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Working Paper

Unleashing governance for sustainable business

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EXECUTIVE SUMMARY

Unsustainability could be understood as, at its heart, a governance failure at a company and country scale. Governments tend to prioritise governing the economy, and companies within it, for gross domestic product (GDP) rather than for the wellbeing outcomes that GDP purports to deliver. In turn, corporate governing bodies tend to govern primarily for short- to medium-term profit maximisation without focusing innovation on wellbeing or ensuring that they are protecting (or, as a minimum, not undermining) the fundamental social and environmental systems that this collective wellbeing relies on. In fact, prevalent threats to wellbeing – such as climate change, nature loss and social inequality – can be seen as a consequence of the way that governance systems have prioritised maximising profits over other factors. As existential threats to long-term wellbeing increasingly become a reality, corporate governance is under growing pressure to wield its power to change this decision-making issue fundamentally – and further, to remember that companies are society's innovation nerve centre. If business, and hence the market economy, is not fully focused on driving solutions to protecting and enhancing collective long-term wellbeing, it is not clear how our grand challenges will be efficiently, effectively and fairly fixed.

There is now an established understanding that organisational governance (of which corporate governance is a sub-aspect) is key to performance. Organisational governance is about defining what value will be delivered by the organisation for whom and within what parameters (direction), for overseeing the effectiveness of that delivery (oversight) and accounting for it (accountability). Although its roots are deep, organisational governance is a relatively new discipline that has developed during a period where the logic of short-term financial value maximisation has dominated business and economic thinking. This means there has been a focus on large corporations and reducing risk to shareholder financial returns that is embedded in the systems and structures companies are subject to.

This summary review explores four core assumptions of organisational governance that are rapidly changing – who and what governance is for, how to motivate those being governed, and how to achieve the goal. It then postulates what governance that brings about a sustainable future might look like. These findings, informed by literature and current practice, are summarised below:

1. WHO IS GOVERNANCE FOR? From shareholder primacy towards long-term wellbeing of people and planet

Within current company law, even in the context of shareholder primacy, there is wide scope for consideration of stakeholders beyond shareholders and the pursuit of purpose beyond serving shareholders. The dominant focus on shareholder value is thus primarily a normative conclusion (rather than a legal requirement),[1] supported by shareholder-orientated corporate governance and stewardship codes arising from the concerns of financial investors (although some scholars, especially in the USA, affirm that stakeholder primacy is a legal norm, applied by court[*]).

As the threats posed to business by the degradation of society and the environment become clearer, the need to divert resources from shareholders in the near term towards innovation that meets broader stakeholder demands and restores and enhances collective long-term wellbeing is increasingly recognised, for example as indicated by the recent 2019 statement on the Purpose of a Corporation by the US

[*] Among many, see e.g., Stephen M. Bainbridge, "In Defense of the Shareholder Wealth Maximization Norm: A Replay to Professor Green," *Washington and Lee Law Review* 50, no. 4 (1993): 1423; Leo E. Strine, "Making It Easier for Directors To "Do The Right Thing"?," *Harvard Business Law Review* 4 (2014): 235; Leo E. Strine, "The Dangers of Denial: The Need for Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware general Corporation Law," *Wake Forest Law Review* 50 (2015), p. 761.

Business Roundtable, whose own press release noted that they had "since 1997 endorsed principles of shareholder primacy" but were now redefining that purpose as being to promote "An Economy That Serves All Americans".[2]

While some governance and stewardship codes have been tweaked to incorporate consideration of non-financial stakeholders, the potential impact on sustainability is likely to be limited. This is because the resulting change has in fact been mainly a shift from short- to long-term shareholder primacy, rather than to an explicit focus on governing for a purpose anchored to collective wellbeing delivery over the long term and within hard parameters that respect the thresholds of the social and environmental system required for this.

2. WHAT IS GOVERNANCE FOR? From governance that maximises financial profits to governance of a sustainable purpose

The historical emergence of shareholder primacy gave rise simultaneously to the assumption that the value that the governing body exists to optimise is financial value. In many governance codes, the directors' obligation is to ensure the long-term interest of the company, which in turn creates value for shareholders (without specifying what type of value) – however, this is widely interpreted in practice to mean the pinnacle objective is short-term financial value maximisation. Fiduciary duty is thus assumed to be tied to money or property, but this focus on money or the consequent focus on profit maximisation at the firm level is not a solid fact in law (although this is contested among legal scholars, especially in the USA): "There is no well-established body of case law or a statute commanding a duty to maximize profit".[3]

The threats that unsustainability poses to society and the environment are producing new perspectives on what kind of value governing bodies should protect, enhance and optimise. There appears to be an emerging view, laid out below, that (1) governing bodies should be clear about what value they intend to create and for whom, (2) this needs to be meaningful and beyond financial capital, and (3) governing bodies need to declare the basis on which they create and distribute value of all kinds among different stakeholders in pursuit of their purpose (ISO 37000:2021[4]). Changes in support of this include new legal vehicles which allow governing bodies to legally bind themselves to the delivery of a purpose that goes beyond shareholders (eg *Sociétés à Mission* in France) and regulatory changes such as the EU Due Diligence Directive, which requires companies to identify, stop and account for any adverse human rights and environmental impacts linked to their operations.[5] However, this is by no means a consensus view.

3. WHAT MOTIVATES THOSE BEING GOVERNED? From governance that protects assets from managers to governance that empowers purpose-driven decision-makers

Assumptions about human behaviour and decision-making shape the views and practices of governing bodies. The dominant view is that governing bodies exist to curtail the overreach of self-interested managers and preserve the interests of shareholders, which relates to a deeper idea that rational financial self-interest underpins human behaviour and therefore the efficient functioning of markets (see *Unleashing the sustainable business* Part 1[6]).

Alternative theories regarding motivations and associated actions are challenging the validity of this perspective, most notably with the assertion that the desire to live a purposeful life (ie the goal of positively affecting other people and from this developing our sense of worth) is an important motivator.[7] Purpose actively harnesses this deep human motivation for meaningful work and lives towards achievement of the firm's purpose. With this in mind, governance for purpose-driven organisations involves empowering senior management to make decisions without being diverted by interests (including those of shareholders) that may conflict with the organisational purpose. Governing bodies must therefore understand how the governance system currently shapes behaviour internally and in their stakeholder groups, what a culture for an organisation aligned with sustainability looks like for them, and how they can utilise their influence over the worldviews and associated cultural hardware and cultural software in order to bridge that gap (see CISL's *Unleashing culture for sustainable business*[8]).

4. WHAT IS THE APPROACH? From governance as compliance to governance as performance of the purpose within real-world parameters

A defining feature of 'business-as-usual' (BAU) governance is its tendency to focus decision-makers primarily on guarding against risk to financial investment and, as keenly argued by Milton Friedman, on sticking to the 'rules of the game'.[9,10] This has tended to limit investment to that which legal compliance or powerful stakeholders demand, which in turn tends to financial myopia.

As risks to investment and to society as a whole from unsustainable economic activity become clearer, governing bodies are increasingly expected to engage in risk governance, including setting risk appetite and risk tolerance levels and overseeing adherence to these. Environmental, social and governance (ESG) data have become a key element of this process, but these data are often of dubious quality, lack definition in relation to limits in society and the environment (a characteristic which defines 'sustainability'),[11] are not routinely referred to in core decision-making, and at best focus on managing risks to organisations and financial capital rather than actively ensuring the protection of their societal and environmental stakeholders.

Governing bodies must be clear not only about the goal that the organisation exists to achieve, but also within what specific decision-making parameters (which are aligned with operating within healthy social and environmental systems and the moral landscape of society) – and then be clear how to use governance levers to enable strategy that can achieve that goal, within those parameters.[12] Where the governing body considers the organisation's core strategic goal to be maximising financial value (short or long term) and governing the stocks and flows of financial resources, the scope and potential of performance and innovation is likely to be limited to a business case that supports that financial value. Alternatively, a purpose-driven organisation (as defined in PAS 808:2022[13]) will be governed explicitly to maximise the performance of sustainability-oriented innovations within healthy thresholds of social and environmental systems, while maintaining healthy stocks and flows of financial and all other capital inputs.[14]

5. CONCLUSION: UNLEASHING THE SUSTAINABLE BUSINESS – Towards purpose-driven governance

Finally, we consider purpose-driven governance as an efficient, effective and central part of the solution to the problem of unsustainability, and postulate four key attributes of such governance, which include:

- **A purpose aligned with sustainability as the primary value-generation goal** that the governance system exists to achieve.
- **A board that is able to pursue a defined organisational purpose within declared parameters, independent from competing interests, including those of shareholders.** The parameters ensure the health of society and the environment, stakeholders, resources including financial, and align with the organisation's values, operating environment and scientific consensus.
- **Societal accountability of the governing body** to ensure that the purpose and values are aligned with the moral landscape, and that the value-generation model, strategy, culture and governance system are appropriately aligned with the purpose and values.
- **Understanding of the firm as a wellbeing value-creation project** driven by a purpose that is aligned with a sustainable future and associated achievable objectives.

To bring about and maintain a highly successful purpose-driven organisation that is genuinely creating value in society's best interest requires governance that can align the organisation to this new value-creation objective. There is emerging consensus about what governance for purpose-driven organisations should look like.[15,16] As this consensus develops it is becoming clear that it is likely to be very different from the BAU type of governance, and it will require a different kind of board leadership. This paper exists to orient readers as to why organisational governance is so critical for achieving a sustainable future and what change in governance appears to be unfolding.

1. INTRODUCTION: the governance we want?

"The role of corporate governance is to protect and advance the interest of shareholders through setting the strategic direction of a company and appointing and monitoring capable management to achieve this."[17]

Why governance is key

"An organization's success or failure depends on the performance of its board", wrote Bob Garratt in his famous book, *The Fish Rots from the Head*[18] or, as Monks and Minow[19] observed, "every strategy, every innovation in product, operations, and marketing, every acquisition, and disinvestment, every decision about asset allocation, finance, joint venture, financial report, systems, compensation and community relations … is determined by some system of corporate governance". Good governance has long been recognised as core to a country's ability to attract inward investment, and the same holds true for its role in sustainability. Often seen as the lesser understood and developed of the trilogy, the 'G' in ESG (environmental, social and governance) nevertheless indicates the value placed on governance in the drive for sustainable practices.

Successive financial crises and interim scandals have encouraged the view that governance underpins the success or failure of an organisation, exacerbated by the sheer scale and reach of many modern international corporations. From Enron and Volkswagen's 'Dieselgate', to pay inequality and ESG impacts, society and experts increasingly look to governing bodies, as those ultimately accountable for an organisation.

Boards, which are a more stable entity in comparison to CEOs who can leave at any point, are uniquely placed to encode and assure the ultimate value that organisations create over the longer term. Governing bodies are primarily constrained and guided by their legal context, to which they are jointly and severally (as individuals) accountable. Aside from this legal context, boards encode in their decisions a governance system that gives rise to the type, scale and process of value-creation within the firms that they govern. Governance is therefore critical in determining the outcomes of the firm's activity for its stakeholders – its goals, parameters for achieving them (direction), accountability for delivery (oversight) and for course-correction if required. If those aspects are not aligned with a sustainable future, then it is unlikely the organisation will be.

Why we need a better starting point to think about governance and sustainability

Discourse around how governing bodies and governance need to change for greater sustainability is lacking in maturity – reflecting the fact that governance itself is a young discipline. There is a need to dig deeper into what precisely makes governance unfit for purpose and how it can be reimagined and unleashed to drive sustainable organisations. There is a need to question our assumptions about (1) on whose authority and in whose interest the governing body acts, (2) for what ends,[20] (3) based on what view of human behaviour and (4) with what approach. In service of this objective, this paper addresses these four questions in order. It starts by outlining the aspects of governance that lock it into taken-for-granted views about the economy and business – in other words, the business-as-usual (BAU) logic and how this is beginning to shift towards alignment with a sustainable future.

The main body of the report should be read alongside Appendix A, which gives an overview of the governing body structure and the system of governance, and Appendix B, which provides historical context for why and how our current understanding of organisational and corporate governance is tethered to a BAU logic. Additionally, the University of Cambridge Institute for Sustainability Leadership's (CISL's) working paper *Unleashing the sustainable business* Part 1[21] provides supporting information on why BAU is incompatible with a sustainable future and how the move to a purpose-driven logic represents a necessary paradigm shift from BAU (see Box 1). As that paper outlines, BAU relies on a belief that the 'invisible hand' of the market, supported by self-interested companies and individuals, will result in optimal wellbeing outcomes for society as a whole. The risks associated with this belief are becoming apparent. As Mark Carney noted during the 2020 Future of the Corporation Purpose Summit:

"The global financial crisis was caused by the under-pricing of risk, and the surrendering of supervisory judgement … to the perceived wisdom of the market".[22]

The unquestioned (and ungoverned) belief in an 'invisible hand' has, as this review will explore, relegated the primary role of a firm to pursuing its own interest by maximising the financial interests of investors, and the primary role of governance to mitigating financial risk (and optimising financial returns) for those investors. As the extent of the existential threat to humanity and life on earth becomes impossible to ignore, the BAU version of the market economy is beginning to be seen as conflicting with the wellbeing it purports to create. As such there are growing calls not only to ensure companies 'do no harm' but further for a move to a Wellbeing Economy anchored directly to the end goals of long-term wellbeing for all (sustainability)[23] and operationalised by purpose-driven organisations that anchor their reason to exist to that end, and are governed on that basis. In this context there is a clear need to rethink the base assumptions guiding governance.

Box 1: Three foundational business logics

In *Unleashing the sustainable business*,[24,25] three alternative business logics were presented that help explain most decision-making in firms today. Each logic requires a different kind of governance:

- The first logic, **corporate social responsibility** (BAU/CSR) holds short-term financial self-interest as the ultimate goal of the firm, and all decisions align with this. Due to reliance on assumptions about the 'invisible hand' of the market, both the ends of the economy (long-term wellbeing for all) and the foundations of it (healthy social and environmental systems, capitals and stakeholders) are out of sight.
- As companies start to identify the threats that unsustainability poses to their longer-term survival and profit maximisation, they start to move into the second logic: **enlightened shareholder value** (BAU/ESV). The 'invisible hand' is still taken for granted and self-interest is still the core goal, but now optimised for over the long term by operating within the bounds of social and environmental thresholds (eg through managing greenhouse gas emissions in line with the latest science).
- **Purpose-driven** logic represents a deep paradigm shift. Here companies take accountability for delivering directly to the ends of the economy (ie long-term wellbeing for all) – and not via faith in the 'invisible hand'. A core difference between this logic and the BAU is that the organisation moves away from self-serving to primarily other-serving – and hence by extension becomes focused on delivering to solve problems of unsustainability and assure long-term wellbeing for all.

