The Future of Corporate Governance

– a personal odyssey

Discovering and redefining corporate governance, finding its paradigm, and reinventing the corporation

Bob Tricker

Part 3

Reinventing the corporation

Calls to reinvent the public company

The need for the place of the corporation in society to be rethought is not new. The author called for the concept of the joint-stock limited liability company to be re-thought, in 2011.[1]

> *'Society has lost the control which it originally demanded for the right to incorporate (limited liability) companies. Faced with government support of failing companies, a growing concern for corporate social responsibility and sustainability (and many other contentious issues), the time has come to rethink the rationale, the purpose and the governance of the joint-stock, limited-liability company.'*

Others have also seen the need to rethink the place of the public company in society.

The 'Tomorrow's Company' project

'Tomorrow's Company,'[2] a UK not-for-profit think-tank, has attempted to encourage an approach to business that creates value for staff, shareholders, and society through a focus on purpose, values, and relationships in the long-term. The project's objectives were re-stated in 2016, in the light of twenty years' experience, to develop companies that had:

- *'a purpose beyond profit and a set of values that are lived through the behaviours of all employees to create a self-reinforcing culture*
- *collaborative and reciprocal relationships with key stakeholders – a strong focus on customer satisfaction, employee engagement, and where possible, collaboration with suppliers, alongside working with society*
- *a long-term approach that embraces risk*
- *investing long-term and embracing disruptive innovation'*

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1 Tricker, Bob (2011) *Re-inventing the Limited Liability Company*, Corporate Governance – an International Review, Volume 19 Number 4, July 2011

2 www.tomorrowscompany.com

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The Business Round Table Declaration

In 2019, over 180 CEOs of major US corporations signed a Business Round Table Statement, accepting the need for a more stakeholder-centric approach to corporate decision making. However, subsequent research showed that many of these CEOs signed the declaration without raising the issue with their boards, with some signing more as a public relations exercise than an intention to change business behaviour or investor relations. [Bebchuk and Tallania (2020)][3]

The Purpose of The Corporation Project

This Project provided 'a strategic platform to promote the long-term health and sustainability of publicly listed companies.' More than 260 leaders in business management, investment, regulation, and academia contributed to a Global Roundtable Series; to 'identify desired outcomes and principles of corporate governance fit for the challenges of the 21st century.' Their report *Corporate Governance for a Changing World* [Veldman, Gregor, and Morrow (2016)][4] asked 'What is the purpose of the corporation?' The Roundtables focused on the relationship between corporations and shareholders, with the intention of reducing short-termism and encouraging longer term strategic thought.

The World Economic Forum initiative

As we saw in Part Two of this treatise, The International Business Council of the World Economic Forum published *'The New Paradigm: a roadmap for an implicit corporate governance,'* which called for a partnership between corporations and investors to achieve sustainable long-term investment and growth. The proposal recognised the inevitable clash with the short-term profit motives of some shareholders and sought a paradigm shift towards longer term profitability, which was unlikely to please some private equity investors intent on making a fast, short-term return.

The academic perspective

The Editors of the research journal Corporate Governance – an International Review (CG-IR), writing about developments in the journal during 2021, commented:

> *'…the debate over the role of corporations in society (is) back in prominence. Both practitioners and academics are hard-pressed to address important questions. Do corporations cater sufficiently to the needs of their stakeholders and societies at large? Are manager incentives too shareholder-centric and do we focus minds on creating corporate purpose that can advance stakeholder interests without compromising shareholder value? Do we need more regulation or will market participants change long-established paradigms and practices themselves to address current as well as future challenges? Are the emerging Environmental, Social, and Governance (ESG) frameworks fit for purpose and how do we create meaningful metrics that lead to more transparency, comparability, and eventually to consequential accountability?* [Stathopoulos and Talaulicar (2021)]

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3 www. papers.ssrn.com/so13papers.cfm?abstract_id=35449768
The Illusory Promise of Stakeholder Governance

4 Papers.ssrn.com/so13/papers.cfm?abstract_id=2805497

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Joseph Rowntree Foundation Report 2021

The Joseph Rowntree Foundation, supported by the UK Government', in a 2021 Report[5], called for capitalism to reflect societies' changing attitudes, with a review of the social licence that society, under the Companies' Act, gives to companies to operate.

Criticisms of shareholder governance

Shareholder capitalism involves a corporate governance system rooted in existing company law, in which power is based on ownership: shareholders have the right to nominate and elect the directors who govern the company for their benefit.

As the Editors of CG-IR suggest, both practitioners and academics have questioned the behaviour of major corporations around the world. These criticisms include:

- in major public companies, shareholder power is an illusion: shareholders are numerous, geographically spread, and vary in their investment objectives. Shareholders no longer wield real power, which has shifted to the incumbent directors, with independent directors, required by corporate governance codes to serve on board nomination and remuneration committees, drawn from connected elites.
- multi-class shares, which give greater voting rights to company founders or other blocks of shareholders, allow them to dominate governance over other shareholders with minority voting rights
- acquisition strategies, led by a drive for growth, that encourage hostile predator activity, which can lead to market domination and monopoly situations
- ignorance of some corporate strategic risks and over exposure to others
- aggressive tax avoidance, in which international companies legally move profits generated in high tax countries to low tax regimes
- growing interest in and questioning of business behaviour, corporate culture, and organisational ethics
- reported cases of domination by over-powerful directors
- perceptions of top management greed and excessive top management remuneration, including golden handshakes, golden parachutes, and bonuses not linked to performance that can reward failure
- sovereign funds, invested by rich states in companies in other countries, which could put pressure on corporate decisions that might be driven by political, governmental interests, rather than economic and commercial criteria
- concerns about government support for failing companies. Many people see no reason for taxpayers to be liable for corporate debt, just because these companies are thought to be 'too big to fail.'

5 Soodeen, Frank (2021), *Purpose-led firms: resolving tensions in stakeholder capitalism and redesigning the economy*, Joseph Rowntree Foundation, January 2021

- criticisms of board membership, lack of diversity
- In the original 19th century public company, society permitted the creation of companies only if their purpose was clearly defined and their life span finite. These constraints no longer exist.

