trowers & hamlins

# Thinking Business

## Issue 13

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# Introduction

Welcome to Issue 13 of Thinking Business, a Trowers & Hamlins bi-annual publication in which we share our latest insights and commercial thinking to help businesses adapt, grow and be successful in a rapidly changing world.

In this edition of Thinking Business:

**The importance of focussing on your culture** – with a spate of news headlines focussing on company culture and toxic work environments, we explore workplace culture and why it is so important to get it right. What is the psychological contract and how can culture make you stand out as an employer of choice?

**Embracing AI requires careful risk management** – ChatGPT heralded a huge leap forward for artificial Iintelligence (AI). As the fastest-growing consumer application ever launched, it has propelled AI up the agenda in every boardroom around the world. Can you afford to ignore benefits and the risks?

**Putting tax policy at the heart of ESG** – with more focus on ESG values, the need for management boards and wider stakeholders to put good corporate citizenship at the heart of everything they do is increasingly apparent. How can your corporate tax strategy become an impactful part of your ESG story?

# THE IMPORTANCE OF FOCUSING ON YOUR CULTURE

**In May 2023, the Confederation of British Industry announced it was hiring a team of ethics advisors to lead an overhaul of its operations following the appointment of a new director general.**

The embattled business lobby group, which is meant to provide a voice to those in power for British companies of all sizes, is teetering on the brink of collapse after a series of claims of harassment and sexual assault in its ranks. In the wake of the allegations, the CBI has admitted that it has in the past hired "culturally toxic" staff and failed to fire people for misconduct. Some of its most high-profile members have deserted the organisation, including John Lewis and BMW, while a raft of others like Tesco and Sainsbury's have suspended their engagement.

Coming hard on the heels of allegations of bullying in the civil service by former Deputy Prime Minister Dominic Raab, and a damning review of the culture and standards in the Metropolitan Police by Baroness Casey, organisational culture is once again top of the agenda. What is clear is that people are no longer willing to tolerate toxic behaviour in businesses that they engage with and are increasingly prepared to speak up.

Rebecca McGuirk, an employment partner at Trowers & Hamlins, says: "Getting culture right is not about having the right words on a piece of paper, it is about walking the walk. You can have great high-performing individuals in your business but if their values do not align with the culture you want, you cannot afford to be reluctant to deal with them. Failing to address issues means you can end up with a toxic culture in a very short space of time, if people think they can get away with things. And people won't tolerate being associated with organisations like that."

In the same way as the CBI is facing desertion by its members, other businesses risk losing the backing of customers, suppliers, investors and other stakeholders if they are not deemed to be good people to deal with.

In a market where there is much more demand for talent than supply, getting culture right can have an especially significant impact on employment.

**"If your culture isn't right at the moment, then employees will leave because they know they can walk into another job," says McGuirk.**

"If businesses don't behave in the right way, it is easy to tell others about it. People are much more willing and able to share their experiences online or on social media, so there is no doubt that this can directly impact on the performance of your business."

There is also growing evidence that potential employees consider workplace culture when looking for jobs. A landmark 2019 survey by Glassdoor of 5,000 workers in the UK, US, France and Germany found 77% would consider a company's culture before seeking a job there and 56% felt a good workplace culture was more important than salary.

Culture also plays a big role in employee turnover. Research by the MIT Sloan School of Management found that toxic work environment complaints were the number one reason driving turnover in a variety of industries, overshadowing other issues.

Experiences like that of the CBI should serve to remind business leaders of the importance of taking culture seriously. "Many leaders don't appreciate the importance of this and its ability to impact on the bottom line," says McGuirk. "If you're going to take this seriously you need your HR director to have a seat at the top table with a genuine ability to feedback on what is actually happening across your organisation."

The HR role is evolving as culture moves up the agenda. Danielle Ingham, another employment partner at Trowers, says:

**"HR and people teams have a valuable role to play here in being more robust about dealing with problematic individuals and addressing cultural issues bubbling under the surface. With this in mind, we are seeing the HR role steadily evolving from day-to-day operational issues towards taking on bigger strategic challenges like culture."**

There is also a growing focus on the 'psychological contract' that exists between employers and their employees, representing an unspoken set of ethics and shared values on which both can rely. It is important to make sure that this contract remains as strong as possible for a wide range of reasons, not least employment, retention, reputation and wellbeing.

Ingham says: "Sometimes maintaining that psychological contract can involve doing things that are difficult, like having tough conversations about things that might be going wrong and what can be done better. Fundamentally, if an employer is not delivering on what they said they were going to do, that chips away at the culture and it is hard to come back from the damage that causes."

