Stakeholder governance

A call to review directors' duties

Institute of DIRECTORS NEW ZEALAND

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1. Foreword

The world of business is experiencing a perfect storm – the pandemic, climate change and social inequality are all presenting business leaders with some of the most extreme economic and social dilemmas in generations.

The importance and need for robust corporate governance and leadership are critical to navigating the challenges ahead.

The current environment has accelerated the need for boards to question and re-examine:

- *how* their organisations are operating and for *what* purpose; and
- *who* they serve and *why.*

As stewards and kaitiaki of company value, boards are increasingly taking a more holistic view of how their companies create long-term value, and they are giving greater attention and recognition to stakeholder interests (including employees, customers, suppliers, communities and the environment).

Directors must act "in the best interests" of their company[1] but the challenge is defining exactly what this means. For example, is it the primary responsibility of the board to look after the interests of shareholders and maximise shareholders' profits, or should directors consider the interests of all stakeholders to discharge their duty of acting in the best interests of the company?

This question was tested recently when some of New Zealand's largest companies claimed significant wage subsidies from the Government, and later posted a profit for the year. Although such companies were entitled to receive the wage subsidy under the Government's criteria, many confronted public backlash and were faced with a dilemma of whether to pay back the wage subsidy. Those boards had to consider the best interests of their company in light of stakeholder reaction. This included potentially repaying the subsidy against prioritising shareholder returns.

About this paper

Stakeholder governance is one of the top issues in global governance. This paper outlines the evolving corporate governance landscape in relation to stakeholders including:

- significant developments and trends around the world and in New Zealand; and
- relevant law in New Zealand and guidance for boards.

The paper concludes with a call for the Government to review the framework for directors' duties in the *Companies Act 1993*.

2. Background

New Zealanders want to see economic growth but there is an increasing expectation that businesses also focus on overcoming social and environmental issues.[2]

Millennials and younger generations, for example, are demanding more and no longer want to work for, invest in or buy from businesses that lack values beyond maximising shareholder profits.[3] Consumers are choosing to support businesses with products and services that have a positive (or at a minimum, not a negative) impact on the environment, people or society.[4] A key finding in the *Edelman Trust Barometer 2020* was that 87% of people believed that businesses need to serve the interests of all stakeholders, not only shareholders.[5] One of the five key indicators of business trust in the *Edelman Trust Barometer 2021* is long-term thinking over short-term profits.[6] Being seen as a responsible corporate citizen is a valuable brand reputation and competitive advantage, particularly for New Zealand organisations who participate in the global economy.

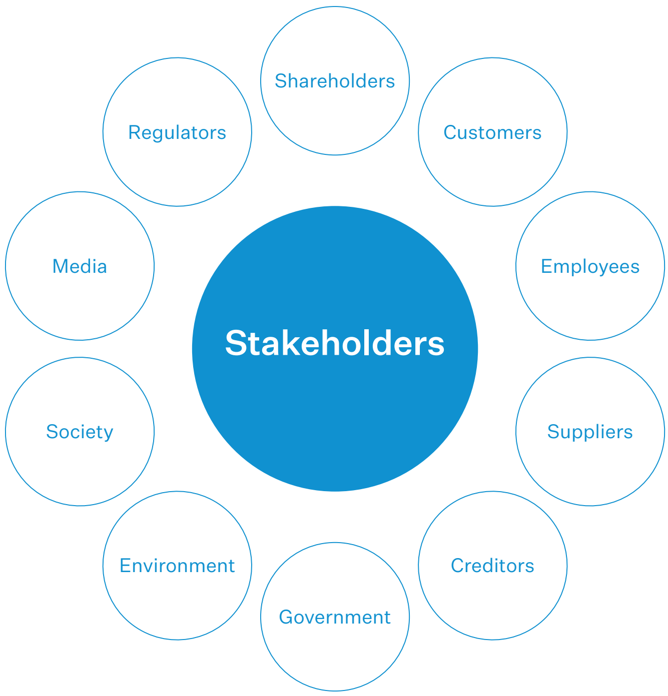
In Larry Fink's 2021 *Letter to CEOs* he warned that companies who ignore stakeholders do so at their own peril.[7] The more an organisation is able to demonstrate its purpose in delivering value to stakeholders, the better able it is to compete and deliver long-term, durable profits to shareholders.[8]

There are competing theories about which interests boards should take into account, or take priority, when governing a company.