These specific issues have been reinforced by a broader concern about the role of companies in society, with calls for greater corporate social responsibility and concern for sustainability. There have also been calls for companies to be measured against environmental, social, and governance (ESG) criteria, in addition to financial profit -based measures. (Sometimes called the 'triple bottom line'). However, enthusiasm for ESG has its limitations. As James Kirkup, Director of the Social Market Foundation, wrote[6]:

> *Without better definitions and rigour, there's a risk that ESG is dismissed by many as little more than shallow PR.*

Advantages of shareholder governance

However, against this catalogue of alleged failings, shareholder capitalism offers substantial benefits, which have been proven over many years and need to be recognised.

The joint stock limited liability company was an invention of the 19th century and, like the steam engine, revolutionised society, creating untold wealth, employment, tax revenues, innovation, and social change over nearly two hundred years. Created initially to raise funds from public investors, the idea proved so successful it morphed into complex corporate groups organised in chains, pyramids and networks, and private companies, incorporated to limit owners' exposure to debt, rather than to raise funds from the public. The benefits of shareholder capitalism include:

- shareholders risk their equity by investing in a company and benefit from any dividends declared and increases in corporate value, reflected in the share price.
- pension funds, life assurance companies, and charities rely on the wealth created by public companies, reflected by the stock market, to meet current demands, and face future commitments.
- directors of a company should not be expected to make decisions on behalf of the community – that is the role of government. The state, at every level, is responsible for managing the community's economic, social and legal situation – and should be accountable for them. A company is not legally responsible to the community, except in its duty to obey the law. In other words, directors should not be expected to decide what is desirable on behalf of the community, but to follow the rules that community sets. Government at the national, provincial and local level should set the control of markets and competition, health, education, the environment, and defence.
- boards of listed companies need to satisfy their shareholders' expectations, or the share price will fall, and potential predators threaten hostile bids; that is the market discipline constantly faced by directors: that is the discipline imposed on boards by the market.

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6 Kirkup, James (2021) *The Overdue Challenge to the law that could save British Capitalism*, The Times, 2 June 2021

– society is also dependent on taxes generated by companies

Nevertheless, shareholder capitalism remains under challenge, so what might an alternative stakeholder capitalism involve?

An alternative model - stakeholder governance

Calls for boards to care for their customers, be fair to their suppliers, be concerned for their employees, and recognise the interests of their shareholders, in the long term, are commonplace. More recently, companies' effect on climate change and the environment have been added to the demands. As Paul Polman said in a McKinsey podcast[7]: '*Companies must now compete on trust and deliver value to multiple stakeholders.'*

The UK Companies Act 2006 (S172) expects company directors to recognise their contractual stakeholders[8]. The act lays down the duty of directors 'to promote the success of the company:

- 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 (i.e. shareholders) 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

  (f) the need to act fairly as between members of the company

Obviously, any company that failed to do these things in the long term would be unlikely to survive, but company law in other jurisdictions typically does not include such strictures.

The Joseph Rowntree Foundation 2021 Report already mentioned[9], called for the UK Companies' Act (S172) to be changed to 'give real force presumably by making proven failure to abide by S172 an offence. The problem might be proving such failures in court.

Stakeholder capitalism calls for an alternative corporate governance model, based on relationships between the company and all those involved with it. In other words, in stakeholder capitalism, power over the company would be based on relationships not ownership. How that is to be achieved is less clear. In fact, interests of stakeholders are not homogeneous but compete for corporate cash flow – better terms for employees, higher prices for suppliers, lower costs to customers, bigger dividends for shareholders.

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7 Polman, Paul (2021), Stakeholder Capitalism - a conversation with Vivian Hunt and Diane Brady, McKinsey Podcast, 6 May 2021

8 As far as the author is aware, no action has ever been brought against directors under this section.

9 Soodeen Frank (2021), *Purpose-led firms: resolving tensions in stakeholder capitalism and redesigning the economy,* Joseph Rowntree 1 June 2021

However, it is not clear how stakeholder capitalism would operate in practice, nor whether it would create more value, higher employment, or more innovation than shareholder capitalism. Advocates of stakeholder capitalism[10], recognising short comings in the shareholder governance model, seem drawn by the apparently more democratic governance structure, involving all those with a stake in the entity. Enthusiasm for stakeholder capitalism, to date, seems rooted more in liberal values of social equity and fairness than on evidence. But approaches to stakeholder governance are evolving. It is recognised that metrics are needed to identify, measure, and report on relationships with stakeholders. Similarly, metrics are needed to evaluate performance on ESG (environmental, social, and governance) criteria. However, such metrics remain nebulous and would only become valuable when issued, regulated, and enforced, like International Accounting Standards are for the reporting of financial information.

Stakeholder governance will not work under existing company law

Directors of companies, incorporated under company law, are stewards for their shareholders and, thus, required to create profits, while remaining within the law. Over every discussion of stakeholder capitalism looms the Friedman shadow: 'the social responsibility of business is to increase its profits…' [Friedman (1970)].

Bower and Paine (2017) argue that shareholders are not *de facto* owners of a company, though *de jure* they certainly are. This leads them to propose a shift from shareholder-centred governance to a company-centred' perspective. The authors offer a range of governance activities that would change, but do not address the key question of where power over this entity would lie. That could only be achieved by changing the legal concept of a company.

As long as the joint-stock, limited liability company remains the constitutional vehicle, the company belongs to the shareholders. Any growth in value accrues to them. On a winding up, the funds belong to them, according to their shareholding, once legitimate claims of employees and creditors have been met. Ownership is the basis of power in the conventional constitutional model of the corporation.

No amount of stakeholder rhetoric can overcome the legal duty to create value for investors, no matter what stakeholder information or ESG metrics are reported.   As long as companies are incorporated under laws that give power to owners, stakeholder capitalism is irrelevant. So, a basic assumption of this paper is that new law will be needed for the incorporation of stakeholder-based governance. Such a law would redefine the joint-stock, limited liability company and embrace other corporate entities in a new governance structure, in which power lay with all those involved.

Criteria essential for stakeholder governance

The ongoing debate about the future of the company is actually a discussion on the balance of power over corporate activities and the ownership of its wealth. Limited liability companies are creatures created by the law: only with a change of law can they evolve. That is why the corporation needs to be reinvented.

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10 In this treatise, 'stakeholder capitalism' is used to cover the underlying concepts; 'stakeholder governance' to describe the governance processes involved.

A stakeholder model of corporate entities would need laws that:

1. applied to all corporate entities, irrespective of their membership, purpose, scale, location, or method of funding. In other words, no distinction should be drawn between public and private entities, or profit and not-for-profit organisations
2. enabled legitimate stakeholders in the entity to be identified
3. facilitated communication with those legitimate stakeholders
4. gave legitimate stakeholders governance power to nominate and elect members to the governing body
5. provided for a governing body that represented all legitimate stakeholders
6. required the governing body to report on their performance and be accountable to the legitimate stakeholders

What might this new corporate entity be called?