Beyond the few obligations that all directors of incorporated companies must fulfil, the law surrounding corporate governance is made real via soft law and voluntary behaviour. While these contexts are imbued with BAU thinking, our understanding of 'what good governance is' is constantly evolving. Even within the fairly stable context of governance in service of BAU, there is still much disagreement on "[such] basic matters as the purpose of the corporation, the role of corporate boards of directors, the rights of shareholders, and the proper way to measure corporate performance".[26] This level of confusion and lack of understanding about governance is common, including within organisations themselves, up to and including directors of some of the world's largest companies.

If we are to build the organisations that we need to transform – and maintain those businesses which drive sustainability – then clarity and excellence in governance is fundamental. This paper is intended to support active stakeholder-driven debate and consensus-building on what governance is and what it needs to look like for today's organisational and societal challenges. In this respect we have already passed one milestone, with the publication of the world's first multi-stakeholder international standard in Governance of Organizations[27] in 2021, which was developed by over 70 countries and finally approved by 164 countries, as well as the first national standard on how purpose-driven organisations are governed and managed.[28]

What this paper does

This paper provides a high-level overview of four core and rapidly changing aspects of governance. It focuses mainly on revealing the current BAU system of governance and why this is incompatible with governing for a sustainable future. At the same time, it outlines a shift from governance aligned with CSR to ESV logic and highlights signs of purpose-driven governance emerging.

Specifically, this paper lays out the foundations of governance, making it easier to see:

- why governance of enterprises is critical to realising a sustainable future
- why governance is set up to fail sustainability due to its 'taken for granted' ties with BAU
- why we need a more transformative approach to reforming governance
- how this reform is already underway, but needs support to be enabled
- why a more profound understanding of the aspects set out in this paper is critically important for leaders and citizens everywhere.

This paper is split into five sections covering four core interrelated aspects of governance and a concluding section:

1. WHO IS GOVERNANCE FOR? From shareholder primacy towards long-term wellbeing of people and planet (*25-minute read*);
2. WHAT IS GOVERNANCE FOR? From governance that maximises financial profits to governance of a sustainable purpose (*12-minute read*);
3. WHAT MOTIVATES THOSE BEING GOVERNED? From governance that protects assets from managers to governance that empowers purpose-driven decision-makers (*10-minute read*);
4. WHAT IS THE APPROACH? From governance as compliance to governance for performance of the purpose within real-world parameters (*10-minute read*);
5. CONCLUSION: UNLEASHING THE SUSTAINABLE BUSINESS – Towards purpose-driven governance (*5-minute read*).

This paper will refer to the logics presented in Box 1 throughout. These are also summarised in the context of a modified version of Daly's Triangle in Figure 1 below, which appears in PAS 808:2022[29] and *Unleashing the sustainable business*[30,31] and serves as a framework for the arguments made in this paper.

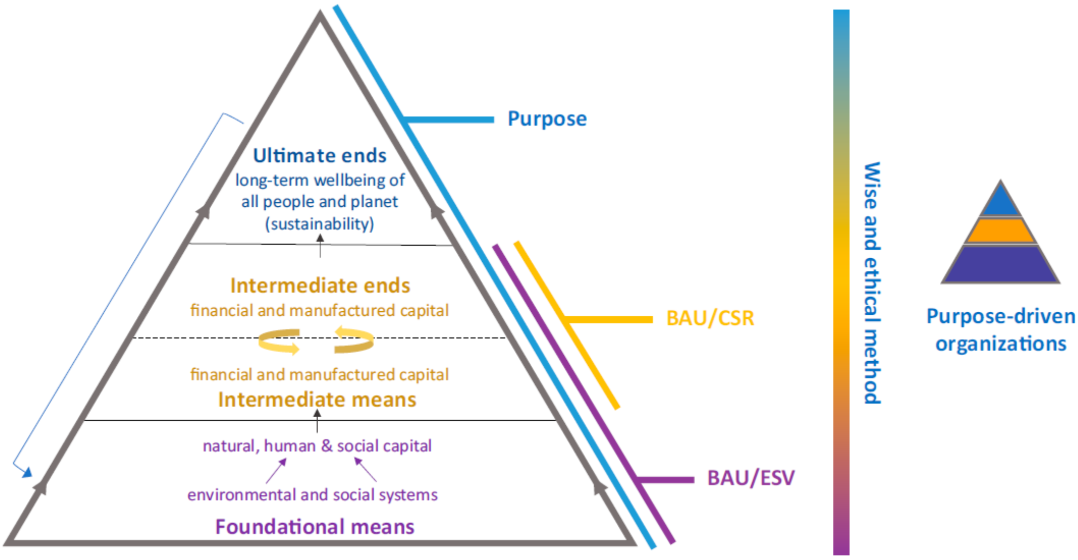

Figure 1: Business logics and governance through the lens of a modified Daly's Triangle
Source: The British Standards Institution[32]

2. WHO IS GOVERNANCE FOR? From shareholder primacy towards long-term wellbeing of people and planet

The first core question when trying to understand governance and how aligned it may be with a sustainable future is: who is the governing body governing for?

The dominant, BAU view of companies is that they are tools for the primary benefit of financial investors. This view is partly explained by the specific belief that those who financially invest in a company, own the company. This belief has in turn become entwined with company law and, perhaps more importantly, with how that law is interpreted.

The relationship between shareholders and companies began as 'legal contractualism', as shareholders came together to create a natural entity (in other words a body 'corp'-orate with its own identity) in law. Under this definition, a company is a distinct entity, born at incorporation and not 'owned' in the literal sense. Segrestin et al.[33] describe a crucial evolution into 'economic contractualism', where "the corporation is no longer a separate entity. Instead, it is an 'aggregation' of its shareholders, with no distinct personality".[34] From this standpoint, directors only have devolved responsibility from shareholders.[35]

As such, over time the legal context of governance has become less about regulating the business–society relationship and more about the shareholder–director relationship. This 'shareholder as owner' view is expressed most distinctly through the wording of fiduciary duty in law. A fiduciary duty is 'an obligation to act in the best interest of another party',[36] with 'best interest' and the 'other party' open to definition. Due to the evolution in perspective referenced above, it is now commonly assumed that the fiduciary duty of a company means a duty to shareholders. Despite that assumption, this is not what the law says. As Rhee[37] summarises:

> "It is difficult to find the locus of law (for shareholder primacy) ... Due to this real legal ambiguity, shareholder primacy has been debated principally on policy grounds and its legal status has been vigorously contested."

The continued prevalence of the normative shareholder ownership view – and the backlash against it – is perhaps best summed up in a Harvard Law article: [38]

> "I continue to hear that the shareholders own the corporation and therefore can order the directors to maximize value solely for the shareholders. I also continue to hear that since the shareholders elect the directors, the directors have a primary fiduciary duty to the shareholders. Lastly, I continue to hear from some quarters of academia that economic theory and financial statistics 'prove' that shareholder primacy and its concomitant short-termism best serve the economy and are critical elements of capitalism."

Even in countries like the UK, USA or Australia which tend to lean towards language that implies shareholder primacy orientation (compared to more stakeholder-oriented countries like Germany), the law leaves the door wide open for interpretation. As Lipton et al.[39] note in a US context, even "Delaware law[†] does not enshrine a principle of shareholder primacy or preclude a board of directors from considering the interests of other stakeholders. Nor does the law of any other state". Nonetheless, this is a highly debated topic and there are several different interpretations, with some scholars, especially in the US, arguing that stakeholder primacy is a legal norm (see footnote *).

The UK provides a useful example of how shareholder primacy – and the governance needed to achieve this – is interpretable, and rather explicitly clear, in shareholder-oriented countries. The UK case also demonstrates both the shift from CSR to ESV logic and the building of momentum towards a purpose-driven approach.

Before 2006, UK law was not explicit regarding to whom directors of governing bodies should direct their fiduciary duty, and what duties were required to fulfil this. However, the 2006 Companies Act[40] saw these encoded for the first time, as:

171. Duty to act within powers
172. Duty to promote the success of the company
173. Duty to exercise independent judgment
174. Duty to exercise reasonable care, skill and diligence
175. Duty to avoid conflicts of interest
176. Duty not to accept benefits from third parties
177. Duty to declare interest in proposed transaction or arrangement

In addition, section 172 outlined how directors should define 'success' and for whom:
"(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,
(d) the impact of the company's operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

[†] Delaware is considered to have business-friendly corporate laws relative to other US states.

(f) the need to act fairly as between members of the company.
(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company."[41]

Although the Act:

a. recognises the long-term interests of the company as a key consideration (something many such as John Kay have argued is the principal duty of the governing body)
b. gives some leeway for the governing body to make decisions which take into account other stakeholders

it nonetheless can be interpreted as confirming that shareholders are the core beneficiary – above all others in the pecking order of value-creation objectives.

Hence, although the letter of the law *allows* for an interpretation of shareholder primacy, it is more often in the cultural interpretation of the law, as if the law was explicit, where shareholder primacy has really taken hold and influenced normal governance practice. Governance regulations, codes, best practice advice and what is tested in the courts are particularly powerful in this normative reinforcement.

Those who advise governing bodies have a pivotal role to play in this. For example, the Australian Institute of Company Directors states in its *General Duties of Directors* document[42] that Section 181(1) requires that directors "act in good faith in the best interests of the corporation". They immediately add:
"In practice, this means in the interests of the shareholders or members of the company as a whole".

Corporate governance codes, along with associated guidance, have also been key for normatively enshrining shareholder primacy, above other interests. Starting from a position of financial trading, the codes tended to be developed in direct response to threats faced by investors as a result of successive scandals relating to the financial misadventures of company management.[43] Hence, these codes primarily focus on aspects such as financial auditing and non-discrimination against different types of shareholders. The ultimate ends and foundational means of the economy (see Figure 1) have traditionally been beyond consideration.

The embedding of shareholder supremacy in national stock exchange codes is a useful marker of how entrenched BAU logic is in various countries. Figure 2 outlines how shareholder protection rose between 1990 and 2013 in 30 countries. This shows that, in general, countries that were shaped by the British colonial legacy tend to share a similar approach to company law, fiduciary duty and the role of the governing body.

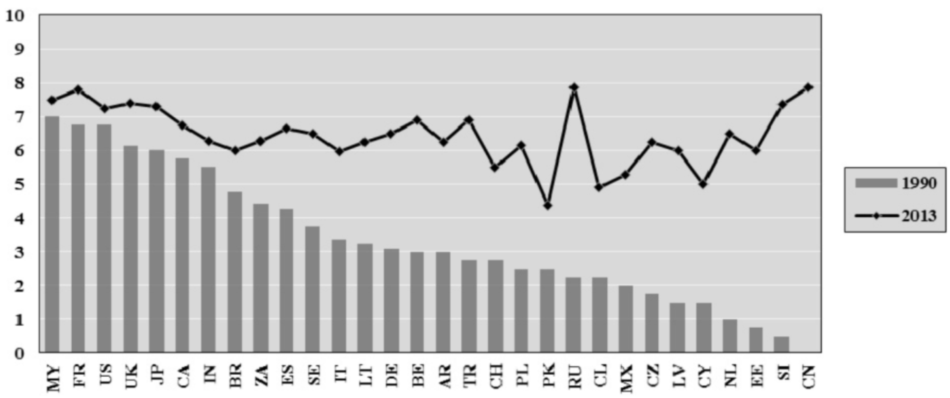

Figure 2: Shareholder protection between 1990 and 2013 in 30 countries‡
Aggregates of 10 different variables of shareholder protection, each based on a scale of 0–1 where 1= highest protection.§ Source: Katelouzou and Siems[44]

Thus, the shareholder primacy norm has become more culturally embedded over time. High-profile lawsuits in the past, particularly in certain American states (eg Delaware[45]), have underlined an aversion by governing bodies to test this norm. However, as highlighted above, it can often be less the letter of the law and more its interpretation that has power over how governance happens. If the governing body assumes that they must act primarily for shareholders, then this becomes the *de facto* reality. Either way, it appears that the norm regarding who the governing body governs for is changing in both realms of the letter and interpretation of the law.

Towards long-term shareholder primacy

Although the normative interpretation that shareholders' interests come first remains dominant, there has been increasing backlash against this view. As the degradation of underlying assets (bottom of the triangle, Figure 1) and lack of appropriately innovative solutions to address critical problems (top of the triangle, Figure 1) become more apparent there appears to be increasing attention paid to the ambiguities in law and how it is interpreted.

Hence the backlash against shareholder primacy challenges shareholders' assumed authority over the corporation's decision-making and over the object of the value-creation of the firm. Many argue that "shareholders have no right to own or possess corporate property",[46] with the likes of Lynn Stout[47] and John Kay[48] suggesting that (in the corporation's current form) shareholders are no more owners than customers:

> "If I own an object I can use it, or not use it, sell it, rent it, give it to others, throw it away and appeal to the police if a thief misappropriates it. And I must accept responsibility for its misuse and admit the right of my creditors to take a lien on it. But shares give their holders no right of possession and no right of use. If shareholders go to the company premises, they will more likely

‡ AR (Argentina), BE (Belgium), BR (Brazil), CA (Canada), CH (Switzerland), CL (Chile), CN (China), CY (Cyprus), CZ (Czech Republic), DE (Germany), EE (Estonia), ES (Spain), FR (France), IN (India), IT (Italy), JP (Japan), LV (Latvia), LT (Lithuania), MX (Mexico), MY (Malaysia), NL (the Netherlands), PK (Pakistan), PL (Poland), RU (Russia), SE (Sweden), SI (Slovenia), TR (Turkey), UK (the United Kingdom), US (the United States) and ZA (South Africa).

§ 'Ten-variable shareholder protection index': Powers of the general meeting for *de facto* changes; Agenda setting power; Anticipation of shareholder decision facilitated; Prohibition of multiple voting rights; Independent board members; Feasibility of director dismissal; Private enforcement of director duties; Shareholder action against resolutions of general meeting; Mandatory bid; Disclosure of major share ownership (Katelouzou and Siems 2015, 6).

