidence and experience to learn how to apply principles and how one can communicate this in a way which others can listen to.

A NED must make their position clear, stand by their principles and if they still believe board action is inappropriate, resign, otherwise inaction helps to perpetuate the problem. The threat of resignation is a last resort.

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[7] Principle Q

14. The entrepreneurial chief executive and navigating environmental concerns

A resource company was exploring a vast marine area to find gas. The challenge was that identifying resources was like searching for a needle in a haystack, it could take a long time and it was too easy to miss the target. A certain type of testing was used to help receive test results more quickly.

The company was led by an entrepreneurial CEO. Despite negative results, the CEO was pushing to continue exploring. At the point where many on the board were ready to give up and stop further costs, the CEO was determined to make one last attempt. The final attempt proved successful.

Government licences had been obtained authorising exploration. The company was aware of one NGO[8] who raised an environmental concern.

Analysis of issues against Section 172

a. the likely consequences of any decision in the long term

The main tension was between the entrepreneurial attitude required to be successful in exploration with the board's prime duty to promote the success of the company.

The nature of the exploration business relies on high investment and risk to identify opportunities with the possibility of high return. This suits an entrepreneurial leader, yet the board has to set constraints on risky activity which could undermine its prime duty.

The CEO can only push forwards with board approval. Boundaries had been set to limit the time and financial cost which could impact the health of the wider business. However, as time progressed and the margin narrowed considerably, some began to question whether a stop should be called.

The board relied on a combination of factors to inform their judgement. This included trust in the CEO built up over many years and his experience, as well as seeking to get the best value for money and test results possible to inform judgement on how far to go. This was combined with setting and sticking to boundaries to maintain financial prudence.

An open and constructive relationship with the CEO, a good mix of board members and the right culture helped to provide effective challenge and support where needed.

The dynamic of an entrepreneurial CEO is needed to help drive the business forward and make progress. This needs to be grounded in a strong and prudent board to provide judgement. This emphasises the importance of a controlled environment to provide counterbalance and avoid the risk of visions tipping over into recklessness.

d. the impact of the company's operations on the community and the environment

Appropriate exploration licences are obtained from the relevant government authorising action. Sometimes an environmental NGO may raise an unofficial objection to the site. This can raise complexities about who to listen to or speak to. A three-way discussion may be required. Where the government permits drilling, the NGO is effectively over-ruling that decision yet is without authority. However, the NGO may have new, additional evidence of environmental impact which is worth taking into account. The reactions of different NGOs vary so getting to know the organisation is important. They are also becoming more influential and the public is better informed.

The business needs to evaluate the environmental risk and balance the evidence and significance of environmental impact with the economic benefits to the local community of a successful project, not just the business. If the company decides not to drill a productive site, then the probability is that another company will. However, if they go ahead without sufficient consideration of the impact, the public interest and reputational damage may be immense.

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[8] NGO – a non-profit organisation that operates independently of any government, whose purpose is usually to address a social or political issue.

The case on both sides needs to be weighed up along with an estimate of how big a battle it is likely to be, the company's wider agenda and if the company has the resources at that point in time to dedicate to pursuing this.

15. Understanding the supply chain and deciding where to do business

A manufacturing company had a supplier in Asia providing high quality cardboard packaging.

Better understanding the supply chain was triggered following the enactment of the Modern Slavery Act section 54 "transparency in supply chains". Although slavery and human trafficking were not identified, investigation of the supplier's business identified that their cardboard was sourced from unsustainable forestry.

Analysis of issues against Section 172

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

The board supported an environmentally responsible approach to business. They had openly expressed a commitment to pursuing a sustainable business model. Alternative suppliers were identified however it was clear that changing suppliers would increase costs.

The board weighed up the reputational risk of supporting unsustainable logging, the inconsistency with their values and cost impact of change. The increased cost was seen as an investment in the business' reputation which it was willing to pay for. This decision by the board was seen as putting into action public statements of intent, "walking the talk" and demonstrating the strength of management; evidencing its tone at the top, culture and sticking to its principles. A decision was made to transfer business to another supplier.

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