The theory of "shareholder primacy" or "shareholder capitalism"[9] was popularised in the 1930s by Adolf Berle who argued that boards should not be responsible to anyone other than shareholders. In part, the argument is premised on the idea that shareholders bear the most risk by investing capital and therefore are entitled to expect a reasonable return on their investment. The theory was also central to Milton Friedman's famous New York Times essay in 1970 about the responsibility of business where he stated that "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game."[10]

It is generally, although not universally, accepted that New Zealand company law is based on, and designed to reflect, the concept of shareholder primacy, which would dictate that acting in the best interests of the company means acting in the best interests of shareholders.

However, in New Zealand, as in most jurisdictions with developed corporate governance regimes, debate is rising over the alleged incompatibility of the shareholder primacy theory with "stakeholder capitalism" or "stakeholderism." Stakeholderism is premised on the idea that a company serves not only its shareholders, but all its stakeholders – employees, customers, suppliers, local communities, the environment, and society.



3. The power of purpose

Defining the company's purpose (and values) is a critical component of determining a company's strategy. It specifies the company's fundamental reason for being beyond making a profit. It helps achieve objectives broader than shareholder returns and is a key driver of success.

Corporate purpose should:

- articulate why an organisation exists and the issues it seeks to focus on; and
- create value for both shareholders and stakeholders.

The purpose should drive what the business does and be integrated in the company's strategy. It should not try to be all things to all people, but rather focus on what the company can bring to the table for its stakeholders.[11]

Formulating a corporate purpose requires ownership by the board, and input from management, staff and other key stakeholders. It also needs to be accepted and supported by shareholders.[12]

An effective purpose should reflect the overall outcome for the business and should:

- be concise;
- be aspirational (but achievable);
- give the reason for the company's existence; and
- be easily remembered by staff.

It is important that boards provide clear direction to management to ensure the business is operating in a manner that is consistent with its purpose. Directors and management should be actively testing and considering "how does this align with the company's purpose?"

Many companies are embedding their purpose into their wider corporate governance frameworks, for example, including the purpose in:

- the company's constitution;
- director appointment letters;
- induction materials and training for directors that incorporates an understanding of stakeholders and the corporate purpose and the impact of the inclusion of a corporate purpose in the company's constitution;
- board charters, for example, including a description of the purpose and impact on decision-making, and perhaps in respect of any nomination and remuneration committee including a requirement that:
  - when directors are appointed to the board, or new directors are sought, demonstrated alignment with the purpose and representation of stakeholder interests is part of the matrix of skills sought; and
  - director and board performance assessments include evaluation of alignment/adherence to the purpose.

B Corporations

Governing for Purpose and Stakeholders in Aotearoa New Zealand, by B Lab Australia and New Zealand provides an overview of "B Corporations":[13]

"B Corporations (B Corps) are businesses that balance purpose and profit, and hold themselves publicly accountable for considering the impact of their decisions on their workers, customers, suppliers, community and the environment. A business can 'certify' when it demonstrates it meets a rigorous set of governance and management requirements, which are administered by the not-for-profit B Lab.

Originally conceived in the United States, where a share price can benefit at the cost of everything else, the B stands for 'benefit'. B Corps represent the idea that a business should be legally able to exist for the purpose of creating benefits for stakeholders other than shareholders.

Today, there are close to 4000 B Corps in more than 70 countries including in North America, the United Kingdom, Europe, China, Australia, Latin America and New Zealand."

B Corps in New Zealand and Australia[14]

- New Zealand had one B Corp in 2014, 22 in 2019 and now has 42
- One in every 10 B Corps globally are based in New Zealand and Australia
- More than 90% of New Zealand and Australian B Corps have practices and policies in place that support diversity, equity and inclusion
- More than 80% of B Corps in New Zealand and Australia share the benefits of business growth and help to create financial security in their workforces through a high to low pay ratio of 1-5 times
- 92% of B Corps are active in addressing social and environmental issues, through providing resources, participating in research, standards setting or forums

Global initiatives on corporate purpose

A number of recent high-profile initiatives have promoted the importance of purpose as companies continue to adapt to changing shareholder and stakeholder expectations, including:

- the US Business Roundtable *Statement on the Purpose of a Corporation* (2019);
- the British Academy's paper *Principles of a Purposeful Business* (2019);
- the new Davos Manifesto, *Universal Purpose of a Company in the Fourth Industrial Revolution* (2020);
- Enacting Purpose Initiative's paper *Enacting Purpose within the Modern Corporation: A Framework for Boards of Directors* (2020); and
- University of Cambridge Institute for Sustainability Leadership, *Leading with a Sustainable Purpose: Leaders' Insights for the Development, Alignment and Integration of a Sustainable Corporate Purpose* (2020).

4. The ascent of ESG and sustainable finance

Boards are giving increasing emphasis to environmental, social and governance (ESG) matters and their relationship to long term performance and value creation.