Often a strong corporate culture is driven by authentic leadership setting the right tone from the top. McGuirk says: “People in leadership roles want to deliver good, positive messages but actually in reality the state of the economy means that everyone is having a difficult time right now. More leaders should be prepared to have those honest conversations and give the complete picture, because trust is fundamental to that psychological contract.”

In a recent poll conducted by Towers & Hamlins looking at trust in leadership, the vast majority of their respondents felt that fewer than a third of employees had full trust in their leaders.

Each employer will be at their own starting point on the journey to getting culture right. Ingham says: “Every business needs to start by establishing what they want their culture to look like, thinking about things like values and ethics and how they want the working environment to operate. Involving employees in those conversations is useful in bringing everyone along on the journey.”

She adds: “Your policies should support what you are saying about your culture, so if you are saying that you are flexible, inclusive and support social initiatives, those values and practices need to feed through into those documents. But living these things in practice requires a constant cycle of checking in on what is happening on the ground.”

Embedding a solid company culture that is an asset to the organisation is not an overnight job. McGuirk says:

**“As a leadership team, it is about having a really hard look in the mirror and asking if the culture is really what you think it is. Organisations need to find out from their colleagues what they think about the business culture, and then keep revisiting that and checking in to make sure it is always what you would like it to be.”**

Surveys show the younger generation of workers value culture even more, making this a topic that is only going to keep growing in importance.

# EMBRACING AI REQUIRES CAREFUL RISK MANAGEMENT

**When San Francisco-based OpenAI launched its chatbot at the end of 2022, heralding the latest leap forward for artificial intelligence (AI), it swiftly attracted 100 million active users within two months. As the fastest-growing consumer application ever launched, it has propelled AI up the agenda in every boardroom around the world.**

The potential for AI to mimic and generate human behaviours presents a wide range of opportunities and threats across the whole spectrum of business activities and indeed societal domains. But as companies rush to integrate the benefits of AI software into their ways of working to create efficiencies, a note of caution is needed. AI may be able to assist in the performance of many tasks, marking exam papers for online education providers, writing reports for time-challenged executives, and even attempting to offer legal guidance at the touch of a button, but if misused or relied upon without the proper process and protections it has the potential to cause big problems.

Elizabeth Mulley, a senior associate in Towers & Hamlins' dispute resolution and litigation team, says: "If used properly there is no doubt that AI can be great for maximising business efficiencies, and we see plenty of examples of our clients using AI to do just that. But businesses are leaving themselves exposed if they are using AI and their cybersecurity is not up to scratch – cybercriminals are looking at AI to see how they can exploit it."

The opportunities associated with AI, come against the backdrop of examples of where AI has been used to target and manipulate individual users, such as deep fakes and cloned audio. Indeed, these methods have become so sophisticated and persuasive that recent concerns around sentient AI have even led Elon Musk and others to call for a pause in the creation of giant AI digital minds, while governments grapple with implementing regulation to ensure appropriate protections. Despite this, it is widely acknowledged that the potential of AI for good should

be embraced. Rishi Sunak opened London Tech Week by stating AI presents "an opportunity for human progress that could surpass the industrial revolution in both speed and breadth" and expressed his sense of urgency and responsibility to seize it.

Benefits aside, before jumping on the AI bandwagon, companies need to carefully think about how they will avoid running into disputes or compliance problems. Businesses need to proceed with caution on multiple fronts:

IP: The sources used within generative AI have lead many to raise copyright concerns – and there are new exposures created when AI or ChatGPT is incorporated into creation of work product, for example companies should take care not to breach the intellectual property rights of any data services they are licensed to use. Incorporating this content into any datasets being used to develop an internal generative AI product will undoubtedly be a breach of contract.

Risk analysis: Businesses should conduct a comprehensive risk analysis and consider how those risks can be mitigated, and whether the appropriate people within the organisation understand those additional exposures.

**"Often companies have tech specialists that understand all the algorithms," says Mulley, "but they might not be talking to the right people in risk and compliance, or governance, or HR, to be sure that everyone understands what the issues are."**

Data Protection: One of the biggest areas of compliance risk associated with AI relates to data protection, which people don't necessarily think about before embracing the tech. After all, AI technology is underpinned by data, because in order to train systems there is usually a huge amount of personal data inputted to inform their ability to answer questions or develop processes. Charlotte Clayson, partner in the dispute resolution team at Trowers, says: "The personal data that is collected and used to make assessments or decisions about people is now a real focus for the Information Commissioner's Office as the regulator of personal data in the UK. They have been working with other regulators on a coordinated approach to AI and issuing fines to companies that have failed to comply with the rules."

The ICO has just published new guidance on AI and data protection and has been working with the Alan Turing Institute to develop practical advice to help companies navigate the issues.