> than not be turned away. They have no more right than other customers to the services of the business they 'own'. The company's actions are not their responsibility, and corporate assets cannot be used to satisfy their debts".[49]

Similarly, big questions have been raised about the governance of organisations being primarily for financial investors when they have no commensurate 'ownership' responsibilities. As stock market trading has become 'gamified' over time, aided by technology, many also point out that the term 'investor' does not fit a large number of those whom organisational governance is seeking to serve. In other words, not all shareholders are equal. The Purposeful Company Task Force – convened by the Big Innovation Centre and in conjunction with the Bank of England – wrote in their 2015 report:[50]

> "There is a crucial distinction between the engaged owner shareholder and a shareholder as a short-term investor. Owners are involved in the oversight and sometimes the management of firms. They accept responsibilities as well as rights – responsibilities to ensure that the company delivers on its purpose and to bear at least some of the consequences for its failure to do so."

The Task Force contrasted owner-shareholders with shareholder-investors who receive returns for their investment. There is a difference between (1) those who invest to make gains from the augmentation of the underlying asset, and (2) those who seek to profit from a short-term shift in share price and have no interest in the firm itself, yet have the same rights as shareholders. The Task Force notes that the law does not adequately deal with this issue.[51]

As *Unleashing the sustainable business* points out, some companies that align with the short-term self-interest logic of CSR are starting to perceive an urgent threat to their interests from social and environmental degradation, and are starting to move deliberately to a long-term self-interested approach (ESV). As a result, an internal business case is created for governing bodies and executives to divert investment from shareholders to non-financial capital stocks and flows, the protection and enhancement of social and environmental systems, and non-financial stakeholders who are custodians and gatekeepers of these capitals and systems – which together are the basis of long-term financial success. Governing bodies and senior executives of emerging ESV firms are also starting to lobby for changes in law and regulation to level the playing field and remove barriers to operating within healthy social and environmental parameters.

The UK 2006 Companies Act introduced the possibility of considering broader stakeholders – and placed more weight on the 'long term'. This can be seen as an example of a legal attempt to encourage and enable BAU/ESV in law. However, research suggests that in this regard the practical results of the new legislation have proved modest.[52]

From another angle, the original UK Financial Reporting Council (FRC) Stewardship Code[53] focused on investors (mostly institutional investors) and the need for them to provide long-term stewardship of their clients' money through more active influencing of the companies they invest in. This was a watershed moment, moving from an arms-length focus on financial indicators to closer scrutiny of governance practices, even if the initial focus was on discrete aspects such as strategy and remuneration.

More recently, a 2020 revision to the UK FRC Stewardship Code Revision moved beyond scrutiny of company strategy by investors as a general topic to explicitly incorporating consideration of three pillars of sustainability. This revision was intended to:

> "[establish] a clear benchmark for stewardship as the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society."[54]

There is a strong focus on the activities and outcomes of stewardship, not just policy statements. There are new expectations about how investment and stewardship is integrated, including ESG issues. In reality, this covers risks to the long-term health of society and the environment only if this aligns with 'long-term value' (a term interpreted by default within BAU as financial value) for clients and beneficiaries. As such, the Code remains unclear regarding what should happen about the negative impacts that are out of sight, eg on non-client or non-beneficiaries.

The FRC noted in its 2017[55] review: "[The] corporate governance framework needs to evolve to meet the expectations of wider society". Similarly, the FRC's 2016 *Corporate Culture and the Role of Boards: Report of Observations* indicated a maturing understanding of the organisational behaviour aspects of governance (beyond financial) which require attention.[56]

Despite its limitations, the shift from governance based on CSR to ESV appears to be motivating a move away from a fundamentalist view of shareholder primacy. The normative shift has been dramatic in the past few years, most likely mirroring the dramatic increase in public understanding of critical levels of unsustainability. As Lipton et al. (2019)[57] summarise:

> "each of the major index fund managers, the Business Roundtable, the British Academy, the UK Financial Reporting Council, the World Economic Forum and a number of other organisations (both governmental and nongovernmental) announced that they did not support shareholder primacy and do support sustainable long-term investment and considering ESG matters".

While this could reflect a mainstream normative shift from CSR to ESV logic, questions concerning whose authority directors act on and for whose benefit are left wide open – with the most discernible answer currently being that what we have seen is a move from short-term to *long-term* shareholder primacy, albeit neatly disguised in cleverly worded announcements like that from the US Business Roundtable on the Purpose of the Corporation (covered in more detail in *Unleashing the sustainable business* Part 1). However, judges have begun to rule against companies that fail to take other stakeholders into account, eg Milieudefensie v. Shell,[58] where the latter was ruled to owe a duty of care to Dutch residents to reduce its CO_2 emissions.

Reflecting the legal confusion in this space,[59] recent rulings have reinforced the view that shareholders are not owners as – in general (there are jurisdictions where shareholders above a certain threshold can initiate derivative actions against directors) – only the company can sue directors. This is because it is the company that has been wronged (as a legal entity) and it is the directors who are responsible for the company.

Survivalism and director-centric governance primacy

A prevalent alternative to long-term shareholder primacy – an alternative that benefits from aligning with wording in law – is that the ultimate duty of governing bodies is to the long-term benefit of the organisation. This could be considered 'company primacy'.

For example, the Big Innovation Centre 2016 report states that directors have a duty to the long-term good of the firm (and not to owners) because companies are incorporated as legal entities and are therefore separate from their owners[60] – reviving the 'legal contractualism' view discussed earlier. Echoing this argument, several high-profile academics – such as the late Professor Lynn Stout and Professor John Kay – have worked to shift this perception of law. As John Kay[61] notes: "Directors are not only entitled, but required, to look at the effect of their decisions on the long-term success of the company".

This emboldens governing bodies to consider decisions that prioritise non-shareholder stakeholders as normatively justifiable. This is a step towards broadening business cases to account for the non-financial value that underpins our collective long-term wellbeing. Given the existential risks currently posed by unsustainable company practices to collective long-term wellbeing, and hence the ability of any business to survive, this paves the way for any number of sustainability actions to be justified in law which forgo optimised short-term profits for shareholders. However, the ability for the firm to invest in action is still bounded by a business case that considers whether the action is in the long-term interest of the firm. As decision-making still sits firmly within BAU understanding of how the market economy best works, then – as will be outlined in the next chapter – this tends to mean the long-term financial best interest of the company. As the company is normatively considered to be owned by members (shareholders) the key shift is in the timescale over which financial income is optimised.

At the same time, while a subtle shift, moving a focus to the long-term self-interest of the company ushers in an argument for control rights moving away from the immediate hands of shareholder interests and instead to the decision-making of the board. This 'board trusteeship' or 'director primacy' perspective reflects an 'organism survival' theory of the firm (see section 4, page 27–28). The director-centric view is that: 'Neither shareholders nor managers control the company – boards of directors do" as "autonomous actors free to pursue whatever interests they choose.' As will be discussed later, this board-autonomy approach (within a clear social accountability structure) is an important piece of the puzzle of governing for a Wellbeing Economy – where the ultimate beneficiary of organisations that make up this sustainability-oriented economy is the whole of society in the long term and not shareholders or other specific powerful stakeholders that have an immediate relationship with the firm. To achieve this, it is important that the board is sufficiently empowered to define a purpose that is aligned with the goal of long-term wellbeing for all, able to focus on delivering the purpose within agreed parameters and to both meet and shape the expectations of stakeholders including shareholders so that this purpose can be delivered. While governing bodies are serving the financial interests of shareholders the organisation will necessarily be out of alignment with delivering for a sustainable future – unless shareholder interest also aligns with long-term wellbeing for all.

Stakeholder orientation

Beyond the 'survivalist' and director-centric approach, perhaps the most influential (and most visible) push-back to the notion of shareholder primacy is that of a stakeholder orientation. *Unleashing the sustainable business* Part 1 outlined this concept in detail and examined how we may understand its relationship to the purpose-driven logic. Sometimes known as 'stakeholderism' or 'stakeholder capitalism', this view is widely interpreted as the belief that the ultimate strategic objective of a firm is to balance value for all stakeholders. This is not the same as serving stakeholders in order to maximise financial income as the ultimate goal of the firm – which is strongly related to ESV. Nor is it the same as serving stakeholders so that they are able to support achievement of purpose, while their wellbeing is not harmed in the process.

Stakeholder capitalism has received widespread criticism for being strategically unachievable and inoperable. Optimising for balance across a wide range of stakeholders is seen as either impossible or undesirable as the pinnacle ambition in a value-creation entity, which needs to make strategically focused decisions and achieve something clear and agreed.

The US Business Roundtable statement of 2019[62] called for a shift in the business sector's overall objective from benefitting shareholders to the benefit of 'All Americans'. Perhaps understandably, it was commonly interpreted as endorsing a move towards the governing body serving stakeholders as equal primary beneficiaries of companies' strategic endeavours. This prompted a strong response from the Council of Institutional Investors (CII) – "the voice of corporate governance" – which noted that their support for stakeholder capitalism did not extend to a move away from shareholder primacy.[63] CII's key argument was that effective allocation (and re-allocation) of capital is what makes the market work and that even if CEOs want more leeway from investors to pursue 'better' strategies, they cannot avoid the way the market moves capital. Reinforcing the BAU view of finance as an end goal of business, with the wellbeing end goal of the economy an automatic consequence of this, they stated:[64]

"If 'stakeholder governance' and 'sustainability' become hiding places for poor management, or for stalling needed change, the economy more generally will lose out."

The fears from the CII seem misplaced, because on closer reading, all the US Business Roundtable statement did in effect was to remind us of a forgotten fact – that the point of an economy is long-term wellbeing for all of the society it serves (ie sustainability). It did not close off the BAU assumption that the best way to do this was to continue to optimise financial income for shareholders. Furthermore, it helped give further credence to the ESV 'long-term self-interest' view as Jamie Dimon, chair of Business Roundtable, stated at the time: "Major employers are investing in their workers and communities because they know it is the only way to be successful over the long term."[65]

Aligned with this landmark statement from the US Roundtable as the bastion of BAU marketing economy thinking, tangible shifts towards a long-term self-interest/instrumental stakeholder approach can also be seen in law. Effective from 2019, new corporate governance legislation mandating reporting against section 172 (a–f) of the 2006 Companies Act among other non-financial disclosure innovation globally – for large companies – can be seen as another landmark. This legislation forces governing bodies to measure and disclose the effects of their decisions on stakeholders (including the natural environment) – beyond what this means for the company. For further details on the evolving sustainability-related legal trends in corporate governance regulations and how these are shaping board practice, see CISL's publication *The Future of Boards Phase 1, Part 2*.[66]

Although these advances and those following hot on their heels are encouraging for a new governance emphasis, the firm-based financial self-interest approach, not surprisingly, continues to be the norm and is perhaps most clearly seen in the International Sustainability Standards Board (ISSB). The ISSB was set up under the International Financial Reporting Standards (IFRS) in order to develop standardised sustainability reporting as a sub-topic of financial reporting. The first two standards on general sustainability disclosures and climate-specific disclosures have now been launched.[67] The ISSB was initially set up to consider only 'single materiality' – disclosure of decision-relevant information about the direct financial impact and opportunity of degraded social and environmental systems on the company, eg how deforestation will increase the price of wood as a material input.

Pressure (eg from the EU's European Financial Reporting Advisory Group) and strategic alliances (eg with the Global Reporting Initiative (GRI)) have led to an interest in 'double materiality',[68,69] where the effect of the firm on the outside world is also considered in financial reporting. However, as discussed above, on interrogation this is not about counting the cost of externalities, so all parties have the decision-useful information they need, but more about 'double-loop materiality'. This is where the focus remains on offering decision-useful financial information to shareholders only under conditions where impacts on the external world are assessed as likely to impact the firm's financial self-interest (eg reporting the impact of the firm on an external issue, like climate change, because of the consequence this may have on the firm's longer-term financial health). The GRI takes a more purpose-driven approach, valuing reporting on the impact on external stakeholders and society as a whole in and of itself. While this is admirable, without a purpose-driven logic (including purpose-driven worldviews – see *Unleashing culture for sustainable business*[70]) at the heart of the firm doing the reporting, it will remain detached from decision-making. It is therefore not surprising that while there is a stated intent to close the gap between the ISSB and GRI approaches to double materiality, this is as yet unresolved.

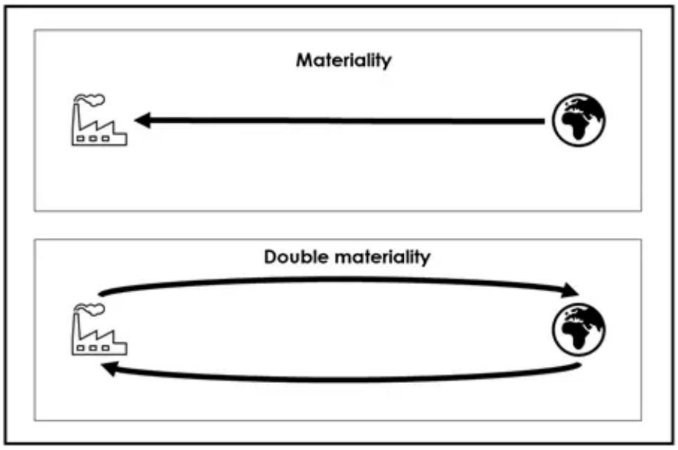

Figure 3: Single and double materiality as interpreted by the ISSB
Source: Täger[71]

Towards purpose

In the unfolding suite of alternatives to shareholder primacy, purpose represents perhaps the most radical and, for the same reasons, the most sustainability-aligned of all.[72] The concept has deep philosophical roots to what it is to live a purposeful life in service of the good of another, in an organisational context. However, in recent decades, coinciding with acceleration of concern about the misalignment of business with society's best interest, purpose as a practice-based concept has grown to become perhaps the defining face of sustainable business via global movements like B Corp.[73] On the one hand, some have become sceptical of purpose as a tool to drive sustainability because of its widespread use as a branding tool to create beneficial relationships with stakeholders without associated organisation-wide decision-making.[74] At the very same time, consensus has been emerging about what purpose means, in specific practice-based detail, to drive the missing accountability. Led by an expert group of practitioners and academics in the space, PAS 808:2022 outlines a first national (UK) consensus view on how this purpose should represent a solution-focused, optimal strategic contribution to humanity's meta-purpose of long-term wellbeing for all – as this is the ultimate context for serving another's good (and aligns with the definition of the goal of an economy and of sustainability, rewording the definition of sustainability (sustainable development) in the Brundtland report (see *Unleashing the sustainable business* Part 1 for details). By anchoring accountability and innovation to the end wellbeing outcomes of an economy, rather than relying on market dynamics to automatically achieve this, a purpose-driven organisation, in effect, rejects the main assumptions of BAU. Specifically, a purpose-driven organisation changes: (1) who the company exists primarily to serve (its beneficiaries), (2) how the company defines the value that it is ultimately there to produce for them, and (3) how the company stays accountable to this. Governing for purpose will therefore require transformation at the heart of organisational governance (this will be covered in more detail later) and therefore a shift to purpose will be necessarily constrained without associated changes in corporate law.