Underpinning this is understanding and responding to the evolving expectations of investors, consumers, staff, and other stakeholders. Some examples of ESG matters include:

Environment	Social	Governance
Climate change and carbon footprint	Human rights and modern slavery	Board composition and diversity
Environmental protection	Employment standards	Leadership
Biodiversity	Health and safety	Remuneration
Pollution and resource depletion	Fair trade	Shareholder rights
Water use	Harassment/discrimination	Ethics
Waste management	People management	Whistleblowing
Energy	Diversity, inclusion and equality	Disclosure and transparency
Sustainable procurement	Supply chain management	Risk management
	Privacy and ethics	Anti-bribery and corruption
	Consumer responsibility	Stakeholder engagement

Financial systems around the world are also being radically overhauled "to contribute to, rather than hinder, the transition to a low emissions, resilient, resource efficient, just and inclusive economy."[15] The *Roadmap for Action Final Report* (2020) by the Aotearoa Circle's Sustainable Finance Forum sets out how the financial system in New Zealand should be redesigned to meet sustainability challenges and opportunities now and in the future. The report explores the purpose, roles, and responsibilities of business and finance in society and sets out potential pathways for achieving a sustainable system.

Sustainable finance

Sustainable Finance – A Means to Incentivise Good Outcomes outlines key issues and trends in sustainable finance in New Zealand:[16]

"Sustainable finance has grown in popularity in recent years, driven by societal change, banks focusing on their licence to operate and increasing regulatory pressure.

"Although New Zealand has lagged behind other markets, it too has seen rapid growth in recent years which shows no signs of slowing. As New Zealand looks to the future to meet its emission reduction goals and as a number of entities look ahead to address climate risks and meet climate reporting requirements, it is expected that sustainable finance will play an increasingly important role in supporting these objectives and in promoting environmental, social and governance outcomes…"

"The sustainable finance market sees no signs of slowing, with the global sustainable debt issuance in 2020 increasing by 29% from 2019's total."

Further increased demand is expected for these products from corporates as they seek to achieve their sustainability goals and demonstrate their ESG credentials in response to increased customer, social and regulatory scrutiny. The benefits of sustainable finance are recognised by the *International Platform on Sustainable Finance Annual Report*, October 2020 which notes the following:

> "We believe that financial institutions, which are placing sustainability at the centre of their decision-making and promoting innovation to solve environmental challenges, will contribute to the common good while increasing their competitiveness."

Māori values and balancing multiple bottom lines

The New Zealand Productivity Commission's report *He Manukura: Insights from Māori Frontier Firms* (2021) highlights that Māori firms often incorporate Māori values, principles and concepts into their operating framework and these "values translate into an intergenerational view, which in turn is reflected in long-term business strategies and approaches."[17] Kaitiakitanga (guardianship), rangatiratanga (leadership, ownership), manaakitanga (hospitality), and whanaungatanga (relationship/kinship) were some of the values, principles and concepts identified as relevant and beneficial to Māori businesses.[18] Multiple bottom-line perspectives balancing social, cultural, commercial, spiritual, political and environmental needs are also common in a Māori context.[19] This operating framework – which includes a focus on the long-term, sustainability and intergenerational wealth and wellbeing - can provide a competitive edge for New Zealand business on a global stage.

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5. Towards a tipping point for corporate reporting

The world of corporate reporting is undergoing significant change particularly in relation to extended external reporting (EER).

EER refers to broader forms of reporting beyond the usual types of information presented in an entity's financial statements. The New Zealand External Reporting Board (XRB) describes this as reporting information on an entity's:

- purpose and business model
- governance
- material risks and opportunities
- prospects (including forward-looking financial information)
- strategies
- economic, environmental, social and cultural impacts.

EER is an evolving field and has developed to meet increasing expectations from investors and other stakeholders to tell a more holistic story (eg beyond financials) on performance, value, risk and impact including on ESG matters.

Reporting has generally been voluntary and organisations have adopted a framework or form to suit their business, including to meet investor and stakeholder expectations. Frameworks, forms and standards relating to EER include:

- non-financial reporting and standards, eg on service performance
- ESG reporting, eg under NZX guidance
- reporting on corporate social responsibility
- Integrated Reporting (developed by the International Integrated Reporting Council (IIRC))
- the Global Reporting Initiative (GRI)
- CDP a global disclosure system on environmental impacts
- Climate Disclosure Standards Board (CDSB)
- Sustainability Accounting Standards Board (SASB)
- the Task Force on Climate-related Financial Disclosures (TCFD) framework
- the World Economic Forum's report *Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation* (2020)
- other sustainability reporting, eg on the UN Sustainable Development Goals (SDGs).