Clearly, it should not be called a 'company;' that word carries too much baggage. In this paper, the new form of corporate entity will be called an 'Enterprise.' This concept carries no preconception about ownership, purpose, operations, scale, or location. It is intended to be a generic name for any corporate entity incorporated as an 'Enterprise.'[11] The word 'Enterprise' would appear in each corporate name, abbreviated to 'Ent'., in a similar way 'Company' being abbreviated to 'Co.' Some financial reporting procedures and accounting standards may need expanding to meet Enterprise accounting needs.

An Enterprise Act would need to cover, *inter alia*:

– Enterprise formation – statement of name purpose, address, founders, initial funding, approval of name

– Enterprise constitution - articles of association (rules for governing and managing the enterprise), role of enterprise secretary, reports to enterprise official registrar

– Enterprise governance – register of stakeholders, meetings of stakeholders, powers of the board, board standing committees

– Establishment of stakeholder rights

– Identification and registration of enterprise groups

– Enterprise directors – nomination, appointment, powers, duties, disclosure of interests, service contracts, disqualification

– Accounts, reports, and audit

– Distributions to investors and other stakeholders

– Returns to the authorities and society – annual and more frequent reports and returns

11 The concept of the Enterprise, developed in this paper, should not be confused with another recent UK development – the social enterprise, which describes the purpose of a business, not its legal format.

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– Acquisition and mergers of enterprises

– Dissolution and winding-up

– The Enterprise Registrar – authority, duties, investigations

What would an enterprise actually be?

An enterprise would be a corporate entity governed by its stakeholders, that is the constituent groups needed to fulfil its purpose and affected by its activities, which will typically include its employees, its suppliers, customers in its distribution or service chain, and its sources of finance, along with the society might affect.

The basis of power over an enterprise depends on relationships not ownership. Governance power is held by the contractual stakeholders, not the shareholders in a limited liability company. In other words, an enterprise involves a relationship between all participants in that entity, not just capital.

An enterprise can own assets, employ people, make contracts, in an existence independent of its stakeholders. The life span of an entity can be determined by its constitution or indefinitely, if no term is specified. This might imply that enterprises exist in perpetuity, but as with limited companies the reality is that most enterprises will have a finite life before being merged, sold, or wound up.

Who are the stakeholders of an Enterprise?

A stakeholder can be thought of as any individuals or entities that could be affected by or whose actions could affect the Enterprise. Consequently, both the stakeholder and the Enterprise have an interest in each other. In the Enterprise governance model, both stakeholders and Enterprise have an opportunity to know about and influence each other.

The Stakeholder Sectors to be included for a given Enterprise would be defined in the Enterprise Constitution. They might include

– members
– employees
– suppliers and the supply chain
– customers and the delivery chain
– providers of capital
– environment and societal interests

Since power over an entity can be influenced by its stakeholders, each sector will need careful definition in the Enterprise Constitution. Moreover, as the Enterprise concept is intended to embrace every type of corporate entity, irrespective of its constitutional structure, purpose, or business model, further elaboration of the broad Stakeholder Sectors is needed.

Members

The members are those for whom the Enterprise was created and for whom it ultimately exists. In the shareholder governance model, the shareholders are the members. But in the

Enterprise Stakeholder model there are no shareholders. So, each Enterprise Constitution will need to specify the membership with some precision.

Essentially, the members are those for whom the enterprise exists. This might, for example be the:

– owners of a family business
– members of a sports club
– supporters of a football club
– patients of a medical or dental practice
– patients of the British National Health Service
– guests of a hotel or a restaurant enterprise
– clients of a consultancy enterprise
– students and faculty of a college or university
– members of a co-operative society
– subscribing members of a charity
– members of a trade union
– members of an arts association
– patrons of a theatre
– parent entity of a subsidiary enterprise

The enterprise constitution would also define members' rights and privileges, who would be bound by the rules in that constitution. Membership rights would, typically, include the right to receive financial and other information about the enterprise, the right to attend members' meetings, and vote on the election of their Stakeholder Representatives to the Stakeholder Forum. Membership of an Enterprise would carry responsibilities as well as benefits.

Employees

Employees represent an obvious Stakeholder Sector. The sector needs to embrace everyone involved, including part-time employees, contract workers, and commission agents, not overlooking past employees and potential future employees. Some employees may be represented by their trade unions; others by representatives they elect to represent them. Managers at all levels will also be represented.

Suppliers and supply chain stakeholders

All suppliers of goods and services to an Enterprise have a place among its Stakeholders. This includes not only immediate suppliers to the Enterprise, but those in supply chains. The mutual interest in the behaviour of a link in a supply chain can be relevant to an Enterprise, for example to avoid child labour or damage to the environment. Suppliers of services, such as consulting advice, information services, and other external contractors would be included. The Enterprise auditors, however, will be excluded, to preserve their independence in reporting to the client Enterprise and its stakeholders.

Customers and delivery chain stakeholders

Enterprise customers form another obvious, stakeholder group. Where a delivery chain exists, for example of agents, representatives, wholesalers, or retailers, these too need to be seen as

legitimate stakeholders. Some entities, however, do not provide their outputs to those they identify as 'customers,' but rather to members (a cooperative, a club, or a professional institute, for example) or to subscribers (as in an entertainment streaming service). Whatever name may be given to the recipient of the Enterprise's output, they are legitimate stakeholders of that Enterprise.

Providers of Enterprise finance

The providers of Enterprise finance clearly form an important Stakeholder Sector. In the shareholder governance model, the shareholders provide the unpinning equity finance: but in the Enterprise model, there are no shareholders. Instead, funds would be provided by interest-bareing or profit-sharing instruments offered by Enterprises to the financial market, subject to Enterprise law. Financial institutions offering investment opportunities in public enterprises to the market would also be included among the financing stakeholders

This sector also includes those providing loans to the Enterprise, irrespective of their contractual terms, including interest-bearing loans (secured or unsecured), over-drafts, and other financial instruments.