Allowing for purpose

The legal basis has long existed for charities whose object is legally required to be some kind of social good for external parties. Legal vehicles for incorporating social enterprises as market businesses that work for the objective of serving a social purpose have also been around for some time (known as Community Interest Companies in the UK since 2004), appearing in various forms depending on the country. However, these also restrict profit distribution and often require specific voting rights for shareholders (eg co-operatives) and usually have democratic governance and a form of public control. While these legal forms can enable benefit from specific tax breaks, this also makes them unnecessarily restrictive and they are not yet governed by a law that ensures that they are delivering on their stated mission.

To address this shortcoming in company forms that effectively target a sustainable purpose, the past few years have seen the creation of legal vehicles which are explicitly positioned as a means of allowing governing bodies of new or incumbent organisations to legally bind themselves to the delivery of a purpose – connected to the wider needs of society – that goes beyond shareholders (eg (Public) Benefit Corporations in the US, *Società Benefit* in Italy or *Sociétés à Mission* in France). These legal progressions fall under the heading of a 'profit-with-purpose' corporation (PPC) – a term apparently coined after a 2014 G7 meeting.[75] As will be outlined below, these do not yet fully align with purpose, and changing the legal basis for the primary goal of the governing body does not in and of itself result in governance that is aligned with purpose-driven organisations.

These new legal vehicles have the following in common: "(i) a corporate purpose to create a material positive impact on society and the environment; (ii) expanded fiduciary duties of the directors requiring the consideration of non-financial interests; and (iii) an obligation for the corporation to report on its overall social and environmental performance".[76] Here, a goal relating to society or the environment is written into the constituting documents alongside the profit motive. As Levillain and Segrestin (2019)[77] outline, these types of legal developments aim to provide "a set of governance rules to protect their engagement toward broader concerns than the company's economic results and financial performance" and this additional purpose "can be as broad as minimizing the negative impacts of the company's activities on various stakeholders, or as specific as a charitable purpose targeting a particular beneficiary population."

These vehicles create a hybrid structure whereby shareholder primacy and the pursuit of some other super-ordinal goal are dually primary. As such, they "simultaneously reinforce both shareholder and director primacy".[78] The complexities and issues associated with trying to strategically optimise for two sets of competing outcomes where win–wins are not always possible – for example, when making decisions about accountability, finance or people management[79,80] – are well known, and are explored within the social enterprise hybridity literature.[81]

Despite such limitations, these PPCs represent an important progression in law which reveals the legal characteristics of a purpose-driven firm and the implications for governance. In a critical paper by Segrestin, Hatchuel and Levillain,[82] the authors build on their previous propositions[83] to outline the innovative rationale behind the *Société à Mission* (the French legal corporate form) and its specific implications for governance. Despite the limitations of hybridity, these PPC innovations make the legal and governance practice foundations of truly purpose-driven firms more tangible even if they are just one piece of the puzzle and one step forward.

Beyond the hybridity of PPCs are companies that enshrine purpose as their sole primary objective. This could include merely changing the existing articles of incorporation, as some publicly listed companies like Anglian Water have done.[84] It could include using existing law that is normatively interpreted for other uses, eg sub-section 2 of section 172 of the 2006 UK Companies Act states: “where or to the extent that the purposes of the company consist of or include purposes other than for the benefit of its members”.[85] As such, “companies are therefore free to adopt other purposes in their constitutions”.[86] This opens the possibility for governing bodies to owe a primary legal duty to anyone at all. Another way companies are enabling governance for purpose is by careful consideration of their investing, and hence power, structures. OpenAI, the pioneer company behind ChatGPT, cognisant of the important ethical implications of their technology, were notably financed under a ‘capped profit’ model for investors and employees.[87] This serves to position investors as stakeholders alongside employees and positions the social objectives of the company as of primary governance focus.

For researchers like Segrestin and colleagues,[88] we can think of companies moving to purpose-driven governance as a shift away from the ‘primacy’ view of corporate governance towards a ‘purpose commitment’ approach. In effect this changes the defining question for the governing body from ‘Which stakeholders are we *agents* for?’ to, ‘What are we doing together, and for what purpose?’.[89] For a governing body, “the existence of a common purpose, explicitly stated in publicly available legal documents, [therefore] enables derivation of objective and stable criteria for controlling executives’ action.”[90]

Mandating for purpose

So long as the wider governance community continues to promote a shareholder primacy view of the law, having the legal *opportunity* to move towards an ESV or purpose-driven logic may have little effect on aligning business as a whole with sustainability.

In this respect stakeholders in some countries, including within governments, are starting to build coalitions advocating a change in the law. For example, in the UK, the Better Business Act proposal,[91] put forward by the Better Business Act Coalition, aligned with the B Corp movement and supported by over 900 companies, suggests a change to the Business Act, 2006. The proposal recommends changing the wording on duty from “promote the success of the company” to “advance the purpose of the company”. Although this fails to deal with inherent issues regarding in whose ultimate benefit this endeavour takes place, interpreted in the right way – and with the right framework for what is considered a proper purpose – this small change could resituate profit maximisation and firm survival as means of pursuing a meaningful purpose rather than end goals.

Similarly, in Canada, the Canadian Purpose Economy Project focuses on changing corporate law to facilitate purpose-driven business. It states that: “the Purpose Economy is an economy powered by the pursuit of long-term wellbeing for all in which business and regulatory and financial systems foster an equitable, flourishing, resilient future. And governments hold the key to its realization”.[92] Partly as a result of pressure from this Project, the Government of Canada commissioned a report on how to progress purpose-driven organisations. Among other proposals, the *Promoting Purpose in Canadian Public Policy* report[93] recommended amending the Canada Business Corporations Act to require disclosure on purpose and progress towards it.

In summary, the generally accepted view regarding who and what the governing body is accountable to/for is starting to shift – both theoretically and practically – from shareholders to company-level stakeholders to society’s best long-term interest. When moving from shareholders/members of a company they in effect become seen as a vital stakeholder group (rather than the focus of the end goal) who invest and risk their assets and who have a specific expectation in return, and who may have important, but specific, legal influences over governance.

3. WHAT IS GOVERNANCE FOR? From governance that maximises financial profits to governance of a sustainable purpose

The shift to shareholder primacy not only mainstreamed the assumption that the governing body should be focused on serving *shareholders* but also that the ultimate value that it should be optimising for those shareholders is *financial capital*. This chapter examines the second element – the focus on financial capital as the primary value-generation objective that the governing body should be pursuing for shareholders.

These assumptions have been subsequently made real in governance codes around the world which have a consistent focus on the governance of financial capital and its protection for investors. The 'financialisation' of the market economy, or 'hyperfinancialisation capitalism',[94,95,96,97] fuels a financial focus, which has been at the expense of governing other value (eg social, human and natural), or taking into account the stakeholders that embody or gatekeep these resources – see Figure 1. The focus on financial capital has become so embedded in our collective consciousness that – even outside the corporate world – the term 'value' is often automatically assumed to mean 'financial value'.

This financialisation of governance is clearly evidenced by the first UK Corporate Governance Code (Cadbury Report) in 1992;[98] indeed, its little-known subtitle was 'The Financial Aspects of Corporate Governance'. The lack of an equally prominent report on the non-financial aspects of governance is telling. This focus on finance implies that corporate governance is only relevant to companies that seek first and foremost to make profits. A further significant consequence is that the very concept of governance can appear less relevant to other types of companies.[99]

However, while fiduciary duty is often assumed in general to be tied to money or property, as outlined in section 2 this is not a solid fact in law but a BAU interpretation which has become grounded in the culture of business and governance. The notion that 'best interest' is maximisation of financial returns is not explicitly stated: "There is no well-established body of case law or a statute commanding a duty to maximize profit."[100]

As growing unsustainability shifts perceptions of who governing bodies are ultimately accountable to (from shareholders to society as a whole), views on what kind of value should be protected, enhanced and optimised by governing bodies are by extension also changing. The assumption that financial value is the core and only real remit of governance is being questioned by a variety of stakeholders.

Governance of resources

As outlined below and in *Unleashing the sustainable business*,[101,102] the current and somewhat mainstreaming calls for an ESV focus on *long-term* financial value optimisation have started to reorient the attention of governance towards the ultimate capitals (natural, social and human) and – more broadly – to the social and environmental systems which underpin them and are in a degraded, and in some cases severely degraded state (eg the climate and a number of ecosystems). Governing bodies are being asked by their stakeholders and investors (and others) to understand, oversee and account for value beyond the financial, even if only as a means to a financial end. This expanded view goes some way to explain the increasing requirements being placed on governing bodies to report their risk exposures to unsustainability and in theory move towards internalising the 'true costs' and associated risks that business investors are exposed to. While many investors will still be operating from a logic where they are protecting themselves from short-term risks to financial income (BAU/CSR), some are beginning to take this broader risk perspective: "For many mainstream investors and asset managers, the key justification for incorporating ESG factors into investment analysis relates to their potential impact on portfolio-level risk-adjusted returns or the relationship between ESG factors and risk management at the company level."[103]

Figure 4 outlines the International Integrated Reporting Council's[**] integrated reporting view of the organisational value-creation system. Governance is depicted as an umbrella system which designs and assures the value-generation model (business model) and its context. This view of value-creation, governance's role within this, and the need to take care of all capitals (not just financial) gained international recognition with the King IV Code. This globally influential South African Corporate Governance Code[104] – mandatory for listing on the Johannesburg Stock Exchange – explicitly requires integrated reporting (or to explain why not), which includes reporting on the six capitals.

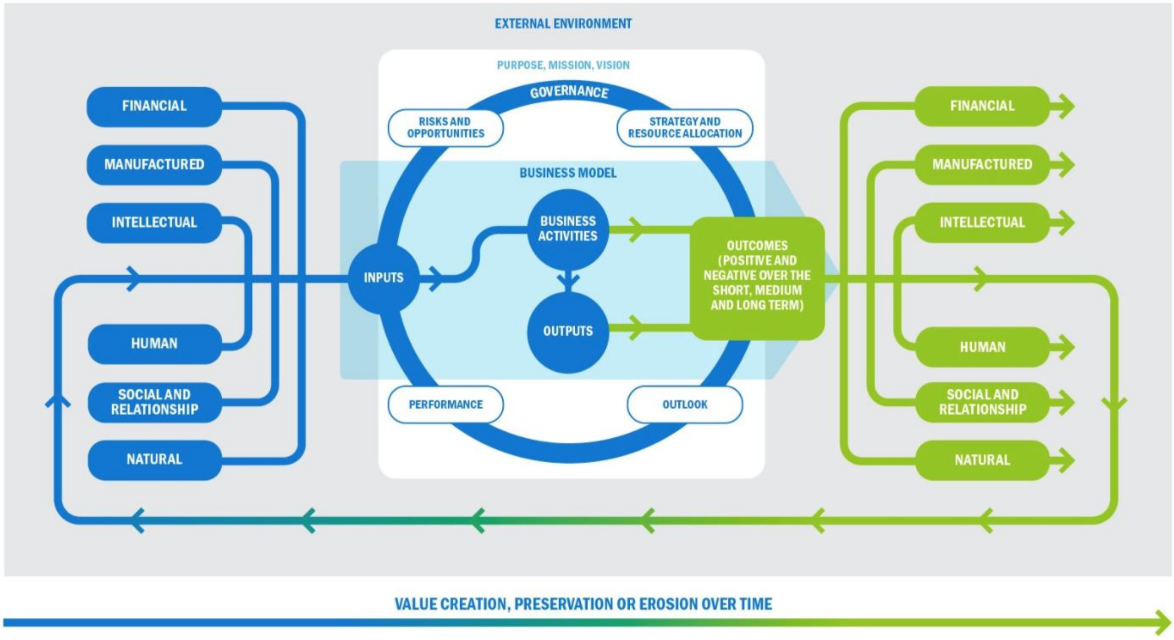

Figure 4: IIRC's business model overview
Source: IFRS Foundation[105]

Governance of, and for, a purpose

As well as a shift from focusing on financial capital accumulation towards protecting the broader suite of capitals this rests on, the notion of financial capital as the rightful overarching value-generation goal of governing bodies is also increasingly questioned.

In a range of quarters, reference to organisational purpose as the pinnacle of value-creation ambition (for which the governing body is responsible) is growing fast. For example, the UK Corporate Governance Code revision gave purpose more formal prominence when it stated in Principle B that "the board should establish the company's purpose, values and strategy".[106] The Code defines purpose thus: "A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society".[107] This is espousing an ESV logic where (a) shareholders are the ultimate beneficiary, and (b) 'value' implies financial value. With this emphasis, the Code is staying true to BAU logic while simultaneously (and deliberately) ignoring the widely expressed and rich meaning of purpose; namely, a

[**] Commonly known as the IIRC, which became part of the Value Reporting Foundation (VRF) and is now part of the International Sustainability Standards Board (ISSB).

meaningful reason to exist in service of the good of another (see *Unleashing the sustainable business* and PAS 808:2022).

While not explicitly anchoring the purpose to long-term societal or natural value, others go further than the UK Governance Code, making it clear that a purpose should be anchored to something meaningful for stakeholders. As a result, such examples exclude financial goals as a purposeful end. This new and emerging consensus is encoded in guidance like IIRC's (VRF) integrated reporting framework or ISO 37000:2021. While identifying financial value as one of the many inputs and outcomes which can result from an organisation's operations, both also agree that financial capital does not constitute a meaningful value-generation 'end' (ie purpose).