The number of frameworks and forms of reporting have created a complex reporting environment but moves to simplify the system are gaining momentum. In September 2020, five global organisations, CDP, CDSB, GRI, IIRC and SASB, issued a *Statement of Intent to Work Together Towards Comprehensive Corporate Reporting*, aiming to achieve global comparability and reduce complexity.

Since then, the IIRC and the SASB have merged to form the Value Reporting Foundation. The IFRS Foundation is also creating a new International Sustainability Standards Board to set IFRS sustainability standards.

Support for climate-related mandatory reporting is building, including with the backing of the G7 countries in June 2021.

New Zealand is leading the way with the *Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill*, which proposes that the following entities will be subject to mandatory reporting (on a "comply or explain" basis):

- all equity and debt issuers listed on the NZX
- all registered banks, credit unions and building societies with total assets of more than $1 billion
- all managers of registered investment schemes with greater than $1 billion in total assets under management
- all licensed insurers with greater than $1 billion in total assets under management or annual premium income greater than $250 million.

The new reporting regime will be based against standards issued by the XRB and developed in line with the global TCFD framework.

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6. Global developments and trends

Attention on stakeholders and their interests are driving governance developments in many jurisdictions and this trend is gaining increasing momentum.

Key global developments include:

The World Economic Forum

The forum (which is an independent international organisation committed to improving the state of the world by engaging business, political, academic and other leaders of society to shape global, regional and industry agendas) has been prominent in driving change. See for example:

- *The Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution* which is centred around stakeholders and provides that "the purpose of a company is to engage all its stakeholders in shared and sustained value creation;"[20]
- *The Future of the Corporation – Moving from Balance Sheet to Value Sheet* (2021) which puts forward recommendations for companies to achieve effective stakeholder governance; and
- *Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation* and *Integrated Corporate Governance: A Practical Guide to Stakeholder Capitalism for Boards of Directors.*

European Union

- Some jurisdictions in the EU already utilise a stakeholder approach to corporate governance (eg Germany and France).
- In 2020, the European Commission established the *Sustainable Corporate Governance initiative* to improve the EU regulatory framework on company law and corporate governance.[21] The aim of this is also to enable companies to focus on long-term sustainable value creation rather than short-term benefits and to align the interests of companies, their shareholders, managers, stakeholders and society. A number of leaders in business, finance, and academia have come out in support of the initiative in a public statement.[22]
- However, other prominent European organisations, including the European Confederation of Directors Associations (which consists of 22 national director institutes) in a joint letter strongly opposed some key aspects of the initiative.[23] A key concern of the organisations is that new "legal requirements would place obligations on companies to reconcile conflicting interests, and any liability attached to such a requirement would lead to legal uncertainty and the risk of paralysing the functioning of the board and management."[24] Instead, they support maintaining principles for corporate governance in the existing format of codes.

United Kingdom

- A key director duty in the UK *Companies Act 2006* is the duty to promote the success of the company for the benefit of its members as a whole and this includes reference to specific stakeholders.[25]
- UK companies can have purposes in their constitutions beyond promoting the success of the company for the benefit of members. Where this is the case, the *Companies Act 2006* essentially provides that directors are legally committed to achieving those purposes.[26]
- Some UK companies must also report on how they have had regard to stakeholders.[27]

- There is now a push for further reform. A key campaign is the *Better Business Act* that was launched by B Lab UK in April 2021 advocating for changes to the duty to promote the success of the company - essentially adjusting the duty to reflect the "B Corporation" model where directors would advance the interests of shareholders alongside those of wider society and the environment (the legal entity remains a company). It is now supported by a coalition of over 650 organisations (including the Institute of Directors UK).
- A similar proposal to amend the duty to promote the success of the company is put forward in *Amending UK Company Law for a Regenerative Economy* (2021) by the Regenerative Business Working Group (associated with the IoD UK Centre for Corporate Governance).

United States

- US law generally embraces shareholder primacy. In 2019 the US Business Roundtable, an association of CEOs of America's leading companies, received worldwide attention when it made a commitment to stakeholders in the *Statement on the Purpose of a Corporation* (moving away from strong shareholder primacy messaging in its 1997 *Statement on Corporate Governance*).
- US Senator Elizabeth Warren has proposed a federal bill known as the "Accountable Capitalism Act" providing that large American corporations should be required to obtain a federal charter which obligates directors to consider the interests of all stakeholders.[28]
- There have also been a range of other public statements and publications advocating for change including from institutional investors, leading lawyers and academics.[29]

South Africa

- South Africa utilises a "stakeholder-inclusive" approach to corporate governance under a voluntary code. The *King IV Report on Corporate Governance* (2016), like its predecessors, provides that boards should take into account the legitimate and reasonable needs, interests and expectations of all material stakeholders in the execution of their duties in the interests of organisations over time.[30]
- The first King Report, named after governance expert and former judge Mervyn King, was published in 1994. This was the first of its kind in South Africa and was ground breaking in advocating an integrated approach to good governance in the interests of stakeholders (having regard to the principles of good financial, social, ethical and environmental practice).

