



House of Commons
Business, Energy and Industrial
Strategy Committee

Corporate governance

Third Report of Session 2016–17



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*Report, together with formal minutes
relating to the report*

*Ordered by the House of Commons to be printed
30 March 2017*

Business, Energy and Industrial Strategy Committee

The Business, Energy and Industrial Strategy Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department for Business, Energy and Industrial Strategy. The Committee's name was changed, from the Business, Innovation and Skills Committee, on 17 October 2016.

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The following was also a member of the Committee during the inquiry:

[Kelly Tolhurst MP](#) (*Conservative, Rochester and Strood*)

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The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via www.parliament.uk.

Publication

Committee reports are published on the Committee's website at www.parliament.uk/beis and in print by Order of the House.

Evidence relating to this report is published on the [inquiry publications page](#) of the Committee's website.

Committee staff

The current staff of the Committee are Chris Shaw (Clerk), Michael Everett (Second Clerk), Josephine Willows (Senior Committee Specialist), Ian Cruse (Committee Specialist), Becky Mawhood (Committee Specialist), James McQuade (Senior Committee Assistant), Jonathan Olivier Wright, (Committee Assistant) and Gary Calder (Media Officer).

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Summary

Following the evidence that this Committee found in 2016 of major corporate governance failings at BHS and Sports Direct, we welcome the Prime Minister's commitment to improving behaviour by big business, as demonstrated by the publication of its Green Paper containing options for reform.

In looking more broadly at this issue, we have found that, 25 years after the Cadbury Report, the UK retains a strong system of corporate governance. However, the environment has changed since then, with new business models, technological developments and growing expectations from stakeholders. The changing ownership structure of British business in a globalised economy has contributed to increased pressures on companies to deliver short-term financial gains for shareholders, rather than invest for their long-term benefit. A worrying lack of trust in business by the general public has been fuelled by recent high profile examples of bad practice, as well as pay levels being ratcheted up to levels so high that it is impossible to see a credible link between remuneration and performance. In this context, these developments demand that our existing framework be improved to keep the UK in the lead globally on corporate governance.

Whilst supporting the current comply or explain basis of the UK Corporate Governance Code, we propose a series of reforms designed to require directors to take more seriously their duties to comply with the law and the Code relating to corporate governance. These include requirements relating to more specific and accurate reporting, better engagement between boards and shareholders, and more accountable non-executive directors. Crucially, to combat what are currently very weak enforcement mechanisms, we recommend a wide expansion in the role and powers of the Financial Reporting Council, to enable it to call out poor practice and engage with companies to improve performance.

Given the increasing number of major private companies, which are subject to weaker reporting requirements, we recommend that a new governance Code for the largest private companies be developed. Compliance with this Code would be examined by an expanded FRC, funded by a small levy on businesses, able to pursue complaints relating to compliance with the Code.

In relation to high levels of executive pay, we agree with the Prime Minister that this is an issue which needs to be addressed for the benefits of society as a whole and in line with her vision of an economy that works for everyone. Whilst there are some encouraging signs that shareholders are beginning to exert some pressure on high executive pay, there are structural problems that need to be addressed. We recommend the abolition of long-term incentive plans, which have become too complex and are liable to create perverse incentives and short-term decisions. Instead, we recommend a more simple pay structure, comprising salary, bonus relating to stretching targets, including those relating to wider performance criteria, and payment by means of equity over the long term.

We also propose measures to improve engagement, including with employees, on pay, and to incentivise better stewardship through more transparency and better reporting. This should include the annual publication of pay ratios.

On board diversity, we fully support the recommendations of recent reviews on gender and ethnic diversity. Whilst progress is being made, we recommend further measures to ensure that diversity is promoted at all stages of careers to broaden the pool of talent at the executive level. To this end, the Government should set a target that from May 2020 at least half of all new appointments to senior and executive management level positions in the FTSE 350 and all listed companies should be women.

We also believe that diversity can be improved by the appointment of workers on boards. This model has worked for some companies, here and abroad, and can help provide both challenge and a different perspective on the board.

We believe that our recommendations will make a strong contribution towards embedding the behaviours of good corporate governance in the culture and values of British businesses, to the benefit of both business and society as a whole.

1 Introduction

Origins

1. Our summer 2016 inquiries into the demise of BHS and employment practices at Sports Direct exposed what we judged to be serious failings in corporate governance at two major businesses.¹ Both these examples served to undermine trust in British business and to shine a light on issues of governance and fairness. In both cases, decisions taken in boardrooms appeared to neglect the interests of those, many on low incomes, who worked hard to generate profits for the owners. In addition, there has been growing dissatisfaction in many quarters with high levels of executive pay, with a widespread perception that these have not reflected company performance, nor been fair in comparison to increases for other employees.

2. Corporate governance is there to support effective decision making by companies for their own long-term success. It provides a framework of law, rules and practices by which company boards balance the interests of shareholders with other stakeholders, including employees, customers, suppliers, creditors, pensioners and the local community. In the two recent cases we considered, something went badly wrong. We undertook then to conduct an inquiry to see whether there were any systemic problems that need addressing in the way corporate governance operates.