Environment and societal interest stakeholders

The final stakeholder sector indentured in figure 1 is the broad category labelled 'environment and societal interests.' This sector includes the wide range of interests now frequently described as ESG (Environment, Society, and Governance) interests. The various metrics that have been suggested for monitoring firms' performance in this field, indicate a wide range of potential interest groups. Identifying representatives of this sector would present a challenge, because in many organisations they would be numerous, occasional, and of varying significance. Nevertheless. representative bodies would undoubtedly emerge, once the concept of Enterprise governance was accepted.

What are the basics of enterprise governance?

Enterprise governance would be founded on:

- Enterprise law
- The Constitution of the Enterprise
- A Stakeholder Forum
- A Board of Directors
- Executive Management

In essence, proposed Enterprise Law would provide the foundation for enterprise governance, just as company law underpins limited liability companies. The Constitution of each Enterprise would identify its purpose, its Stakeholder Sectors, and determine how each sector would be represented on the Stakeholder Forum. The Stakeholder Forum would oversee the work of the Board of Directors. Each Enterprise's Constitution would also determine the number or percentage of directors to be appointed to represent stakeholders on the Board of Directors. The Board of Directors would also have the right, under Enterprise Law and its Constitution, to appoint Independent Outside (non-executive) Directors to the Board, to provide advice, experience, and oversight.

Figure 1 illustrates the structure of Enterprise governance. The board in this example has 6 stakeholder Directors (S), 5 Independent Outside Directors (I), and 3 Executive Directors (E).

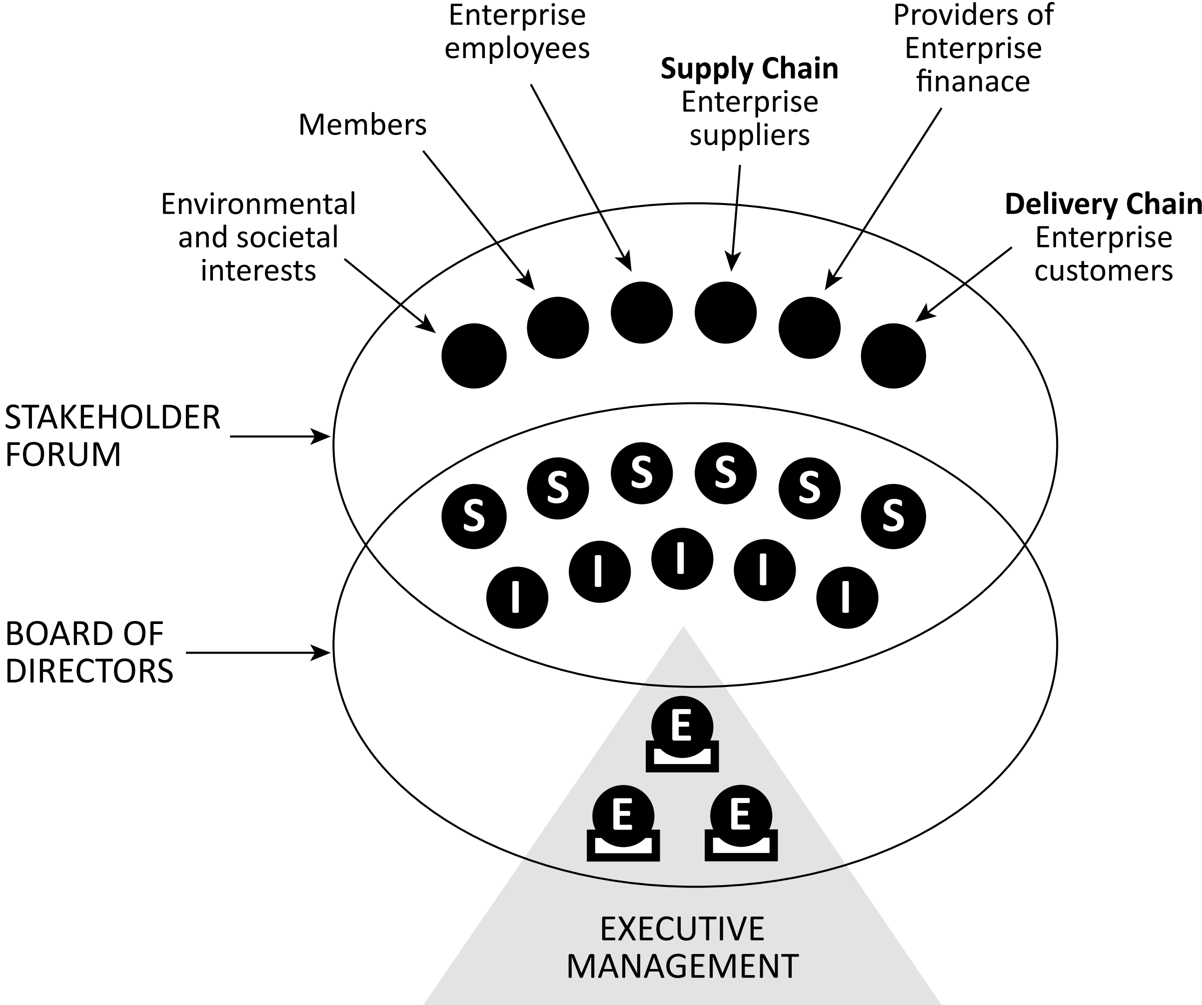

Figure 1 Outline governance structure of an Enterprise

- S Stakeholder Representative Directors
- I Independent outside directors
- E Executive directors

In the Enterprise stakeholder governance system, the Board of Directors would be the dominant power, just as in shareholder governance. The founders of an Enterprise would establish its Constitution and, therefore, determine the number and balance of the Stakeholder Forum. Members of the subsequent incumbent board would, subject to the constitution, appoint both independent and executive directors.

The basic elements of Enterprise governance

Enterprise law

Enterprises would be incorporated under a new Enterprise Act, within a specific jurisdiction. The Act would determine the requirements for Enterprise incorporation and registration, relations with stakeholders, nomination and election of directors, required financial and other reporting, audit, and other matters concerned with the governance of the Enterprise.

Enterprise law would enable the creation of an artificial being, with many of the attributes of a human being – to own assets, incur debts, employ people, make contracts, and be accountable under the law – very much like limited liability companies under Company law.

Consequently, the answer to the question 'who owns the enterprise?' is 'the Enterprise.' In a limited liability company, the company itself is owned by its shareholders. In an Enterprise, however, there are no shareholders, so the Enterprise would in effect own itself, until a decision was needed about its disposal, in which case the Board of Directors, acting through the Stakeholder Forum would act, subject to the Enterprise Constitution.