Australia

- Australian company directors' duties are set out in the *Corporations Act 2001* and there are similarities to the duties in New Zealand – for example directors have a duty to discharge their duties in good faith in the best interests of the corporation and a duty of care and skill.[31]
- In April 2021, the Australian Institute of Company Directors published a paper on stakeholder governance entitled *Elevating Stakeholder Voices to the Board: A Guide to Effective Governance*. It has also announced that it has commissioned a legal opinion on directors' duties and stakeholders.[32]

OECD

The OECD has also announced that it will be reviewing the *G20/OECD Principles of Corporate Governance* (last updated in 2015). These principles are critical to aiding policy makers around the world in evaluating and improving corporate governance.

7. Developments in New Zealand

There is also a greater focus in New Zealand on stakeholders.

Regulator expectations of boards have shifted and increased significantly in recent years. A prominent example in relation to stakeholders that attracted considerable attention was Rob Everett's (Financial Markets Authority's CEO) speech to the Capital Markets Forum in 2019 entitled *Thinking Beyond Shareholders*. He stated:[33]

"Back to what we expect of boards. As the title of this speech makes clear, I'm looking to provoke the discussion about boards serving a much broader set of stakeholders than just shareholders."

"Yes, directors owe their duties to those who entrust their hard-earned capital to the company. Of course. But it is employees too. Many jurisdictions broaden those duties to their local community, the environment and of course in many cases to their regulators (assuming they operate in a regulated space of course). Last and not least to customers. Those who pay for products or services. They have a right to be treated with respect, not to be lied to, misled or avoided when they aren't happy with how they have been treated."

"... whether it is customers or employees, the environment or the communities in which they operate, I believe companies need to ask themselves what their purpose is and what their values are. And if it is purely to make money at the expense of everyone else they should not be allowed to operate."

He concluded by saying "that regulators and the law should reflect the expectations and needs of society. And those goal posts are moving."[34]

Investors have also become much more engaged and vocal on stakeholder issues. It is not just large institutional investors; retail investors are stepping up their expectations – for instance, the New Zealand Shareholders' Association is developing relevant policies including on diversity and climate change.

An important turning point in the governance ecosystem was the fundamental overhaul of the *NZX Corporate Governance Code* in 2017. This included new content on stakeholders and ESG matters. The NZX has announced that the code will be reviewed in late 2021 and consultation is expected to include stakeholder/ESG practices among other topical governance matters. The FMA's handbook for directors, executives and advisors *Corporate Governance in New Zealand: Principles and Guidelines* (and its predecessors) includes coverage of the board's role in relation to stakeholders, as does the Institute of Directors' *Code of Practice for Directors*.

Questions about New Zealand's model of corporate governance are also becoming more common, for example:

- the Supreme Court in *Debut Homes* referred to the different models of corporate governance but found that it did not need to make a finding on which of the competing models of corporate governance was correct for the purposes of the case.[35]
- the Aotearoa Circle's legal opinion on climate risk noted the emerging relevance of stakeholder theory and that "it is unclear whether and to what extent a New Zealand court could seek to interpret a director's duty to act in the best interests of the company as indirectly including a requirement to consider the interests of broader stakeholders. That is an issue for future discussion and beyond the scope of this legal opinion."[36]
- leading academics have also been active in discussing these matters in the context of companies in New Zealand.[37]

> In a chapter in *Waking the Taniwha, Māori Governance in the 21st Century* (2021), Julie Cassidy considers shareholder primacy and stakeholder theory and suggests that tikanga sets an example and provides lessons for New Zealand non-Māori entities:[38]
>
> "Māori corporate governance focuses on long-term goals and the emphasis in Tikanga on balancing economic, cultural and environmental factors provides an appropriate framework for the role of companies."

One way forward is signalled in the *Roadmap for Action Final Report* (2020) by the Aotearoa Circle's Sustainable Finance Forum which sets out how the financial system in New Zealand should be redesigned to meet sustainability challenges and opportunities now and in the future. Under the subheading "From shareholder to stakeholder capitalism," the report states:[39]

"We see a sustainable financial system as one where impacts (planet, people and profit) are afforded equal importance. When considering the coverage of our recommendations we believe this stakeholder perspective should drive threshold settings."