It also recently fined facial recognition database company Clearview AI more than £7.5 million – one of its biggest ever penalties – for using images of people that were collected from the web to create its global online database. The company breached UK data protection laws in a number of ways, including failing to use the information of people in a fair and transparent way, failing to have a lawful reason for collecting people's data, and failing to have a process in place to stop the data being retained indefinitely. Clearview received even larger fines at €20m apiece from data protection authorities across Europe.

"The fact they had so many fines gives a stark warning about using AI," says Clayson. "The tech can be great but before you use it you have to think about how you are going to make sure you comply with the law. The new guidance from the ICO should be really useful in helping companies through that."

Anna Browne, Head of Innovation and Legal Technology at Towers & Hamlins, says

**"Companies should have a data strategy and effective policies on data governance to ensure that they have the compliant processes in place and to ensure they can leverage their data to make smarter decisions".**

Richard Elson, Director for Information Services at Trowers and Hamlins says " Organisations need to take both strategic and tactical steps to ensure their approach is coordinated across the business. To this end an authoritative multidisciplined group reporting to the strategic board should be mapping these opportunities and threats and ensuring there is focus and attention to prioritising actions to actively manage both."

Part of the challenge for business leaders is that regulators themselves are at times struggling to keep pace with the speed at which the tech is developing in this area. A recent case involving the use of cryptocurrency, which is classed as AI because of the blockchain behind it, highlights the issue. The claimant, Tulip Trading, was the owner of some very high value bitcoin, the keys to which were apparently stolen in a hack. Tulip was unable to access the assets and move them to safety, so it argued the software developers owed fiduciary duties to customers using their network that extended to safeguarding their assets.

In the first case in the English courts to consider the roles and duties of cryptoasset software developers, the Court of Appeal held that it is arguable that software developers do indeed owe fiduciary duties to owners of cryptoassets. Deciding it was a serious issue to be tried, the case is now expected to go to full trial in 2024.

**Clayson says: "The Tulip case is just part of a wider issue of the law and regulation working to keep pace with developments in technology.**

"On the regulation side, there are authorities that already exist to regulate different sectors, but they are working to make sure they can apply themselves appropriately to keep up with developments in the tech world. In the UK, AI is a key priority for government, so they are making a lot of noise about how they are going to regulate it and make it a safe space."

In Europe, the Artificial Intelligence Act proposed by the European Union is the first law on AI by a major regulator anywhere, meaning it could become a global standard in determining to what extent AI has a positive or negative impact on our lives.

For UK companies, there is a lot to get to grips with. Helen Briant, another partner in the dispute resolution team at Trowers, says: "When we first started talking to clients about cybersecurity, one of the key things we would focus on was human training to help staff recognise phishing emails, for example. But with the pace at which AI has developed, from a cybersecurity perspective phishing emails are now so much more realistic, with the ability to replicate people's voices and ways of speaking that makes it even harder to recognise imposters."

She adds: "AI is great but it is creating a completely new and much more sophisticated set of issues, making it even harder to put in the checks and balances that organisations need to protect themselves. Companies must weigh up the benefits of automation and cost savings versus the unknown risk parameters, which are sometimes quite difficult to articulate."

## To protect themselves against cyber attacks through the use of AI, organisations should:

- Invest in AI-powered cybersecurity tools and solutions that can help detect, prevent, and respond to cyber-attacks.
- Ensure that AI systems are secure and regularly tested for vulnerabilities.
- Train employees on cybersecurity best practices, including how to identify and respond to cyber threats.
- Develop an incident response plan that outlines the steps to be taken in the event of a cyber-attack.
- Regularly review and update cybersecurity policies and procedures to ensure they are up-to-date with the latest threats and best practices.


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# Putting tax policy at the heart of ESG

**With investors, customers and employees putting so much more focus on the environmental, social and governance (ESG) credentials of the companies with which they engage, the need for management boards and wider stakeholders to put good corporate citizenship at the heart of everything they do is increasingly apparent.**

In this context, rarely have management teams and stakeholders appreciated or considered the interaction between ESG policies and a particular organisation's tax strategy, even though all three ESG levers directly and indirectly cross over in to all things tax.

Taken individually, there is nothing particularly new in the three ESG pillars when it comes to tax, such as the way in which a government may employ fiscal tools to change behaviours in relation to the environment (whether those are tax incentives to drive investment in clean tech or the imposition of higher levies on polluting fuels or products). Or the debate around what is one's fair share of tax as a contribution to society versus the amount of tax that is properly due as well as an organisation's tax compliance record being used as a measure of good (or bad) corporate governance.

But the mood music around tax has changed over the last decade, and now more than ever stakeholders and the media are taking a greater interest in the tax that businesses pay (or don't pay).