Developed over five years by 77 countries and 25 liaison organisations, ISO 37000:2021 – written to be applicable for all organisational types and countries – is the first global (and unifying) norm to define what good governance is. It defines organisational purpose as an "organisation's meaningful reason to exist". Purpose is situated as primary among 11 governance principles, and governing bodies are required to specify their reason to exist in (1) a purpose statement, and (2) a statement which frames the ultimate value-generation goals of the organisation. This global guidance also states that governing bodies need to establish and publicise the precise value that they intend to create and sustain to achieve this purpose – and to consider the long-term systemic and moral context when doing so. It describes the "value generation model" as the place where these value-generation decisions are brought together, and stipulated that these (and all) governance decisions should be anchored to the meaningful outcomes encoded in the purpose. Figure 5 provides an overview of the 11 principles of organisational governing in ISO 37000:2021, as well as the three governance outcomes.[††]

Governance for shareholder wellbeing

Even from a shareholder primacy perspective, questions are being asked about whether investors are in fact solely concerned with increasing their financial wealth and if, therefore, focusing on financial income is enough to carry out the fiduciary duty of care. Research by Harvard and Chicago Booth School of Business[108] has argued that investors care about the sustainability performance of companies independent of their financial performance. Eccles and Klimenko[109] further evidence this argument: "In 2006, when the UN-backed Principles for Responsible Investment (PRI) was launched, 63 investment companies (asset owners, asset managers, and service providers) with $6.5 trillion in assets under management (AUM) signed a commitment to incorporate ESG issues into their investment decisions. By April 2018, the number of signatories had grown to 1,715 and represented $81.7 trillion in AUM."

We can already see this translating at a global level away into broader definitions of a governing body's fiduciary duty. The international standard on Sustainable Finance (ISO 32210:2022[110]) for example, defines Fiduciary Responsibility as: "[the] requirement of fiduciaries to act in the best long interest of their clients

[††] ISO is a collaboration of 164 national standardisation bodies (the next largest stakeholder group of nations that have produced guidance on governance is probably the OECD with 38 members). In effect, ISO is home to an internationally agreed process of consensus building to establish global norms around any topic, normally related to organisations. ISO standards are often used to inform countries' regulatory environments. The level of impact an ISO can have on a country's policy environment depends on factors such as its applicability, current deficiencies in understanding the topic in question, how widely and quickly it gets utilised by stakeholders, and the extent to which national policymakers rely on ISO standards to support their regulatory development. Using an applicable example, ISO 26000:2010 on social responsibility has been adopted by 80 national standardisation bodies that are part of ISO, with a further 21 going through the process of adoption. This does not make it mandatory for organisations to adhere to it but does set an expectation and a common language. It has been translated into 31 languages – another indicator of impact.

and beneficiaries." Some scholars would maintain that in any case the duty of care means that the governing body's "fiduciary task is to promote the well-being of the shareholder body as such well-being may materialize from time to time in the fortunes of the corporate entity."[111]

There are a number of ways in which investors are making known what they feel is in their 'best interest' beyond financial returns. The number of activist investors with a focus on sustainability is increasing and their successes are becoming more notable (eg the hedge fund Engine No.1's successful campaign to get three sustainably minded board members elected to the Exxon board, which was supported by large institutional investors such as BlackRock[112]).

Additionally, there are progressive commitments towards 'stewardship' among investors. The investor forum concluded in 2021 that: "We have reviewed the stewardship landscape in each of our reports since 2015 and the cumulative change has been dramatic. The shift in priorities that has been catalysed in 2021 is nothing short of remarkable."[113] Impact investors are also stretching normative views on fiduciary duty very practically, with some defining the 'best interest' they are seeking for themselves specifically in terms of the wellbeing impact (eg specific social or environmental outcomes) they want to see, with financial return a fixed or lesser objective.

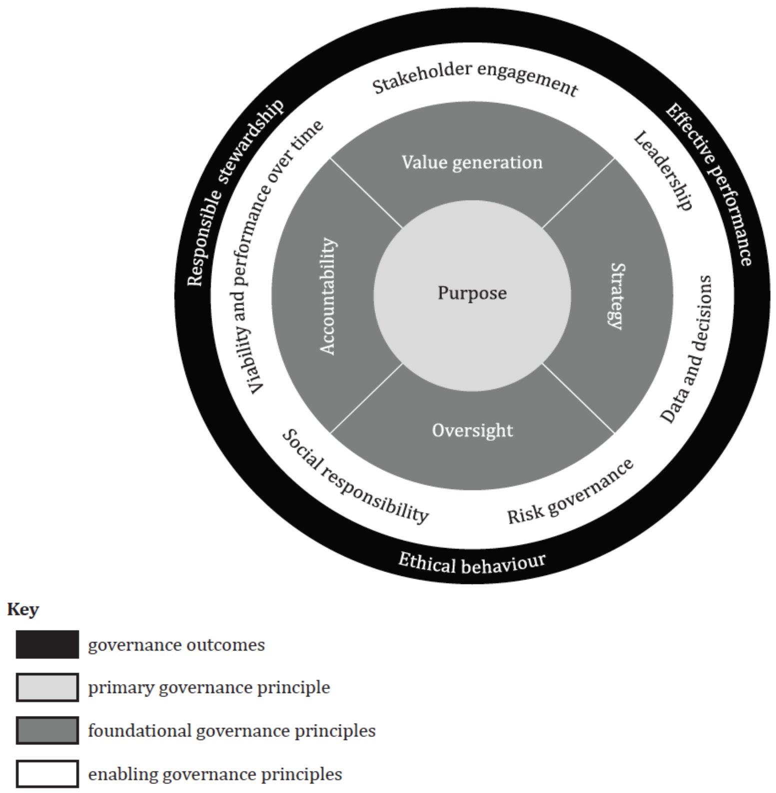

Figure 5: Governance of Organizations – Overview
Source: ISO 37000:2021[114]

The interpretation of what constitutes a legitimate ultimate value-generation goal for governing bodies matters because all governance decisions should be anchored to this goal.

As consensus emerges on what a legitimate purpose ought to be and how it should be governed, there is a need to encode this in clear guidance that represents common conceptualisation, language and a shared accountability frame. The first national standard on Purpose-Driven Organisations published by the British

Standards Institution (PAS 808:2022) is perhaps a watershed moment in this regard. The argument underpinning that standard (as summarised in *Unleashing the sustainable business*) is that only by fundamentally aligning organisational goals, and the governance of them, with goals that serve our shared best interest (and those of the economy) can society start to effectively remove value-stripping activities which harm us all as well, as unleashing innovation towards our collective long-term good. This builds on the previous groundbreaking standard ISO 37000:2021 (Governance of Organizations – Guidance) which for the first time laid out a multi-stakeholder consensus view on governance with purpose as the primary principle to which all other ten principles are anchored.

Given the critical deadline humanity is under to achieve these assurances and innovations, this move towards a more accurate and specific interpretation of purpose is likely to accelerate. At a minimum, we are likely to see a more explicit acknowledgement that purposes which work *against* the 'meta-purpose' of sustainability (either in intent or in delivery) are not acceptable. For example, given the Business Roundtable's statement on the purpose of business being to 'serve all Americans' (see section 2, page 17), some sections of American society could begin pressurising government to weed out organisations where their purpose (or delivery of it) does not legitimately 'serve all Americans'.

In summary, there is a clear questioning of financial orientation of governance. The sustainability-aligned emerging global view appears to be that: (1) governing bodies should be clear about the ultimate value they intend to create, (2) this value needs to be meaningful and beyond financial capital, and (3) governing bodies need to declare the basis on which they create and distribute value and profits among different stakeholders in order to achieve the purpose in the way it is intended.

4. WHAT MOTIVATES THOSE BEING GOVERNED? From governance that protects assets from managers to governance that empowers purpose-driven decision-makers

One of the most important elements shaping views and practices of governance relates to the assumptions about human behaviour that are relied on for decision-making. As highlighted earlier, a core feature of modern governance derives from the 'principal–agency' theory. As well as providing much of the rationale for having a governing body in the first place, it also provides the behavioural assumptions that underpin how governance is encouraged to be practised.

In 'principal–agency' theory, an agent (eg a company director or manager) is required to act on behalf of a principal (eg a shareholder). This is the basis of fiduciary duty in law. In alignment with the behavioural assumptions of BAU, this assumes that people are rationally self-interested. It is accordingly assumed that, all things being equal, the agent will not tend to act in a way that benefits the principal but instead will act to benefit themselves.

The core assumptions at the heart of principal–agency theory – and, as such, dominant views of governance – are:[115,116]

- conflict between owners and managers is inevitable
- costs/benefits are accurately calculated by people
- rewards and punishments guide behaviour (especially financial)
- owners have a fundamental right to dictate the actions of the organisation
- managers know more than governors and can use this to their advantage (asymmetric information).

When applied to governance and the fact that ownership and control have separated as companies have grown, the governing body becomes an innovation which helps shareholders to better oversee the actions of self-serving management as individuals that need to be controlled, to serve the shareholders' interests.[117,118,119,120] As Jensen and Meckling[121] summarise: "managers will not act to maximise the returns to shareholders unless appropriate governance structures are implemented in the large corporation to safeguard the interests of shareholders".

This theory can be seen as the basis for most of the legal and regulatory governance environment (eg codes). For example, the UK Corporate Governance Code[122] states: "A person (the agent) can enter into a contract on behalf and with the authority of another (the principal), but the principal remains liable for the contract". The same theory is also key to understanding the risk-avoidant language and thrust of governance which has come under attack in recent years.

The changing view

A number of alternative behavioural theories underpinning governance are emerging. Reflecting a broader shift in management research, these de-emphasise self-interest and put emphasis on the capacity for humans to work together for a shared goal and to be particularly motivated when that goal meaningfully affects a third party (ie purpose-driven). As discussed earlier and in *Unleashing the sustainable business*, these theories underline how – if we see human motivation differently – we come to very different conclusions about effective ways of governing. It is therefore important that governing bodies are clear about their assumptions regarding organisational and individual behaviour, in order to determine what their organisational systems need to achieve governance goals.

Some of the key emerging theories are summarised below:

Stewardship theory

Meta-analyses have shown that financial rewards are only effective up to a certain point.[123] Supporting this, stewardship theory proposes that employees are primarily motivated by a need to feel a sense of achievement, to gain intrinsic satisfaction through challenging work, to exercise responsibility and authority, and to gain recognition from peers and bosses.[124,125] Further it states that self-esteem can become fused with corporate prestige, particularly when employees have worked at a company for a while and are 'invested'.[126] Hence, even when a manager may deem an action personally unrewarding, they often act out of a sense of duty or "normative compliance".[127]

How distinct the interests of a manager are from those of a company's owners is based on their own subjective view[128] and hence highly influenced by how those managers are assumed to act and therefore treated and rewarded. In turn, such a perspective shifts the question from 'how can we keep directors and managers in check?' to 'how far can directors and managers be motivated to achieve the good corporate performance to which they aspire?'.

In stewardship theory, the core issue facing governance is whether or not the autonomy of the CEO and senior management is supported by organisational structures which:

- provide clear, consistent role expectations
- authorise and empower them.[129]

Therefore, stewardship theory could be considered a form of 'CEO-centric' governance. Rather than the governing body keeping a careful watch over the CEO (and in turn senior management) lest they 'run off with the silver' (a reflection of BAU assumptions) – the governing body's role transitions to giving managers boundaries and incentives that match stewardship motivations and empowering them to deliver – ie "governance structures will help achieve superior performance to the extent that the CEO exercises complete authority over the corporation and that their role is unambiguous and unchallenged."[130] Consequently, stewardship theory holds that success is more likely when the CEO is the chair of the board.

As will be discussed later, stewardship theory offers some useful reflections on the intrinsic motivations of humans, both in general and specifically in the workplace – insights that gain more specificity and orientation within a purpose-driven frame.

Organism survival theory

Organism survival theory proposes that organisations are "living organisms that are influenced by their past history and experiences and the learning, skill and commitment of the people who work in them and have a purpose of their own".[131] Hence, an organism can be seen as "a unified whole ... that is made up of different parts that cooperate well, but for an overall common purpose, and do so with minimal conflict."[132]

Rather than serving shareholders or stakeholders, a company could be therefore seen as primarily serving itself – its core purpose is to ensure its own survival in alignment with the legal interpretation of fiduciary duty. Growth in company size, a core objective within a BAU economy, is therefore a natural result of trying to outcompete others and ensure this survival. Survival therefore helps "guide the board members of a company in taking the right decisions"[133] based on four proposed principles of successful organisations:

1. "Sensitivity to the environment, representing a company's ability to learn and adapt.
2. Cohesion and identity, which are aspects of a company's innate ability to build a community and a persona for itself.
3. Tolerance and its corollary – decentralisation – that are both symptoms of a company's awareness of ecology and its ability to build constructive relationships with other entities, within and outside itself.
4. Conservative financing as a key attribute that enables an organisation to govern its own growth and evolution effectively."[134]

While this aligns with the legal context and with the ESV approach to long-term self-interest, it is hard to understand how a self-serving motive – survival for survival's sake – of a non-human entity is motivating enough to harness collective human endeavour. The theory also fails to provide the basis for a clear identity or frame concerning how an organisation is compelled to perform (rather than merely to exist over the long term).

Purpose theory

Stewardship theory assumes that financial value is the core value created by the firm, while organism survival theory asserts that the central motive is self-preservation – which, in a BAU context prioritises financial value as the core means to this survival. Therefore, both still support the assumption of financial self-interest at the heart of BAU thinking. Purpose-driven organisations, however, are based on a different motivational theory entirely. This theory emphasises that humans are foundationally driven by a desire to live purposeful lives (being in service of the good of another), which are therefore full of meaning because they tell us that the world is a better place with us in it. As such, as humans we avoid the abyss of anomie where our lives and roles in the world are meaningless. In other words – we are driven and rewarded for being in service of the good of others. *Unleashing the sustainable business* covers the evidence regarding this.

A purpose-driven organisation aligns this energy with its own core value-generation goals and its ways of pursuing them. As with the above theories of motivation, purpose has significant implications for governance. ISO 37000:2021 and PAS 808:2022 give the first international consensus view on purpose-oriented governance practices. Complementing this, the British Academy's *Principles for Purposeful Business* reflect the new behavioural emphasis for governance that comes with purpose.[135]

As assumptions about both the motivations of employees and the value(s) organisations should be producing diverge from the BAU emphasis on self-interest, rationality and financial value, we begin to see knock-on effects on other areas of governance. A detailed analysis is beyond the scope of this paper, but areas of impact include: how to better govern for compliance; diversity; transparency; effective board functioning; effective board dynamics and decision-making; stakeholder engagement; governance of culture; whistleblowing and anti-corruption (including financial compliance); specific new organisational forms, including decentralised autonomous organisations (DAOs); and how to govern the use of data.