A key recommendation in the report is that environmental and social factors should be included within applicable fiduciary duty legislation – and this is expected to include directors' duties in the *Companies Act 1993*.[40]

The report also refers to removing barriers to purpose-led businesses and investment models and supports recommendations in the paper *Structuring For Impact: Evolving Legal Structures for Business in New Zealand* by the Law Foundation and the Impact Initiative (a social enterprise sector development partnership between Ākina, the Department of Internal Affairs and the Community Enterprise Network Trust).[41] The paper recommended that New Zealand develop a company model fit for social enterprise – referred to as an "impact company."[42] This would involve amendments to the *Companies Act 1993* to incorporate opt-in provisions for a social enterprise model.

8. The New Zealand legal position – a high level view

The *Companies Act 1993* governs the incorporation and organisation of New Zealand companies. Among other things, the Act provides a framework for defining the relationships between companies and their directors, shareholders and creditors.

The Act affirms the company as a means of achieving economic and social benefits through the aggregation of capital for productive purposes, the spreading of economic risk, and the taking of business risks.[43]

The Act encourages responsible management by providing directors with a wide range of powers while at the same time providing protection for shareholders and creditors against the abuse of such power. To provide for this, the *Companies Act 1993* sets out overriding directors' duties.

Section 131

A director must act in good faith and in what the director believes to be the best interests of the company.[44] The duty "focuses directors on their fiduciary mandate of loyalty."[45] It contains both an objective requirement of acting in good faith and a subjective measure of acting in what the director believes to be the best interests of the company.

Our view is that even if following a strict shareholder primacy theory, this would not prevent directors from considering stakeholders in their governance of the company. Acting in the "best interests" of the company is increasingly being understood to require active consideration of stakeholders, not least because they often have a material financial impact on the company, even if indirect.

Section 137

A director must when exercising powers or performing duties as a director, exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances, taking into account:

- the nature of the company;
- the nature of the decision; and
- the position of the director and the nature of his or her responsibilities undertaken.[46]

We do not consider that this duty prevents directors from considering a broader range of relevant factors beyond shareholders.

Section 133

A director must exercise powers for a proper purpose.[47] In simple terms, this duty may be said to come into play where a director exercises powers beyond what is necessary for the director's role and does so in accordance with an ulterior motive, ie has an "improper purpose."

Again, we do not consider that a director properly considering stakeholders when exercising their powers in a manner that does not prejudice the company or its shareholders or creditors would be at an increased risk of breaching this duty.

Section 134

A director must not act, or agree to the company acting, in a manner that contravenes the *Companies Act* or the company's constitution.[48]

This duty is generally understood to apply to both positive acts and failure(s) by a director to act where that would be in or result in a contravention of the *Companies Act* or constitution.[49] Constitutions are binding between a company and its shareholders.

Obligations to consider stakeholders

New Zealand law requires directors to consider the interests of the following stakeholders:

- the paramount duty of directors is to act in the best interests of their company;
- it is commonly accepted that directors must consider the interests of creditors in their decision-making once the company becomes insolvent or is near insolvency;[50]
- directors are permitted to make provision for the benefit of employees and former employees of the company in connection with ceasing to carry on the whole or part of its business, and this permission is noted as a qualification of the directors' duty to act in the best interests of the company;[51] and
- directors must consider shareholders in a takeover scenario (they have an obligation to make a recommendation to shareholders as to whether they accept or reject a takeover offer).[52]

There is also a myriad of other legislative provisions in New Zealand which requires directors to consider and provide for the interests of other stakeholders, such as the *Health and Safety at Work Act 2015*, the *Resource Management Act 1991* and the *Anti-Money Laundering and Countering Financing of Terrorism Act 2009*, which often do not directly align with shareholders' financial interests.

Adopting a stakeholder clause

New Zealand law permits (and sometimes even mandates) directors to consider a broad range of constituencies, and not just shareholders, when acting in the best interests of the company. However, there is still room for shareholders to argue that the duty should be aligned with "shareholders' return/profitability" as that was the original mandate given by investors contributing capital into the business.

Following that line of thought, and in absence of explicit wording in the law or in the company's constitution, some shareholders may argue (possibly successfully) that shareholders' supremacy should be the guiding principle for directors.

This discussion may become critical in connection with directors' potential liability when a company is distressed, and there is a risk of creditors not being paid in full due to prior judgment calls of directors to prefer non-financial stakeholders. An amendment to the Companies Act along the lines of the UK Companies Act would be useful in these circumstances.