Larger Enterprises might be required by the law to create board audit, nomination, and remuneration committees, as required by moist corporate governance codes for listed companies. Under Enterprise law, power over the Enterprise would be exercised by the Stakeholders, through the Stakeholder Forum and the Board of Directors.

Strategically significant decisions on the future of the Enterprise, including its sale, merger, or acquisitions will be proposed by management, agreed by the Board, and approved by the Forum. Fundamental decisions, as defined in the Enterprise Constitution or Enterprise Law, would need to be approved by the Forum after consultation with Stakeholder Sectors.

Only if an enterprise is sold or wound-up will ownership become important. On a sale of the enterprise, the Stakeholder Forum, working with the Board of Directors, will decide the distribution, subject to the constitution. On a winding-up, again the Forum and the Board would decide the outcome, with no Stakeholder Sector being liable for corporate debts.

The Enterprise Constitution

The Enterprise Constitution is the fundamental governance document, which creates the entity, identifying its name, location, and purpose. A crucial element of every Constitution would be the identification of the Stakeholder Sectors relevant to that Enterprise.

The Constitution would also establish the number or percentage of directors to be appointed to represent each stakeholder sector. It would also establish rules for the governance and management of the Enterprise, within the Enterprise law of the relevant jurisdiction.

The Board would have the ability to appoint independent, non-executive directors to add weight to the board, providing advice, experience and, above all, a measure of independent oversight.

The Enterprise Constitution would be of considerable strategic significance to the work and success of the Enterprise. Its purpose would be clearly stated. The objectives clause of the 19th century company Memorandum of Association was supposed to do this but, over the years,

this clause has become so broad that it now often allows a company to carry out most activities within the law.. Indeed some jurisdictions no longer require an objects clause in a company Memorandum of Association. Although, the UK Charity Commission do insist on a clear statement of charitable purpose prior to registration. By identifying its purpose, its Enterprise Constitution would also clarify the stakeholder sectors involved.

For large, complex Enterprises, probably operating in many jurisdictions, the Constitution would probably be detailed and lengthy: for smaller enterprises, with activities similar to many private companies, charities, and clubs, the Constitution might be relatively simple and short. Enterprise Constitutions could be amended if and when circumstances changed.

The Stakeholder Forum

The Stakeholder Forum has representatives from each stakeholder sector. Their number and method of appointment will be determined by Enterprise law and each Enterprise's own Constitution, reflecting the purpose, scale of each Enterprise. The role of the Stakeholder Forum is to nominate and elect the stakeholder directors to the Board of Directors, and to advise that board.

The Stakeholder Forum does not have the powers of a supervisory board in the two-tier board in the shareholder governance model: it does not have the power to hire and fire executive directors. Its role though advisory, is likely to be significant, because it reports to its constituent stakeholder sectors. The Stakeholder Forum is a fundamental cog in the Enterprise governance mechanism.

An underlying problem in any stakeholder governance model is the potential conflict between the objectives of each stakeholder sector: higher wages, lower customer prices, better supplier terms, higher interest rates, more expenditure on the environment and society. It is important to avoid sub-optimisation; that is the achievement of the goals of one sector to the detriment of the interests of the whole. It is the role of the Stakeholder Forum to resolve such issues and work with the Board of Directors accordingly. Each Stakeholder Forum appoints its own Chair from among its own members on terms within the Enterprise constitution.

Appointing Stakeholder representatives to the Stakeholder Forum

The choice of representatives to serve on the Stakeholder Forum would hinge on the Constitution of the Enterprise, which reflects its size, purpose, and structure. In relatively small enterprises the Stakeholders can be identified, meet, and choose their Forum members. In larger Enterprises, formal procedures would be needed to identify and give a voice to Stakeholder Sectors.

The Board of Directors

The Board of Directors consists of the Stakeholder Directors, the Executive Directors, and Independent Outside Directors, in number or percentage required by the Enterprise Constitution. The Independent Directors and the Executive Directors are nominated and appointed by the Board, advised by its Nomination Committee, if it has one.

The role of the Board is to ensure effective governance and management of the Enterprise: in other words, to achieve the Enterprise objectives in the long-term, while meeting other

governance issues as they face the organisation. Typically, this would involve formulating strategy, setting policies, supervising management, and being accountable, working with and through the chief executive (by whatever name that role is known) and the top executive team. This is similar to the responsibilities of boards in the shareholder governance model, except reporting to Stakeholders through the Stakeholder Forum rather than reporting to the shareholders.

Executive Management

No changes are needed, under the stakeholder governance model, to management strictures or processes. The management report to the Board, through their chief executive and the senior executive team, particularly any executives who are members of the Board.

Overall, the aim of Stakeholder Governance is to allow the Enterprise to work for the benefit of every Stakeholder.

The process of Enterprise governance

Enterprise governance has many of the attributes of shareholder governance; the obvious distinction being that power has shifted from shareholders to stakeholders. The essence of Enterprise governance needs to:

1. Define Enterprise Stakeholder Groups
2. Identify specific Enterprise Stakeholders
3. Enterprise Stakeholders appoint their representatives to the Stakeholder Forum
4. Stakeholder Forum nominates and appoints their Stakeholder Directors to the Board of Directors
5. Board of Directors appoints Executive Directors
6. Board of Directors nominates and appoints Independent Non-executive directors
7. Board of Directors governs the Enterprise, working through the Chief Executive and Executive management
8. Board of Directors reports to the Stakeholder Forum, as required by the Enterprise Constitution, in accordance with Enterprise law

Considering each of these stages in detail:

Defining Enterprise Stakeholder Groups

Stakeholder groups will vary depending on the type of Enterprise and its purpose. All Enterprises are likely to have employees, suppliers, and sources of finance, whereas a retail store will have customers, a hospital its patients, and a football club its supporters. The Constitution of each Enterprise would specify the Stakeholder Groups relevant to its activities.

Identifying specific Enterprise Stakeholders

Enterprise Law would provide rules to identify all stakeholders in each of their Stakeholder Groups. Small Enterprises may be able to identify each individual stakeholder. Larger, more complex Enterprises would follow the requirements of Enterprise law and their own Constitution to determine representatives for each Stakeholder Group. No doubt, organisations would appear to represent specific Stakeholder Groups: interest groups to represent suppliers or customers, trades unions and other bodies to support the interests of employees, and so on. Enterprises would follow the requirements of Enterprise Law and their own Constitution to determine who is a member of each Stakeholder Group. It must be recognised that the interests of different Stakeholder Groups are not synonymous, indeed they may conflict.