Of these topics, one that has taken centre stage is the governance of culture. As commentators consider how organisational behaviour can be shaped to produce outcomes that work for, not against society's best interest, they invariably end up focusing on the vital role of culture and of the governing body in this. A useful example is the ISO standard on Sustainable Finance (ISO 32210:2022) where the primary role of governance is presented as governing culture.

Culture grounds and shapes all organisational behaviour, and hence the emerging focus on this is understandable. Culture starts with worldviews about what is valuable to protect and enhance, how the world works, and – therefore – what the organisation is there to do and how. These assumptions are then manifested in routinised 'norms' and thinking and acting ("cultural software"), which are embedded in systems, processes and structures ("cultural hardware") which lock-in and further reinforce these norms. CISL's paper on organisational culture[136] provides more detail on how we can think about culture and the role it plays in bringing about the organisations we want.

The beginnings of concerted debate about the governance of culture are partially rooted in the 2007 financial crisis where unethical practices and risk-taking were seen as central factors. As a result, there tends to be an emphasis on how to prevent extreme risk-taking and unethical cultures (ie those leading to actions that are unaligned with the moral landscape of stakeholder expectations).[137] For example, in 2016, the UK Financial Reporting Council (FRC) published its report on *Corporate Culture and the role of Boards*,[138] emphasising board independence and the 'tone from the top'. Its core message was that culture cannot be left to chance. This was subsequently embedded in the 2018 update of the UK Corporate Governance Code, a core principle of which was that a board must confirm its purpose, values and strategy "and satisfy itself that these and its culture are aligned".[139] The code goes on to state that the board has a responsibility to set an example when developing this culture: "All directors must act with integrity, lead by example and promote the desired culture."[140] In more explicit terms:

> "The board should assess and monitor culture. Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company's purpose, values and strategy, it should seek assurance that management has taken corrective action. The annual report should explain the board's activities and any action taken. In addition, it should include an explanation of the company's approach to investing in and rewarding its workforce."[141]

As such, culture is emerging as a key tool for governing an organisation and shaping its outcomes. Governing bodies must consequently become literate in what culture is, how it can be influenced, and what a culture for an organisation aligned with sustainability looks like.

5. WHAT IS THE APPROACH? From governance as compliance to governance as performance of the purpose within real-world parameters

The final core assumption about governance that is changing is how the goal of governance (whether that is financial capital for shareholders, survival of the firm or innovating for collective long-term wellbeing) should be achieved. This includes what information is brought forward for the board to consider in its decisions and who makes decisions based on that information.

A defining feature of BAU governance is its tendency to focus decision-makers on avoiding negative risk to financial investment[142] and, as argued by Milton Friedman, on staying within the legal and social 'rules of the game'. Unsurprisingly, this means that board time, structure, oversight, accountability, reporting and all other governance activities also tend to focus on guarding against risk to financial capital. It is not a coincidence, therefore, that the only board committees usually mandated in law are concerned with financial audit and financial remuneration.

Adherence to the law is also critical within BAU because it keeps an organisation aligned with society's norms and expectations. As discussed previously, the law reinforces negative risk orientation because it has primarily evolved in response to financial scandals (such as that of Enron). Therefore, governance tends towards being a compliance function which keeps a company within the letter of the law, and maintains its social licence to operate, and this is compounded by the governing body's potential liability for criminal negligence and their resulting focus on minimising this risk.

While driving performance is now also seen as core (nominally), there remains a tendency towards the back-foot response orientation focused on compliance and risk.

The changing view

As governance thinking has evolved, there has been a global shift from a normative sense of governance as a means to avoid negative financial risk to a more rounded view of both the positive and the negative aspects of risk-taking. As a result, there is now a focus on:

- understanding risk
- determining what level of risk is acceptable
- leaning into that risk.[143]

In this context, governing bodies are increasingly expected to set risk appetite and tolerance levels for the company – which embed the reality that zero risk is impossible – and then ensure that these are adhered to. For example, this is outlined in ISO 37000:2021's principle of risk governance. Additionally, in 2013, the Financial Stability Board – an international body which monitors the global financial system – noted in its guidance that "the Board of Directors must establish the institution-wide RAF (Risk Appetite Framework) and approve the risk appetite statement, which is developed in collaboration with the Chief Executive Officer (CEO), Chief Risk Officer (CRO) and Chief Financial Officer (CFO)".[144] Around the same time, the UK Corporate Governance Code (2012) made it equally clear that "the board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives."[145] The

UK Governance Code, published in 2014,[146] subsequently clarified that: "The Board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The Board should maintain sound risk management and internal control systems."

Risk, true value and ESG

A deeper rationale for the governing body's role in governing risk has also begun to emerge; which is likely to have been influenced by recognition of the seismic and urgent risks to firms' financial self-interest posed by the continued degradation of social and environmental systems (as outlined in *Unleashing the sustainable business*).

The scientific revelations about the state of people and planet puts in stark relief the fact that governing bodies currently report financial profits and make statements about their long-term value based on what might be considered a misrepresentation of the true costs to society and nature, and therefore the true value of their organisation. Indeed, there has been at least a decade of mainstream awareness that if organisations accounted for the true costs associated with the externalities they create, the financial profits of many would be substantially (or even entirely) eroded. Even in 2012, KPMG was publicly estimating that if companies had to pay for the full environmental costs of their production, they would lose 41 cents for every US$1 in earnings on average[147] – and this figure only covered certain environmental costs (not social costs). Although this represents a drop from an estimated 91 cents in 2002,[148] this decline can be attributed to an increase in earnings rather than a reduction in absolute environmental costs.

Statements of stranded assets and other revaluations are being reflected in accounting 'impairments' or – more notionally – in the minds of investors. This fundamentally changes what factors the governing body needs to consider when financially reporting – something that a few governing bodies have voluntarily realised, and which others are being forced to consider, as global accounting standards bodies such as the ISSB and the European Financial Reporting Advisory Group (EFRAG), and codes of practice such as the Task Force on Climate-related Financial Disclosures (TCFD), begin to integrate non-financial risk into standard reporting requirements.

Beyond concerns about the risk of environmental and social impact costs increasingly being placed 'on the balance sheet', more sophisticated governing bodies and investors are beginning to see the degradation of social and environmental systems as a foundational threat to the viability of all organisations (not just their own) and to the wellbeing of themselves and those that they love. As a result, ESG reporting has moved from the fringe to the mainstream.[149]

While many organisations and investors are likely to operate under CSR logic, asking for and reporting on ESG factors mainly for reputational reasons to alleviate stakeholder pressure, those in the long-term self-interest ESV logic are becoming genuinely concerned about the data they are seeing. Indeed, their fears mirror the more vocal concerns of a range of other stakeholders (and society at large) about the role that organisations are playing in humanity's ongoing social and environmental crises. For such investors and stakeholders, ESG appears to be a currently inadequate tool for concerned stakeholders to try and gauge whether an organisation is:

- unaware of whether it is asset stripping the long-term wellbeing potential of both people and planet (because it is undermining the health of society and the environment)
- aware but not working to address the issue within the necessary time frame
- aware of what risks the above pose to the stakeholder in question.

ESG data, in theory, provides some useful information about these points which can then be used in decision-making by others to reduce negative risks. However, there are a number of problems with these data, outlined below, which provide a challenge for boards, especially those without an elevated level of understanding of the social and environmental issues we face and how these relate to their organisations.

Governing bodies reporting on issues are often themselves unclear about what their real contribution to these issues might be and therefore what they should be reporting to stakeholders and using for their own decision-making. At the same time, no general agreement has yet emerged on the threshold conditions necessary to keep social and environmental systems healthy. Despite the existence of important initiatives such as the Science Based Targets initiative, Science Based Targets Network, and Doughnut Economics Action Lab, there remains no consensus on either how a fair contribution should be allocated among organisations or how such measures might need to adapt to non-compliance or interaction effects. This is something that organisations such as r3.0 are actively trying to concertedly resolve.[150] Their 2022 publication with the United Nations Research Institute for Social Development (UNRISD) on 'Sustainable Development Performance Indicators'[151] is perhaps the beginning of step change because they focus on the reporting context of these thresholds, brought down to the individual company level.

Aspects of ESG reporting are – or are becoming – mandatory in some countries. However, these do not necessarily represent what is most important for the board to measure or what the science says we should be measuring. Moreover, as primarily a tool for ESV, ESG reporting has been based on threats to the financial situation of organisations and therefore largely focuses on this. The impacts that an organisation has on others that do not fall within this assessment, for example in the approach taken by the ISSB, is beyond scope.

Furthermore, ESG reporting indicators and methods have been designed primarily for investors and so are likely to be unfit for use by other stakeholders that they have not been designed for, unless stakeholders receive guidance on how to interpret or act on the data. Additionally, assurance about the quality of the data gathered and communicated is currently poor, something the United Nations has been working to resolve as part of their Impact Standards.

With the 'G' of ESG relating to governance and how boards operate, ESG also influences views of how boards should function and what effective governance looks like. In this respect, there are very few comprehensive and strongly justifiable measures. While governance is coming increasingly into view through initiatives such as the Task Force on Climate-related Financial Disclosures (albeit very lightly), ways of understanding and measuring governance are still inadequate (eg UNCTAD 2020[152]). This means that those looking at these measures as an indication of 'good governance' are likely to come to an inadequate conclusion.

In this respect, ISO 37000:2021 provides a helpful basis. Additionally, ISO is in the process of developing three new standards: ISO 37006 will translate the principles and practice of ISO 37000 into indicators of effective governance; ISO 37005 will create guidance for governing bodies on how to select, create and use indicators; and ISO 37004 will create a maturity framework for effective governance. These standards (if consensus can be arrived at) will hopefully provide a foundational view of effective governance that will help governing bodies navigate not just the 'G' of ESG but also the wider ESG reporting space.

The amount of time and energy being diverted to reporting ESG and keeping up with ESG rankings is increasing – without necessarily resulting in any commensurate change in action to resolve issues that are highlighted. While there are currently prominent efforts to standardise reporting requirements for governing bodies (eg ISSB and EFRAG), it remains to be seen whether these will bring about substantive changes in society and the environment or whether they will serve to reinforce BAU through 'double loop materiality' as discussed above.

The role of company objectives

The nature of the organisation's objective is key to unleashing its ability to innovate for a sustainable future and doing so in a way that does not undermine its goal. ISO 31000:2018[153] defines risk as the "effect of uncertainty on objectives". Assuring a minimum contribution to the health of society and the environment – which we all rely on – is not the organisation's reason to exist (the objectives or ends).[154,155] Instead, it concerns the *way* in which the organisation goes about achieving its objective (the means). The two (ends and means) are intrinsically related and without the right ends in sight, governing bodies will find it potentially impossible to govern the means until hard laws enforcing ESG minimum thresholds are implemented and enforced.

For governing bodies of CSR organisations, there is no rationale for moving to a leadership position where they act on social and environmental crises in advance of legislative obligations. For ESV organisations, there is – in theory – a strong rationale to go ahead of the law and lobby to shape it, but for this to happen, governing bodies will need to fully accept the systemic nature of these crises and the threats they pose to business viability. Even for ESV organisations that are focused on long-term financial income, most governance action is constrained by a profit-maximising business case and the limits of long-term thinking that imposes. Where a business case might be able to be made to protect long-term financial interests – such as through access to core resources at the right price, the ability to recruit talent, or protecting the social licence to operate and brand value – creating a business case to invest and innovate in protecting and enhancing society and the environment will likely still be largely beyond scope.

As outlined in *Unleashing the sustainable business*, we would expect to find that purpose-driven organisations are more easily able to establish a clear rationale for diverting resources to lead on operating within social and environmental system thresholds. This is because the ultimate objective of purpose-driven organisations is to contribute to long-term wellbeing for all (sustainability) via a purpose which represents its optimal strategic contribution to this agenda. Hence, understanding and acting in ways that preserve the ultimate means would be logical. We would expect this ultimate objective to be reflected in the assessment and setting of levels of risk appetite by a governing body.

A further key consideration – which purpose underscores – is the role of the governing body in establishing and arbitrating the relative importance of stakeholder interests in relation to the purpose. This includes choices about the relative distribution of value (financial or otherwise) through strategy or the allocation of excess value (eg profits). The importance of this balancing role in a complex business environment, where stakeholders are core to success and difficult decisions about residual value need to be made, was emphasised in Blair and Stout's Team Production Theory.[156] In this respect, the purpose – along with the firm's associated stated values – becomes the central reference point for making these decisions. Even when this purpose is unable to help the board arrive at a clear conclusion, the meta-purpose of sustainability serves as the ultimate frame of reference for making choices and resolving dilemmas in a way that aligns with society's best interest. This is in stark contrast to the BAU approach where financial value returned to shareholders consistently takes precedence above other types of value and all other stakeholders.

CONCLUSION: Unleashing the sustainable business – Towards purpose-driven governance

As *Unleashing the sustainable business* describes, purpose is a specific form of organisational logic that, done well, embeds delivering sustainability into the heart of an organisation's reason to exist. Regardless of whether an organisation truly possesses such an authentic and useful intent, it is almost impossible to imagine that this could be realised without the right kind of governance.

This paper has outlined four core assumptions that shape how we think about and 'do' organisational governance. From this it is readily evident both that new perspectives of governance are emerging and that the direction of travel is somewhat baked in – unless and until we arrest the degradation of global environmental and social systems and the pressure to change reduces. Some legal and regulatory environments have been trying to tweak the system to move from CSR governance towards enabling ESV governance. Hence in some countries governing bodies may consider other stakeholder needs, but only to the extent necessary to deliver financial income for shareholders.

As the realities of unsustainability hit through mounting social and environmental crises, there is growing pressure for companies to be regarded as enterprises that exist to serve the collective wellbeing of the societies that sanction them – which will need to be enabled by empowered governing bodies. Most major businesses are taking some action on sustainability, but unless they have clarity of purpose, reinforced by governance, it risks being wasted effort. The assumption that governing bodies are there to oversee self-interested companies and managers and make sure profits are maximised for shareholders is starting to be slowly eroded, although there is also backlash against this move. Purpose gives clarity in this changing and contested context – and thus a governance platform for purpose-driven capitalism (a Wellbeing Economy[157]), is being created.

We currently sit in a messy period of paradigmatic transition – both in general and in terms of governance. The governance platform for delivering a truly purpose-driven organisation is commensurately messy. This results in a range of challenges for governing bodies.