In the absence of legislative reform clarifying expressly what is the right interpretation of the directors' duties contemplated in the *Companies Act 1993*, a provision in the company's constitution[53] permitting the board to consider stakeholders in its decision-making (a stakeholder clause) is an extra layer of protection. Inclusion of such a clause may assist directors because under section 134 they are obliged to act in a manner that does not contravene the company's constitution, provided of course it is not inconsistent with the *Companies Act*.

In our view, including a stakeholder clause in a company's constitution, particularly in listed or widely-held companies, could be helpful to assist directors to navigate their duties and decision-making. By seeking the approval of shareholders to constitutional change, the company ensures that the shareholders have endorsed the matters that directors must consider in determining what is in the best interests of the company. This also provides directors with some comfort and confidence in exercising their duties.

If obligations to consider stakeholder interests are enshrined in constitutions, directors will be obliged to comply with them, failing which they will be at risk of breaching a duty. It is less clear, however, who would be entitled to sue for breach and what remedy might be sought.

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9. Engaging with stakeholders

The *2020 Director Sentiment Survey* found that most directors (87%) agree that stakeholder interests are very important to their business.[54]

Boards have a key role in fostering constructive relationships with (and between) shareholders and stakeholders, encouraging them to engage with the organisation.[55] This may include, among other things, publishing clear policies which communicate the goals, strategies and performance of the organisation, publishing up to date information regularly, encouraging shareholders to engage in annual and special meetings and, importantly, also helping shareholders to understand that it can be in their interests to take account of stakeholder interests. While shareholders have contributed capital to the enterprise, the success of a business is often due to multiple factors, in which different stakeholders (and not just capital) have a pivotal role to play.

All boards should identify their key stakeholders and seek to understand their needs, wants and aspirations and how the organisation can address or resolve these interests. As we outlined in our paper, *Always on Duty: The Future Board* conducting such an exercise can be advantageous including for the following reasons:[56]

- identifying the needs, wants and aspirations of stakeholders (both existing and latent) can lead to the development of new markets and new business opportunities, as well as a more accurate understanding of existing operations;
- it can provide a competitive advantage over those not attuned to stakeholder needs;
- ensuring business operations and policies align with broad community support can enhance corporate reputation, strengthen an organisation's brand, build defensive barriers against competitors and a greater responsiveness to new opportunities;
- being seen as a responsible company can attract and retain more skilled and motivated employees, leading to higher staff morale, increased productivity, lower staff turnover and a continual reinforcement of a company's market reputation; and
- a company which closely monitors social or community concerns can develop a much more responsive and accurate risk management capacity (and strategy).

The New Zealand Productivity Commission in its paper *New Zealand Boards and Frontier Firms (2020)* noted:[57]

"Larger companies have a greater range of stakeholders, whose views need to be factored into decision-making. Boards of bigger companies need to be more stakeholder-aware (compared to early-stage firms which might be more shareholder aware). There are also growing expectations on companies to be thinking more broadly than shareholder returns – such as environmental and social/community concerns. However, shareholders should not get lost in this process – they should be 'first among equals' in terms of stakeholder priority."

There are various frameworks that boards can use to improve stakeholder engagement and governance. For example the IoD UK Centre for Corporate Governance's *From Intention to Action – Board Effectiveness in Stakeholder Governance Working Group* (2021). This sets out observations from interviewees about the following areas (including challenges and potential improvement strategies):

- formal responsibility for company purpose;
- board stakeholder expertise;
- board agenda setting;
- board level stakeholder insights;
- oversight of stakeholder-related issues and deliverables; and
- reporting.

10. Time to review directors' duties

Stakeholder governance is now one of the biggest topics in global governance. A number of trends and developments in relation to directors' duties and stakeholders are highlighted in this paper – and it is reasonable to expect that this will be a topic of ongoing interest in the future.

In recent times the world of business has radically transformed and governance has had to keep in step – and try to stay ahead.

Much more is expected of directors now – greater responsibilities, professionalism, commitment, leadership, accountability and continuous learning. All eyes are now on the board and expectations are high for how they guide their organisations towards sustainable success for shareholders, employees, customers, and communities.

It is critical that directors have clarity in relation to which stakeholders they can/should legitimately have regard to, to what extent, and whether they can/should give priority to others over the stated preferences of shareholders.[58]

This is becoming more urgent, for example as demonstrated by the Sustainable Finance Forum's recommendation in its *Roadmap for Action Final Report* that environmental and social interests be included in fiduciary duties.

Earlier this year the Court of Appeal also highlighted the need for a review of the directors' duties in relation to insolvent trading to ensure that there is a coherent and practically workable regime.[59] Other stakeholders at the time endorsed this call including the Institute of Directors.[60]

There are other issues relevant to directors' duties such as those raised in our paper *Should I Stay or Should I Go: Directors, Leave of Absence and Liability* that also need to be considered.