Appointing representatives to the Stakeholder Forum

Having identified specific stakeholders, each Enterprise would follow its Constitution and Enterprise Law to ensure that appropriate representatives were appointed to its Stakeholder Forum. Enterprise Law would need to cover the rights of stakeholders to be recognised and to appeal.

Appointing Stakeholder Directors to the Board of Directors

A primary duty of the Stakeholder Forum would be to nominate and appoint Stakeholder Directors to represent each Stakeholder Group on the Enterprise Board of Directors. Such Directors would be appointed for a given period, in line with the Constitution. Subject to Enterprise Law, Stakeholder Directors might be eligible for re-appointment, in which case the Stakeholder Forum would again act.

The activities of Stakeholder Forums, such as appointing the Chair, meeting notices and procedures, minutes and accountability, would need to be covered by Enterprise law, so that a Stakeholder Forum could not be dominated by a Stakeholder Group, which had the scale, the influence, or the wealth. The balance of power between the representatives of Stakeholder Groups would have to be addressed by Enterprise law, to ensure that no group could dominate, but adequate recognition was given to legitimate interests. The law would also have to cover potential conflicts of interest.

Appointing Executive Directors

On incorporation, the first Executive Directorships would be created by the founders of the Enterprise. Thereafter, the responsibility for the appointment, re-appointment, and should it be necessary, the removal of Executive Directors would be the responsibility of the Board of Directors. This process would be similar to the appointment and approval of directors of a company with shareholder governance.

Board of Directors appoints Independent Non-executive directors

Independent non-executive directors would play a fundamental role in the governance of Enterprises, just as in shareholder governance. Independent directors can bring advice,

experience, strategic insights, and above all critical oversight and supervision to board deliberations.

The choice of independent directors would be critical, and the use of a board nomination committee, possibly supported by external advisers, might be desirable.

Board of Directors governs the Enterprise

The Board of Directors is at the heart of stakeholder governance, just as in shareholder governance. In line with its Constitution, the Board would be responsible for formulating Enterprise strategy, ensuring that appropriate polices and plans were made, and that executive management was achieving the desired performance, working closely with and through the CEO (by whatever name the post was known) and top executive management.

Each Board would appoint one of its members to chair the Board, subject to its Constitution and Enterprise Law.

Board of Directors reports to the Stakeholder Forum

The Board is responsible to the Stakeholder Forum for the overall behaviour and performance of the Enterprise. Regular reports on financial, operating, environmental and societal performance would be published, in line with the Enterprise Constitution and Enterprise Law.

Creating an Enterprise

Essentially, there are three ways for an Enterprise to be created:

- incorporation by founding entrepreneurs or other interested parties
- conversion of a private limited company or other corporate entity, with members' agreement
- conversion from a public limited company, through a share buy-back or other arrangement with shareholder agreement

Unincorporated entities, such as associations, clubs, and societies, should find it relatively straight forward to incorporate as an Enterprise. The members would be a vital Stakeholder Sector. Existing rules and procedures would be incorporated into the Constitution, which would also define the Enterprise purpose, identify its other Stakeholder Sectors, and add any other requirements of Enterprise law. Some charitable organisations might be in a similar situation.

Wholly-owned subsidiaries in a group should find re-incorporating as an Enterprise straight forward, with the parent company becoming a primary Stakeholder. Where subsidiary and associate companies in a group have shareholders in addition to the parent company, their agreement would be sought to replace the value of their shareholding with bonds or another financial instrument.

In a family company, with shares held by family members, incorporation as an Enterprise, these family members would become a Stakeholder Sector, with the Constitution drafted to give that Sector power over the Enterprise. Meetings of the 'family stakeholder sector' could also serve

as a family council, to resolve issues between branches of the family involved in management and those not.

Companies limited by guarantee are incorporated, predominantly by not-for-profit entities such as charities, historic projects, arts and crafts societies, and academic and scientific institutions. Not having shareholders, companies limited by guarantee already have some of the attributes of an Enterprise. The guarantors of the company would be a Stakeholder Sector.

Where an employee-owned company incorporated as an Enterprise, the employee shareholders would form a Stakeholder Sector, with the Constitution defining their rights and responsibilities.

A state-owned company, having the state as its sole shareholder should have little difficulty in incorporating as an Enterprise, indeed in China state companies are already called 'State Owned Enterprises.'

An entity incorporated under its own state act, such as the English National Health Service, may be able to incorporate as an Enterprise by embracing the requirements of its foundation Act into its Enterprise Constitution. An entity incorporated under a charter, such as the Institute of Chartered Accountant in England and Wales, might be able to incorporate as an Enterprise, by writing the terms of their charter into their Enterprise Constitution. Such an Enterprise would clearly identify the role of their chartered body and the other stakeholders involved.

The UK recently introduced a new type of limited company – the Community Interest Company (CIC), whose purpose was to benefit the community rather than private shareholders. The CIC Regulator requires a corporate constitution that includes a 'community interest statement', explaining what the business plans to do and an 'asset lock,' which is a legal declaration that the company's assets will only be used for its social objectives, and setting limits to the money it can pay to its shareholders. The Enterprise concept could readily embrace CICs.

However, public, listed companies would represent a very significant Enterprise group. Though much fewer in number than other corporate entities – private companies and the wide range of other corporate entities – the governance of the public company is of vital significance, as we have already seen. Indeed, the corporate governance codes and most other interest in the subject to date has been about the governance of public companies. Unless the Enterprise model applied to entities in which the financial markets could invest, the concept of Stakeholder Governance would have failed.

Creating a public Enterprise

The proposed Enterprise Law would include provisions for the incorporation of Public Enterprises able to offer investment opportunities to the public and the market. Safeguards in the law would include requirements for registration, investor protection, and reporting.

A range of financial instruments is likely to be designed by the financial institutions for their Enterprise clients. Some might provide for participation in the added-value created by an Enterprise; others could offer interest only, the rate depending on perceived risk and market interest. Terms could include provision for payments, related to profit. These Enterprise financial instruments could be traded, probably through existing stock exchanges, their market values reflecting Enterprise performance, its discounted future value, and market conditions.