There appears to be particular momentum to reduce shareholder influence on decisions for which they have no accountability and put this power more firmly in the hands of governing bodies. Given how high the stakes have become, it may be that society is increasingly prepared to take back the governance reins. Rather than reverting to a time when the ruling class would decide whether a company could validly exist,[158] we may be moving onwards to a more democratic governance of organisations and governing bodies – with society taking a more active role in 'governing government' and ensuring that companies that are allowed to exist serve their best interests. That means that governing bodies may more concertedly be asked to be accountable to society as a whole.

Slow moves in this direction can be seen, with shareholders and regulators starting to be persuaded of the need to relinquish shareholder primacy in service of a collectively positive future. For example, new governance opportunities or requirements have been introduced in incorporated forms – such as *Sociétés à Mission* (France) or Benefit Corporations (USA) – but these appear to create a platform of 'hybridity' (see section 5.2 in *Unleashing the sustainable business* Part 1) where governing bodies are posed with the challenge of needing to optimise for *both* financial income and wellbeing outcomes. Developing strategic direction and policy for such thoroughly different but equal goals is not easy, and it is unclear how effective organisational culture can be built around this. This is exemplified by *Sociétés à Mission*, where a multi-stakeholder committee (with no board presence) oversees the achievement of the social purpose and reports directly to shareholders. Although theoretically an innovation to advance purpose, this simultaneously provides additional powers of oversight of the governing body by shareholders – whose interests are assumed to be aligned in a different direction towards financial income maximisation. Consequently, there is an inherent conflict of interest, and such an approach could potentially reinforce shareholder primacy and further limit the board's ability to make independent decisions that preference its purpose.

At the same time, this new vision of governance gives governing bodies both the accountability for, and authority to carry out, actions needed to achieve the purpose, protected from undue influence from the vested interests of any group which might reduce their independence to do so (including shareholders). This also situates governing bodies as central to overseeing the company–society relationship in all its complexity, in a way that they are transparently accountable for. To carry out this role, boards will need commensurate skills which can align both the long-term organisational purpose and these (often shorter-term and conflicting) interests. By necessity, this will involve a greater focus on leadership and decision-making in the presence of conflicts of interests. As part of a Wellbeing Economy, the governing body should be actively resolving these for the maximum sustainable benefit, with the purpose – and ultimately the meta-purpose of long-term wellbeing for all – the key way to do this by providing the overarching decision-making frame.

From the above conclusions and the implications we can propose from them, we might surmise four key pillars of purpose governance, all of which appear to be crucial if we are going to deliver the level of innovation and compliance needed to optimise the ultimate ends of the economy (top of the triangle, Figure 1), protect and restore the ultimate means (bottom of the triangle, Figure 1), and carry out both appropriately:

1. **Purpose as the primary value-generation goal** that the governance system exists to achieve, and which is a firm-level strategic contribution to the meta-purpose of long-term wellbeing for all (sustainability).
2. **A board that is able to pursue a defined organisational purpose within declared parameters, independent from competing interests, including those of shareholders.** The parameters ensure the health of society and the environment, stakeholders, resources including financial, and align with the organisation's values, operating environment and scientific consensus.
3. **Societal accountability of the governing body** to ensure that the purpose and values reflect the moral landscape and that, in turn, the business value-generation model, strategy and governance system are appropriately aligned with the purpose and values. How exactly societal accountability can be mechanised is a core topic of current debate.
4. **The firm as a wellbeing value-creation project** driven by a sustainable purpose, rather than the firm as an entity to be used for optimised financial gain for any group or as an entity that the board should be obliged to sustain in perpetuity for its own sake.

These core pillars are beginning to be reflected in practical detail in multi-stakeholder consensus standards PAS 808:2022 (Purpose-Driven Organisations: Worldviews, Principles and Behaviours) and ISO 37000:2021 (Governance of Organizations). These standards mark watershed moments in clarifying the emerging consensus on how these kinds of principles can be incorporated in day-to-day governance practice, offering collective starting points that we can experiment with and improve on as a global community. The intention is that PAS 808:2022 will now go through an ISO process to test and expand this globally. Alongside these codifying documents, the literature on what constitutes effective governance practice – including governance of the board itself – is now plentiful, with a multitude of codes, reports and evaluation frameworks emerging. Going forward, we can expect the learning and consensus around governance, purpose and sustainability to accelerate. The emerging consensus about good governance throws up important questions about how supportive or actively discouraging the legislative and regulatory systems that shape governance practice are. More work is needed to understand this gap and then work to bridge it. Given how critical governance is to enabling organisations to drive, and not undermine, a sustainable future, there are perhaps few more important tasks.

Appendix A: The governing body structure and the system of governance

Organisational governance is a system which everyone in the organisation (including members) has a role in enacting. For example, the governing body is ultimately accountable for the organisation's goal and whether it is achieved, and every time a manager creates a new sub-level strategy or policy they are acting as part of this governance system. Similarly, while the governing body assures that company-wide reporting data is correct, it is employees (at all levels) who make sure that this data reflects reality. In addition, external stakeholders exert influence on how governance is understood and enacted within an organisation – both formally and informally. Hence, governance is a system of recursive layers of direction, oversight and accountability nested within broader systems of governance. Ultimately, therefore, society as a whole is the governing body of governing bodies through the legislative and regulatory environment which acts on its behalf.

Ultimate accountability

While it is easy to think of governance in terms of national codes, governance – and the role of governing – is a much wider concept and is applicable to any organisation.

The accountability for any organisation and its actions and inactions ultimately lies with the governing body. It is important to note that every organisation has one governing body, although within a non-legal entity this can also be thought of as a 'governing group' (for example, a sole trader will have a governing group of one). 'Governing groups' can also exist at various sub-levels in an organisation, depending on its structure (eg subsidiaries). Regardless of its structure, a company that is a legal entity will only have one accountable governing body.

ISO 37000:2021, the first multi-stakeholder international view on governance of organisations, developed between 2017 and 2021, defines a governing body as the "person or group of people who have ultimate accountability for the whole organisation" and includes the following notes:

- "Note 1 to entry: Every organisational entity has one governing body, whether or not it is explicitly established. When the organisation is not an organisational entity, the term governing group is applicable where 'governing body' is used throughout this document.
- Note 2 to entry: A governing body can be explicitly established in a number of formats including, but not limited to, a board of directors, supervisory board, sole director, joint and several directors, or trustees.
- Note 3 to entry: ISO management system standards make reference to the term 'top management' to describe a role that, depending on the standard and organisational context, reports to, and is held accountable by, the governing body."[159]

Joint and several liability

The governing body is jointly and severally accountable for a company – this means that they make decisions (and are accountable for them) as a group. Directors can still be liable for criminal acts and acts of negligence but the law varies between countries and a detailed overview is beyond the scope of this report.

Decision-making independence and single and two-tier systems

Governing bodies can take different forms, depending on the company and country within which they are constituted. For example, the UK and USA both favour a single board structure where the CEO and executives can be directors and part of the governing body (which also includes independent non-executive directors).

The make-up of a governing body tends to depend on how conflict of interest is viewed and the level of independence or distance from the company seen as necessary to achieve optimal decision-making and enact a duty of care and fiduciary duty. Under BAU, optimal decision-making has traditionally been interpreted as decision-making that optimises profits for shareholders (members). As outlined previously, the BAU 'principal–agent' theory assumes that managers are self-interested utility maximisers in possession of more information than shareholders, which consequently requires them to be 'kept in check' by independent, non-managerial directors selected by shareholders. It is therefore common for boards to include both executive and independent (non-executive) directors (NED), either together or in separate boards. Some feel that only NEDs are able to properly govern an organisation as executives cannot make independent decisions, but the debate remains active.

In some cases, the CEO can be chair of the board. However, many consider this poses an unacceptable conflict of interest, and the UK Corporate Governance Code explicitly asks for separation. As Williamson[160] advised: "Shareholder interests will be safeguarded only where the chair of the board is not held by the CEO or where the CEO has the same interests as the shareholders through an appropriately designed incentive compensation plan".

In Germany, the utilisation of a two-tier board system separates executive and non-executive decision-making. Here, the governing body is seen as split between the supervisory board (which does not have any executive directors) and the executive board (which does not have any independent directors). A chair does not have responsibilities beyond any other director but rather acts primarily as a spokesperson. The supervisory board appoints and dismisses the members of the executive board, devolving certain responsibilities (by law) to the executive board (but not ultimate accountability, which can never be devolved) and holding them accountable. Whereas normatively the two boards are seen as having equal power and responsibility (therefore balancing each other out), in legal terms, the supervisory board holds all ultimate power and accountability, and hence, in effect, is the governing body.

Sometimes there will be stipulations by the company or a governance code concerning how many NEDs are required and what roles they must take – for example, the UK Governance Code 2018 states that "At least half the board, excluding the chair, should be non-executive directors whom the board considers to be independent."[161]

The idea and emphasis of 'independence' is shifting as assumptions change about whose interest a company is run in (and hence how optimal decision-making is achieved). This fundamentally alters how we understand the critical notion of board independence. Rather than the optimisation of shareholder interests through independence *from* managers, independence is increasingly and more precisely about independence from any other obligation or pressure that would result in poor decision-making – in other words, decisions which fail to prioritise delivery of the purpose in the way intended or fail to meet the meta-purpose of long-term wellbeing for all (sustainability) (see PAS 808:2022). For example, a question for all directors in a purpose-driven organisation might be whether they were sufficiently independent from shareholders, managers, employees or other interests (including self-interest) to be able to make optimal decisions against the purpose.

Board committees

Governing bodies of large companies normally have different committees – and sometimes sub-committees – due to the workload required. Sometimes, such committees are mandated by a governance code (eg following the Walker Review of 2009[162] in the UK,[163] an audit committee, nomination committee and remuneration committee are all compulsory, with banks also requiring a risk committee). Although these will usually be subject to 'comply or explain', many of the duties carried out by an audit committee, for example, are mandated by law and so must happen regardless. These stipulations are again changing as the law moves towards supporting purpose-driven organisations – for example, the French *Société à Mission* legal form of incorporation requires a committee that has at least one employee and is intended to bring together the interests of shareholders, managers, employees and external stakeholders to oversee delivery of the purpose.

Governance and management hats

Governance and management are different tasks and require different skills. A limited company with one director and no employees will have a governing body of one, with the person also acting as management. For this reason, it is helpful to think of governance and management roles as 'hats' rather than 'people'. If an executive takes up a place on the governing body, they are no longer wearing an executive 'hat' and performing management tasks but are instead part of a group decision-making body, thereby earning a governance 'hat' and performing governance tasks. This is a vital distinction but one which is often misunderstood, even by executives of large companies who sit on the governing body.

Appendix B: Background and definition of governance

Definition: Writing in *The Republic*,[164] Plato was perhaps the first to use 'governance' as a metaphor in reference to the king steering the state. The term 'governance' has its roots in the Greek word *kubernao*, which means to steer or pilot a ship (as opposed to hoisting the sails and managing the sailors). In a 2020 speech, Jim Snabe (Chair of Siemens and Maersk) echoed this 'direction' analogy in an organisational context: "I often say that management is driving the bus, and the [board] … ensures the GPS is set correctly".[165] Governance is about more than just direction setting – as will be outlined below – but this differentiation between governance as steering and management/executive as 'doing' is key, no matter what level the governance happens at. This includes nationally, internationally and organisationally (both incorporated and unincorporated), as well as any other context where people come together to achieve a mutual goal.

Reflecting the Corporate Governance Code, the Cadbury Report described corporate governance as "the system by which companies are directed and controlled".[166] These core concepts of 'direction' and 'control' (referred to in this paper as oversight, of which 'controls' are a tool) have been the basis of enterprise-level guidance and regulatory corporate codes around the world – including the OECD, the EU, the United States and the World Bank – and are also reflected in academia.[167] Although absent from the core definition in the Cadbury Report, accountability was brought to the fore by it, with the innovation of 'comply or explain' as a way of reporting against the code (since influential in almost every market in the world).[168] The current consensus-based definition of organisational governance, relied on in this paper, is in ISO 37000:2021, where it is defined as a "human-based system by which an organisation is directed, overseen and held accountable for achieving its defined purpose".[169]

The concept of *organisational* governance provides a bridge to a more foundational view of governance as a political act which transcends, and is vital for, any form of collective human endeavour. As Thayer – the original theorist of governance – accurately predicted in 1971: "There will be a gradual blurring of, then perhaps erasure of existing distinctions between public, private, municipal, provincial, national, and international forms of organization [and therefore governance]. All activities in all organizations … affect the future course of society."[170] Indeed, he believed that "governing and politics would need to be conceptualised as simply general human activity, of making and sustaining a world."[171] Given the challenges faced by the world today and the way we now think about governance in purpose-driven organisations, Thayer's view seems rather prescient. Governance bodies comprise the people who are jointly and ultimately accountable for the whole of a defined system. At a national level this is the government. This is where the interests of all stakeholders ultimately meet and must be resolved to ensure that:

- the system is going where it intends to
- the system is going in the way it intends to
- the where and how are both 'correct'.

Hence, while this document puts an emphasis on incorporated (specifically, non-charitable) companies, the principles of effective governance outlined here are relevant for all organisations.

While a holistic view of governance is vital, important changes are happening in the legal context of organisational governance. These changes highlight the difference, but intricate interdependency, between governance of the 'corporation' as a legal entity (generally understood as a nexus of contracts and structured by law) and governance of the 'enterprise' as an organised economic activity, regardless of its legal form (until recently, this has been outside a legal framework).[172,173] Further uniting the legal and enterprise domains is the fact that changes in both represent an effort to align organisations with purpose and sustainability – something that is covered in detail throughout this document.

The rise of organisational governance as discipline

In comparison to other established disciplines of practice, organisational governance – despite having roots that go back to at least Plato – is still young. This is even more true in terms of 'corporate governance'.