Directors have a critical leadership role in contributing to the wealth and wellbeing of New Zealand. They need to be enabled to succeed. A key part of this is to ensure that they have clarity and certainty around their core duties.

It has been almost 30 years since the introduction of the *Companies Act 1993*. To stay relevant and at the forefront of governance globally, it is now a timely opportunity for the Government to review the framework for directors' duties in the Act.

> *New Zealand and the business community need to debate and discuss this now. We welcome your feedback to glc@iod.org.nz and we will be engaging with IoD members and the director community over coming months.*

Endnotes

1 Companies Act 1993 (NZ), section 131.
2 Sustainable Business Council New Zealand, *Social Licence to Operate Paper*, 2013, page 2.
3 See, for example, *The Deloitte Global Millennial Survey* 2020.
4 See, for example, *Edelman Trust Barometer 2021 Special Report: Trust, the New Brand Equity*.
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6 Edelman, *Edelman Trust Barometer 2021*, page 36
7 BlackRock, *Larry Fink's 2021 Letter to CEOs*, 2021.
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33 Rob Everett, *Thinking Beyond Shareholders*, 2019.
34 Ibid.
35 *Madsen-Ries v Cooper* [2020] NZSC 100 (Debut Homes), paragraphs 28-31.

36 Aotearoa Circle/Sustainable Finance Forum, *Legal Opinion*, 2019, page 20.

37 See, for example, Peter Watts "*To whom should directors owe legal duties in exercising their discretion? — a response to Mr Rob Everett*" [2019] CSLB 49 and Susan Watson "*What More can a Poor Board Do? Entity Primacy in the 21st Century*" (2017) 23 NZBLQ 142.

38 Julie Cassidy, "*Frankenstein Incorporated" v social citizen – Learning from Māori Tikanga in framing New Zealand Corporate Governance Principles* at page 207 in Waking the Taniwha: Maori Governance in the 21st Century, Robert Joseph and Richard Benton (eds), Thomson Reuters 2021.

39 Sustainable Finance Forum, *Roadmap for Action Final Report*, 2020, page 8.

40 Ibid, pages 10, 24 and 26.

41 Ibid, page 26.

42 The Law Foundation and the Impact Initiative, *Structuring For Impact: Evolving Legal Structures for Business in New Zealand*, 2019.

43 Companies Act 1993.

44 Companies Act 1993, section 131.

45 Susan Watson and Lynne Taylor (eds), *Corporate Law in New Zealand* (online ed, Thomson Reuters) at [16.18.3.1].

46 Companies Act 1993, section 137.

47 Companies Act 1993, section 133.

48 Companies Act 1993, section 134.

49 Silvana Schenone and Igor Drinkovic, *Duties and Responsibilities of Directors and Company Secretaries* (5th Ed, Wolters Kluwer, May 2016) at [613].

50 Companies Act 1993, sections 135 and 136.

51 Companies Act, section 132.

52 Takeovers Code Approval Order 2000.

53 If a company also has a shareholders' agreement (in particular one to which the company is party) it would be prudent to record in that document the agreement of the shareholders to the company being bound by the Stakeholder Clause, both for consistency with the constitution and to avoid shareholder disagreements on the issue.

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55 Financial Markets Authority, *Corporate Governance in New Zealand: Principles and Guidelines*, 2018, page 26.

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Key resources

Institute of Directors and MinterEllisonRuddWatts

- *Always on Duty: The Future Board*, Institute of Directors and MinterEllisonRuddWatts, 2019.
- *Code of Practice for Directors*, Institute of Directors.
- *Director Sentiment Survey 2020,* Institute of Directors and ASB, 2020.
- *Should I Stay or Should I Go: Directors, Leave of Absence and Liability,* Institute of Directors and MinterEllisonRuddWatts, 2020.
- *Sustainable Finance – A Means to Incentivise Good Outcomes*, MinterEllisonRuddWatts, 2021.

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- *Anti-Money Laundering and Countering Financing of Terrorism Act 2009.*
- *Companies Act 1993 (NZ).*
- *Companies Act 2006 (UK).*
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The IoD is New Zealand's leading organisation for directors and at the heart of the governance community. We believe in the power of governance to create a strong, fair and sustainable future for New Zealand. Our role is to drive excellence and high standards in governance. We support and equip nearly 10,000 members and the broader governance community who lead a range of organisations from listed companies, large private organisations, state and public sector entities, small and medium enterprises, not-for-profit organisations and charities.

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