Financial institutions, attracted by significant fee income, are likely to produce imaginative and entrepreneurial financial products to generate capital for the Public Enterprise market. Fundamentally, these financial instruments would be debentures[12], which give security over the Enterprise's assets but do not render the holder liable for Enterprise debts. In practice, the financial instruments offered by Enterprises are likely to have a variety of names: but for simplicity, in this treatise they will be referred to as 'debentures',

An Enterprise intending to invite the public to invest in it would publish its Constitution, which would include debenture holders as a key Stakeholder Sector, defining their rights to be represented in the Stakeholder Forum. The Constitution would also outline the Enterprise's purpose, including the intention to create long-term wealth for the benefit of stakeholders.

Creating a start-up Public Enterprise would be similar to making an IPO (Initial Pubic Offering) for a public company, with similar safeguards for investors. Converting an existing listed, public company would require the approval of shareholders, who might be offered a share buy-back and reinvestment scheme, or a conversion from shares to debentures on terms that reflected the current value of company's shares and the future potential as an Enterprise.

The fixed assets and net working capital of a public company are typically funded by shareholders' equity reserves, and any borrowings. An Enterprise would be funded by Enterprise debentures, reserves and any other borrowings. Financial gearing (leverage) would acquire a new meaning.

Who would actually own the enterprise?

This appears to be a most significant question, because it raises the fundamental difference between stakeholder capitalism and shareholder capitalism. To those committed to shareholder governance, this question will seem vital: in fact, for the enterprise it is irrelevant. With no shareholders, the enterprise is not owned: like a company limited by guarantee, the entity owns itself.

When an Enterprise is bought or sold, title to the entity, based on its constitution and a valuation based on its audited financial accounts, would be transferred, in accordance with Enterprise law. Should an enterprise be wound -up, any value remaining, after investors and other creditors had been repaid, would be distributed in line with the enterprise constitution, in line with enterprise law, and subject to the agreement of the stakeholders. Similarly, the enterprise constitution and enterprise law will cover how an enterprise that has failed will be wound-up. The rights of employees who lose jobs, creditors who lose money, and investors who lose funds will be determined by relevant law.

How would Enterprises be regulated?

The proposed Enterprise Act would create the regulatory framework in each country. In some jurisdictions, the oversight of Enterprises might be passed to the existing companies' registry and financial regulatory authorities. (In the US, the Securities and Exchange Commission for

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12 For more on debentures see: What is a debenture and what are the risks? UK Government Gazette: https://www.thegazete.co.uk/insolvency/content/102414

Public Enterprises and State regulatory bodies for other Enterprises: in the UK Companies' House, the Financial Control Authority and the Financial Reporting Council). In some jurisdictions, however, the demands of Enterprise regulation may require the formation of a new Enterprise Regulation Authority, with appropriate reporting and control procedures.

On Enterprise corporate groups

Enterprises could be organised in groups, similar to corporate groups in shareholder governance; but instead of one company owning shares in another, in Enterprise groups enterprises would form legal relationships to achieve agreed outcomes. In other words, enterprise groups would be based on relationship not ownership. Enterprise groups could be formed at various levels, but unlike corporate groups based on ownership the rationale for the relationships would have to be clearly and legally identified.

Enterprise governance in practice

Some examples of the practical application of enterprise governance show the widespread potential benefits of enterprise governance.

- multi-national companies typically operated through groups of subsidiary companies. If the parent company remains a limited company with shareholders, while wholly-owned subsidiaries were incorporated as enterprises, each subsidiary would relate to its own stakeholders, while the parent company maintained overall control as the provider of overall group governance, group management, and finance.
- family companies, particularly those with some family members involved in management and others not (often the case in family companies in the second generation) could reach agreement in stakeholder sector discussions, before issues reached the board
- the constitution of a charity would clarify its purpose and identify all of its stakeholders and their respective powers
- the millions of associations, clubs and societies, if incorporated as enterprises, would share a single, legal, and well-understood form of governance
- professional institutions and societies incorporated as enterprises would have a clear governance relationship with their members and other stakeholders
- many professional football teams in Europe and the UK and other sporting clubs in the United States are incorporated as shareholder companies, some owned by rich individuals. A few of the top UK and European football clubs planned to form a European Super League, excluding other clubs. Had they been enterprises, this ill-fated venture would not have been launched, because the hostility of supporters and government would have been known in advance.
- partners in a partnership are liable for partnership debts: incorporated as enterprises, they would not – creditors knowing that they can only look to the enterprise to meet their claims
- a joint venture between two other companies or entities could be incorporated as an enterprise, with the joint venture partners recognised among the stakeholders

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- academic bodies, such as schools, colleges, and universities, could be incorporated as enterprises, with the staff and the student body being among the stakeholders
- hospitals, medical practices, and other health services around the world, even though profit-orientated, could benefit from incorporating as enterprises, because their stakeholders would include patients. The National Health Service (NHS) in England already has a sophisticated corporate governance system, which establishes and monitors performance of hospitals. doctors, practices, pharmacies, dentists, and other elements of this nation-wide free service. The NHS is currently seeking to widen involvement in its governance to embrace mental health and other parts of the social care system and voluntary services to reflect the overall impact on peoples' health. Enterprise governance would meet this challenge.
- retail co-operative societies would include the customers among their stakeholders. Co-operatives created for the mutual benefit of members in bulk buying or sharing expensive equipment, for
- example, farmers, would have those members as stakeholders
- some religious organisations might also find Enterprise governance useful, including the clergy and the congregation among the stakeholders
- coalitions, federations and similar groupings of other corporate entities might also find enterprise governance valuable for establishing and maintaining relationships
- the railways in Britain have had a chequered governance history – from separate railway companies running on their own networks, nationalisation, partial de-nationalisation with franchised train operators running on a rail infrastructure provided by another company, which is virtually funded by the UK Treasury. Now a further reorganisation is planned. The enterprise governance model would offer the newly proposed Great British Rail organisation to run the infrastructure of the rail network, with private companies running the trains, a governance solution, with the key stakeholders, including passengers, employees, the government and the operating companies all involved.

If the United States enacted enterprise law at the Federal level, for the first time, country-wide organisations could be recognised, governed by their stakeholders, including the states where they operated, as well as Federal authorities. If individual states adopted enterprise law, key stakeholders would include that state, together with representatives of any other state involved in its work and Federal authorities.

In China, the enterprise governance model might prove particularly useful. When the Chinese authorities decided in 1999 to shift to a market-driven economy, there were no companies. The production of goods, the provision of services, including education, health, and housing were the responsibility of towns and city governments. So, companies act was passed in 1994, revised in 2006, modelled on the Western shareholder model. The assets needed by each company had to be identified, valued, and balance sheets created. These companies were state-owned enterprises. Private companies were also allowed. A minority of the shares in some were floated on the Shanghai, Shenzen, and Hong Kong stock exchanges, and subsequently a few listed in New York.