Figure 6 depicts the rise and relative youth of this concept, even in comparison to the also relatively young discipline of 'management'. These graphs use a proxy measure of the number of times an article has been published that includes a particular keyword. Figure 6 shows Google Ngrams plotting the percentage of times, over time, that the words 'management' and 'governance' or 'corporate governance' have appeared across Google's reference library.[‡‡]

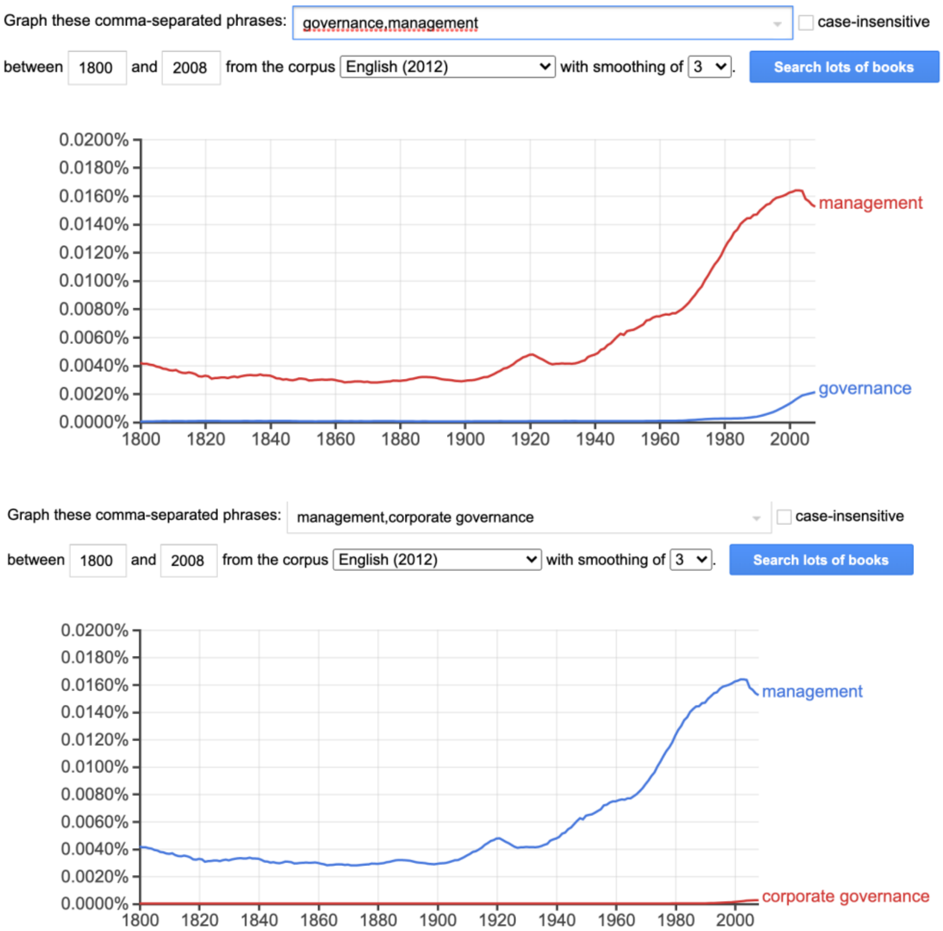

Figure 6: Google Ngrams plotting the growth of governance as a concept

The below list helps situate the emergence and trends in governance by detailing some of the key publications shaping both organisational governance as a practice and the corporate governance landscape:

- 1932 – Berle and Means, *The Modern Corporation*.

[‡‡] It is worth noting that many of the 'governance' results would have been in specific reference to national governance.

- 1984 – Bob Tricker's seminal work: *Corporate Governance*.
- 1990 – John Carver publishes *Boards That Make a Difference. A New Design for Leadership in Nonprofit and Public Organizations* marking the beginning of a streamlined approach to governing called Policy Governance.
- 1992 – First UK Corporate Governance Code – 'the UK Cadbury Report' (The Financial Aspects of Corporate Governance).
- 1993 – King Report on Corporate Governance (South Africa) – the first national governance code that orientated explicitly to the role of an organisation in society and in being central to a sustainable future for all.
- 1996 – Bob Garratt: *The Fish Rots from the Head* – a ground-breaking board practice book.
- 1999 – OECD Principles of Corporate Governance first published – the landmark global regulatory-focused guidance on governance.
- 1999 – Institute of Directors launches the first independently accredited qualification for directors, Chartered Director.
- 2002 – King II – reflecting 2002 'Jo'burg Summit' on Sustainable Development, recognises the need to go beyond a focus of governance on profit maximising and embeds the triple bottom line, but as separate reporting area.
- 2008 – King III – integrates sustainability into governance and strategy. Written in corporate governance language but with the intention that it could apply to all types of organisations.
- 2012 – USA Sarbanes–Oxley Act (SOX) Public Company Accounting Reform and Investor Protection Act – Requirements for listed companies.
- 2013 – BS 13500 'Code of Practice for delivering effective governance' – first full national standard in governance.
- 2016 – King IV – fully integrates sustainability into governance via inclusive, integrated thinking and the six capitals.
- 2018 – Updated UK Corporate Governance Code, which puts more emphasis on governing the relationship between the company, shareholders and stakeholders and sets out purpose as the guiding focus and responsibility of the board.
- 2021 – First global consensus benchmark of Organisational Governance which sets out 11 governance principles with purpose as the primary principle: ISO 37000:2021 Organisational Governance – Guidance.

How organisational governance came to be intertwined with BAU

As Bob Tricker, one of the foundational governance thinkers, neatly summarises:[174] "[governance] came centre stage, less as the result of academic, research-based deliberations, more as a result of official inquiries set up in response to the corporate collapses, perceived board level excesses and apparently dominant chief executives of the later part of the 80s." For example, while the UK is often seen as a leader in defining corporate governance and best practice, the key progressions in its governance law and codes have tended to be reactive, following scandals that exposed issues for investors.

Led by financial parties, the Cadbury Report was a response to financial losses incurred by the sudden failure of Coloroll and Polly Peck, where there was no warning about the collapses in the accounts.[175] Based on the Walker Review,[176] which was commissioned after the 2007/8 financial crisis, the 2009 update to the Governance Code focused on banks and financial institutions. The main objective was to help boards to understand their role in creating or stemming unhealthy levels of risk-taking. In the USA, corporate governance regulation has been mainly concerned with financial protection. One example is the Sarbanes–Oxley Act (SOX), which established independent financial audits and ensured that US boards had a financial expert on the audit committee.

Why is it then, that organisational governance and financial investment are so interconnected? Although originating in the 1930s, the use of the term "'corporate governance' only came into vogue during the 1970s in the United States."[177] This was precisely the time that Friedmanism was challenging contemporary understandings of the role of business in society and how best to protect the interests of shareholders, shifting the focus of directors away from the notion of being management-led. From here, within just 25 years, corporate governance had become the subject of global debate by academics, regulators, executives and investors.[178]

While the work by Berle and Means[179] and their contemporaries undoubtedly set the scene, it took the dramatically changing face of a globalised, multi-national system of companies – and their far-reaching risks and rewards – to ensure that governance become a topic of global multi-stakeholder concern. Similarly, while early books like those from Tricker, Garrett and Carver (see list above) set the scene for a deeper appreciation of the skill of governance, it was developments in the legal context of 'corporate governance' that most deeply shaped how we have come to think about governance today. And this legal influence developed precisely at the time that BAU was embedding itself deep in social consciousness as the one right way to enact capitalism. In this sense, the roots of organisational governance are inseparable from BAU thinking: where, due to a set of flawed assumptions about how the market creates wellbeing, the primary role of a firm has become to pursue its own interest – in the interests of financial investors. By extension, the primary role of governance is to mitigate financial risk (and optimise returns) for those investors.

As a sub-aspect of organisational governance, the term 'corporate governance' refers strictly to the roles and responsibilities of actors in the governance system, specifically in relation to incorporated organisations (which include charities, small limited companies, etc). Legal frameworks surround the right to start and run a corporation, including the requirement to have director(s) and their basic duties and responsibilities. Deciding what kind of governance is most useful for enacting the intent of these legal frameworks, usually captured in corporate governance codes, tends to be where debates about governance happen – often in reaction to scandals and issues for investors.[180] These regulatory codes are often written by financial experts, specifically for companies listed on a particular stock exchange (eg the UK Corporate Governance Code, previously the 'Combined Code, 1998'[181]) meaning that the very notion of organisational governance has become a shorthand for the governance of large, profit-maximising BAU companies. The dominant thinking about how to govern these types of companies therefore has a reverberating effect.

There are two key insights that help us understand how and why governance has become intertwined with a BAU view:

The separation of financial investment from operations

For some, the separation of financial investors from their ability to control the operations of an organisation is the best way of marking the roots of our views on 'best practice' corporate governance.[182] The importance and implications of this separation spread following a famous paper on the topic by Berle and Means.[183] When companies became owned by an increasingly complex array of investors, following the granting of incorporation and limited liability, many investors lost direct control of their companies. Consequently, there was a perceived – and in many ways real – risk that manager decisions would run counter to the interest of those who started the company – and that the latter were the rightful owners of the incorporated company. The view of governance as a risk mitigation measure for investors is widely believed to have been fuelled by this fragmentation of investors, particularly in the USA and UK where fewer but more powerful and active blockholders[§§] exist.[184,185] This, to a certain degree, explains some of the differences that are observable in governance frameworks around the world.

The same separation of financial investment and control also helped facilitate the explosion of large, complex, global companies.[186] *Unleashing the sustainable business* Part 1 provides more context to the rise of governance, particularly regarding the perceived issues with 'managerialism' and related fears of unprecedented power being placed in the hands of a few unelected and uninvested individuals.

Limited liability

The second major factor was that the granting of limited liability encouraged the flow of financial investment into firms. Additionally, there was a view that the risk to investing inside a company structure – compared to other non-company investment – needed to be offset by financial returns of a certain magnitude.[187]

Berle and Means,[188] among others, make the point that it was the separation of financial investors from those running the company that allowed for two new groups of incredibly powerful wealthy individuals to exist and expand. First and foremost, *financial investors* in companies – no longer constrained by their personal time or wealth – were now able to benefit from, and create, a more globalised world. This enabled hugely expanded financial capture from global markets and value networks. In turn, this exponentially increased the size of companies and markets and served to concentrate wealth and power, and retain it in largely 'Western' hands. Second, the previously unheard-of *executive class* were now possessors of vast decision-making power and began to be financially rewarded as such.

The wealth and power distributed to both these groups as the result of modern-day enterprises reveals how the history of the corporation is intertwined with contemporary issues of inter-national and intra-national structural inequality. It also highlights the pivotal role governing bodies play in shaping inequality through decisions such as pay, remuneration, investment and dividends.

Given this unprecedented power and influence, and the ability for the public at large to invest in many of these companies, Berle and Means[189] considered the form of the modern company to be quasi-public – and that there was hence a need for these companies to be run in a quasi-public, institutional way.

These factors – financial investors being accepted as the primary beneficiary and 'owners', global decision-making power being concentrated in investor and managerial hands, the role of finance as a proxy for society-wide wellbeing[190,191] and the wider influence of corporate governance codes – are together core to the interconnection between organisational governance and a BAU logic. They underpin a situation where, due to a set of flawed assumptions about how the market creates wellbeing, the primary role of a firm has become to pursue its own interest – in the interests of financial investors – and where the

[§§] "A blockholder is the owner of a large block of a company's shares and/or bonds. In terms of shareholding, these owners are often able to influence the company with the voting rights awarded with their holdings," James Chen, "Blockholder: What it is, How it Works, Activist Shareholders," Investopedia, updated April 29, 2022, https://www.investopedia.com/terms/b/blockholder.asp.

primary role of governance is to mitigate financial risk (and optimise returns) for those investors.

Beyond 'corporate governance'

While the above investor/owner/management relations are core to the history of corporate governance – and hence governance as a whole – this paper reflects the emerging view that this historical narrative can lead to somewhat irrelevant thinking. We now live in a time where the rights and responsibilities of a far broader set of stakeholders are core social deliberations, where the consequences of global systemic issues of environmental damage and inequality (for example) are massively felt, and where the power and influence of the modern enterprise is extreme beyond what was wildly imagined even half a century ago.[***]

As *Unleashing the sustainable business* outlined, it is this highly constrained BAU view of firms and their governing bodies that sits at the heart of the unsustainability crisis. The governance needed in the context of an enterprise being a value-generating, societal and planet-altering endeavour is new, and consensus on what this means is only just beginning to emerge.[†††]

Our idea of a company has moved far beyond that of a legal instrument to protect investors. In fact, we now see companies as the way that society structures and governs shared human endeavour, and where innovation towards a desired future happens.[192,193] Hence, it is argued, the duties and responsibilities that come with this expanded view should be reflected in law (something that is beginning to happen with, for example, the French *Loi Pacte*).

Therefore, while a fairly stable view of corporate governance – rooted in arms-length control by 'investor owners' – has existed until now, an ardent debate is gaining momentum regarding who really are the owners of a company and the valid reasons for a company to exist. As a result, all other assumptions about governance are also under discussion. The paradigm of governance, intertwined with that of organisations (see *Unleashing the sustainable business*), appears to be shifting fast.

As such, moving beyond the language of 'corporate governance' to 'organisational governance' is a useful way to avoid the symbolic constraints which BAU places on how we think about governance. Making this change allows us to consider the companies that can deliver a sustainable future and their implications for the kind of legal context required.

It is also important to derive decisions about the nature of effective governance – and what it needs to look like to deliver sustainability and purpose – from a foundational basis underpinned by deep thinking, rather than starting from where the current conversation has tended to be (which is inherently unsustainable and orientated towards financial value[194]) – we cannot solve problems with the same thinking that created them.

[***] "International corporations have much greater economic clout than most countries in the world: if companies' revenues and selected emerging GDPs are compared, the leading corporations are much richer than most countries. The economies of most developing countries are diminutive compared to the revenues and assets of the largest international corporations." Thomas Clarke, Justin O'Brien, and Charles O'Kelley, *The Oxford Handbook of the Corporation, 1st ed, Oxford Handbooks* (Oxford, UK: Oxford University Press, 2019), 3.

[†††] ISO 37000 as the first view of this which represents global multi-stakeholder consensus, and King IV is perhaps the earliest and most relevant corporate code in this respect.

Similarly, we are rethinking previously unquestioned terms such as 'for-profit' and 'not-for-profit' that embed BAU thinking in legal constructs, and in turn lock it into language and action. PAS 808:2022 defines financial profit as "monetary gain, especially the difference between the amount earned and the amount spent in buying, operating, or producing something".[195] It contains an assumption that businesses exist to maximise profits and that charities (and often social enterprises) are somehow unaffected by the need to make and invest surplus financial income. However, it is becoming increasingly apparent that all organisations must be 'for' rather than 'against' 'profit', as without it they cannot pay the bills, satisfy stakeholders or invest in their goals. What 'for profit' really means, then, is 'for profit maximisation'. While this was always the case, the boundaries between different charities, social enterprises and private and publicly traded organisational forms are beginning to blur – just as Thayer foresaw.[196]

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