**Nathan Williams, a partner specialising in corporate tax at Trowers & Hamlins, says: "Businesses have to take their customers' views into account, not to mention those of their investors, suppliers and other stakeholders, and those views are changing when it comes to tax.**

"The direction of travel is that an organisation's attitude to tax compliance and strategy is seen as a key part of good business governance, and also arguably a marker of one's social values. That includes paying the appropriate amount of tax and not taking unnecessary risks or engaging in aggressive tax planning. All of which has the potential to feed in to the ESG credentials of a business."

A case in point is Starbucks, which following media speculation over its UK corporation tax affairs it was reported to have 'voluntarily' paid additional tax to HMRC. It and other global organisations were historically held up as businesses that did not pay material amounts of tax in all the jurisdictions in which they generated their profits and that was understood (by those businesses and often the tax authorities) to be the way things were done.

But then the tide started to change, with consumers taking the view that those organisations were not paying their fair share of tax and failing to contribute to the communities in which they operated, with tax changes at the international level also being implemented to address certain tax planning arrangements.

Plenty of other companies and individuals have suffered a similar fate in the years since, with media scrutiny of how much tax is being contributed by high-profile taxpayers reaching fever pitch – just look at the spotlight shone on the tax bills of Prime Minister Rishi Sunak and former Chairman of the Conservative Party, Nadhim Zahawi.

The huge government support paid out during the pandemic, and the extent to which highly profitable businesses took advantage of certain tax breaks, intensified the sense that a corporate tax strategy focused on aggressive tax planning and paying as little tax as possible may no longer be the right approach in any context let alone an ESG one.

**"When we look at ESG through the tax lens, it becomes clear that what is changing is the attitude to tax and tax risk, both inside and outside the organisation. An organisation's approach to tax is no longer about paying the minimum, although some will still aim for that," says Williams.**

"Neither is it just about compliance and paying the tax owed. Tax is increasingly becoming an indicator of how a business views its role in society and how it demonstrates its commitment to sustainability and social responsibility, alongside its commitment to its purpose. This is not totally altruistic of course. A business will want to demonstrate this to its existing and future customers, stakeholders and investors which is ultimately for the benefit of the business".

If the tax policy is properly aligned to a company's ESG strategy, a positive outcome is to enhance transparency and make use of tax reporting disclosures as a means to gain trust. An ESG-based approach to tax reporting is about more than just publishing data though – it is about having a clear tax strategy and having a narrative around that strategy that is aligned to the organisation's core values.

Williams says: "What we are seeing with our larger clients, such as the property investment funds, PLCs and multinationals, is much greater transparency on tax strategy and reporting with the expectation that the wider business and its suppliers adhere to that tax strategy going forward."

That means all the managers in a business need to understand the tax policy and any tax risks that the business faces, in order to make sure they are not entering into transactions that run counter to the stated position. Some of the large property investment houses now expect a tax checklist to be signed off, and their tax team to be notified, every time managers sign up to real estate transactions that may create a tax exposure, for example.

Williams adds: "Our smaller clients – such as the start-ups, entrepreneurs and owner-managed businesses – may not have a tax strategy themselves right now, nor may they want one. But if they are suppliers to, or seeking investment from, larger organisations it will become relevant to them down the road whether they like it or not."

Admittedly, businesses will not necessarily think 'tax' when it comes to ESG reporting, but at a minimum it is about good governance: being tax compliant and managing risk. Whether having a policy in place to deal with specific tax issues affecting the business (such as the Criminal Finance Act offences) or an overall tax policy governing its own tax affairs – now it is not just about what the business does or doesn't do in respect of its own tax affairs.

**"One trend we see is a greater emphasis on having to police your own supply chain for tax non-compliance, evasion and fraud," says Williams.**

"We see this in the context of VAT and PAYE compliance with clients and sectors heavily reliant on labour supply chains, for example, whether that is dealing with construction companies seeking labourers, the logistics businesses recruiting drivers, the care home operators seeking care staff or the recruitment agencies supplying those sectors."

He adds: "We also see it with the introduction of secondary tax liabilities passing through the supply chain in new tax legislation, such as with the off-payroll IR35 rules and the plastic packaging tax."

This then comes full circle as these new exposures feed into tax risk management and the wider allocation of risk under terms and conditions, transaction documents and due diligence.

The key takeaway is a company's approach to tax matters to others a lot more than it used to and failing to walk the walk on promises made creates serious exposure to reputational risk.

Aligning an organisation's tax strategy with the wider ESG reporting does come with significant potential upside though. "By reporting and having transparency on the tax policy, a business can show to the wider world, including investors, clients, suppliers, employees and future recruits, that it really operates in a responsible way," says Williams. "We can see that going forward organisations will be much more open about what they are paying and why they are paying it. It will no longer be enough just to have a tax strategy – one will need to make sure it is being implemented and that it is balanced and fit for purpose. If it is, it can become an impactful part of your ESG story."

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