Corporate governance in China borrowed elements from both the two-tier German and

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the unitary board Anglo-American models. A supervisory board is required, with employee representation and often chaired by a local Party member. The executive board, however, also has independent outside directors. With a single-party national government, corporate governance has unique Chinese characteristics in relations with government, at all levels.

Sir Adrian Cadbury, who wrote the world's first corporate governance code, chaired the Board of the family Cadbury Chocolate Company. Had that company been an Enterprise, instead of a listed public company, the American Kraft company could not have succeeded in their hostile bid for Cadbury Chocolate, because there would have been no shares for them to acquire.

The governance of major public companies, with minority shares listed in China and abroad, would be influenced by its key stakeholders including its top management, employees, suppliers, customers, investors, and 'the people' through the Party and the government at local, industry, and state levels. China might be among the first to recognise the value of the enterprise governance model.

Pros and cons of Enterprise stakeholder governance

No doubt the reaction of many of those involved in shareholder governance will dismiss Enterprise stakeholder governance as irrelevant, unimportant, and unnecessary: after all they benefit from the present system in reward and reputation. Arguments advanced against stakeholder governance might include:

- shareholder governance has served society for over hundred and fifty years, producing enormous employment, economic growth, and wealth: leave it alone
- the market for equity shares is attractive to fund managers and other investors wanting to pit their investment skills against the market to make money, particularly private equity investors and hedge funds
- many directors believe that their role is to create wealth for their investors while satisfying other stakeholders
- some directors reject corporate societal responsibilities, arguing that boards are not qualified or mandated to make decisions about environmental or societal matters: these are the responsibility of government, who should legislate to achieve required corporate behaviour
- ongoing efforts for companies to measure and report environmental, societal, and governance matters demonstrates companies recognition of their commitment to stakeholders
- some economists and corporate governance experts believe that the threat of predator take-over (the market for control) provides an essential discipline on weak or over-confident boards

On the other hand, some directors of public companies might welcome reincorporation as an Enterprise to avoid predator challenges for control. The other side of that argument, of course, is that Enterprise governance would remove the overriding power that shareholders currently wield, which could slow investment and damage stock markets.

However, more positive advantages in Enterprise Stakeholder governance will be seen by others, including:

- Enterprise governance offers millions of not-for-profit organisations and private companies a balanced constitutional identity and a justifiable power base that would involve and legitimise relationships with all those involved with the Enterprise
- for public listed companies, being recognised as an entity that accepts a responsibility to all of its stakeholders, including the environment and society, could add value to the Enterprise, and to society
- some investors will see the attraction of investing in Enterprises, replacing the possibility of short-term gain with a higher likelihood of longer-term growth and stability
- society may reward enterprises that show stakeholder and societal concern through taxation and other incentives
- pressure on incompetent directors or inept boards would come from the stakeholders, meeting in the Stakeholder Forum, more directly than potential adversarial predators of a public company
- societal pressures for representative stakeholder involvement, already directed against shareholder governance, are likely to grow
- environmental and societal pressures will continue to grow, and stakeholder governance is more responsive than shareholder governance. Obviously, the membership and balance of the Stakeholder Forum and the performance of the Stakeholder Directors would be crucial.
- not-for-profit organisations, formally governed by their members, find their boards have become self-perpetuating, the incumbent directors nominating new directors. Members of the organisation, though entitled to nominate and vote on new board members at members' annual meetings, actually have little influence. There are millions of such organisations[13]. Incorporation as an Enterprise would ensure that the Board of Directors reflected Stakeholders' interests.

Moving on

This treatise has assumed that stakeholder capitalism is desirable and the creation of Enterprises acceptable. But there are underlying philosophical issues that need to be recognised. Some indeed might argue that 'stakeholder capitalism' is an oxymoron.

Capitalists stake their money to make a profit: Lacking opportunities to risk their funds for speculative gain, some investors might cut the funds available to Enterprises, driving capital away from any companies re-incorporating as Enterprises. Of course, the Enterprise would be an alternative to, not a replacement of, limited companies and other forms of corporate entity.

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13 Already mentioned in footnote 1 Part 2, these organisations include alliance, association, body, brotherhood, circle, coalition, consortium, federation, fellowship, fraternity, group, guild, institution, league, lodge, order; organization, ring, set, society, sorority, or union.

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Rather than shifting power over companies from capital to all stakeholders, some might rely on the law to direct corporate behaviour, using corporate accountability through reporting, to influence corporate behaviour to all those affected, including the environment and society. Others might point to the growth of philanthropic capitalism (such as the efforts of Bill Gates) to offset capitalism's excesses.

On the other hand, proponents of stakeholder capitalism would point out that employees stake their livelihoods, contractual stakeholders stake their contractual relationships, and society stakes its future on corporate activity.

The joint-stock limited liability company was a mid-19th century invention, designed to attract capital from investors, without them becoming liable for the company debts. The law invented a corporate entity, with many of the legal attributes of a human – to own, employ, sue and be sued. Power over the joint stock company rests on ownership. Such a joint stock company would not be invented today, because the way of doing business has moved on. It would more likely be a type of legal entity in which power lay with those affected by it - its stakeholders. That is the theme of this treatise and the rationale for the Enterprise.

Moreover, the concept of stakeholder governance can be applied to every corporate entity, whatever its purpose, membership, or current constitutional form. In other words, corporate governance is about the way power is exercised over corporate entities – not only public companies, which is what many people still think. The acceptance of stakeholder governance would add legitimacy to all corporate entities in society.

This treatise offers no more than the bare bones of an idea. Much more work would be needed to strengthen the skeleton, perhaps adding more limbs, create the necessary organs, flesh it out and give it some muscle. Hopefully, the challenges will be pursued in the academic, business, and legal worlds: as well as among those directly interested in corporate social responsibility, shareholder capitalism, and shareholder democracy. Hopefully, this paper will provoke discussion. Certainly, the idea would bring decision-making closer to those directly impacted by it. If adopted, some countries might encourage stakeholder governance with grant incentives or tax benefits. There is pioneering work to be done.

In the generation of new thinking, the author readily admits to being among the 'hewers of wood and drawers of water,' not an advocate. But a pebble dropped in the meme pool can wash ashore significant waves in due course: it happened once before with the phrase 'corporate governance.'

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