3. Since our Reports of July 2016, a new Prime Minister has taken office, who spoke in her brief election campaign of a “need to get tough on irresponsible behaviour in big business.”² The Prime Minister has since described the scrutiny provided by those responsible for holding big business to account as “not good enough” and she subsequently spoke of the damage to the social contract between business and society caused when “a small minority of business and business figures appear to game the system and work to a different set of rules.”³ The Government subsequently published its Green Paper on Corporate Governance in November 2016, focussing on three aspects: executive pay, private companies, and workers on boards.⁴

4. Our own inquiry has considered these issues, along with broader aspects of corporate governance, such as the existing legal and regulatory framework under the Companies Act 2006 and diversity on boards. This Report is complementary to our Report on industrial strategy, published in March 2017, which reviewed the Government’s own Green Paper on Industrial Strategy and proposed a new framework for informing long-term decision making for businesses and government.⁵ It also links to our current inquiry into the Future World of Work, which is considering whether current employment law is adapting fast enough in the face of new employment models and the rise of the “gig economy”. In this Report we examine whether our corporate governance framework is

1 [BHS](#), First Report of the Work and Pensions Committee and Fourth Report of the Business, Innovation and Skills Committee, Session 2016–17, HC54; Business, Innovation and Skills Committee, Third Report of Session 2016–17, [Employment practices at Sports Direct](#), HC219.

2 Rt Hon Theresa May MP, Prime Minister, [Speech](#) on 11 July 2016

3 Rt Hon Theresa May MP, Prime Minister, [Speech](#) at CBI, 21 November 2016

4 Department for Business, Energy and Industrial Strategy, [Corporate Governance Reform Green Paper](#) 29 November 2016

5 Business, Energy and Industrial Strategy Committee, [Industrial Strategy: First Review](#), Second Report of Session 2016–17, HC 616

still fit for purpose: whether it provides the right structures to assist businesses in making high quality decisions for the long term, taking fully into account the wider interests of society, and how good behaviour can be embedded in business through cultural change and persuasion.

Our inquiry

5. We published terms of reference on 16 September 2016⁶ and subsequently took oral evidence from a cross section of over 170 organisations and individuals who submitted written evidence.⁷ In addition, we held discussions with: a range of chairmen and chief executives of major companies at the Confederation of British Industry (CBI); Professor John Kay, Visiting Professor of Economics at the London School of Economics, and others; and with a range of businesses and trade unions during a visit to Sweden. We are extremely grateful to all those who contributed to our inquiry. We also place on record our thanks to our specialist advisor on this inquiry, Paul Coombes, of the London Business School and to the Institute of Chartered Accountants for England and Wales (ICAEW) for their assistance in analysing the written evidence submitted.

6 [Corporate Governance inquiry launched](#)

7 See List of witnesses at Annex 1

2 Context and background

The evolution of corporate governance

6. It is 25 years since the Cadbury Report ushered in our modern framework for corporate governance, following a number of high profile governance failures and company bankruptcies.⁸ This report and its successors established an approach to corporate governance that mainly relied, not on hard law and enforcement mechanisms, but on encouraging dialogue between companies and their shareholders. This was to be based on a “comply or explain” principle of accountability, now overseen by the Financial Reporting Council (FRC). Under this regime, companies are required to comply with guidance, or to explain why they have not done so. This model was designed to preserve sufficient flexibility to cope with the diverse nature of businesses but also to foster a sense of accountability.

7. Since the Cadbury Report, corporate governance has gradually evolved, usually following reviews and reports established to tackle a particular failing.⁹ The Financial Reporting Council consolidated the previous Combined Code for listed companies into the UK Corporate Governance Code (hereafter “the Code”) in 2010 and published for the first time a Stewardship Code, covering best practice for investors. The Government’s Green Paper of 2016 represents the latest iteration of an ongoing process.

8. This evolutionary approach to reform, although frequently reactive in nature, has served to refresh the UK’s corporate governance framework and helped to keep it at the leading edge of international standards. The overwhelming majority of evidence we received considered the UK corporate governance framework to be in good health: standards are highly regarded internationally and help to promote investor confidence. High standards of governance are also an important driver of good business performance, as a clear framework for decisions to be made is conducive towards well-run and ultimately successful companies. Good corporate governance should not be seen as excessive regulation; it is in the interests of business, as the driver of productivity and economic growth, and the wider society in which it operates, for these standards to be maintained. **The UK’s strong corporate governance regime is a considerable asset which enhances the reputation of the UK as a place to do business. The Government should therefore be very cautious about taking steps that risk adversely affecting the UK’s attractiveness as a place to invest. However, although the UK has a high international reputation in this field, there should be no complacency, nor any sense that improvements cannot be made. Within this context, the challenge is for businesses and Government to keep improving standards, without the impetus of high profile corporate scandals, in order to minimise the risks of future failings and to reflect both changes to the business**

8 Report by the Committee on [the Financial Aspects of Corporate Governance](#), December 1992, paras 1.3 and 3.7

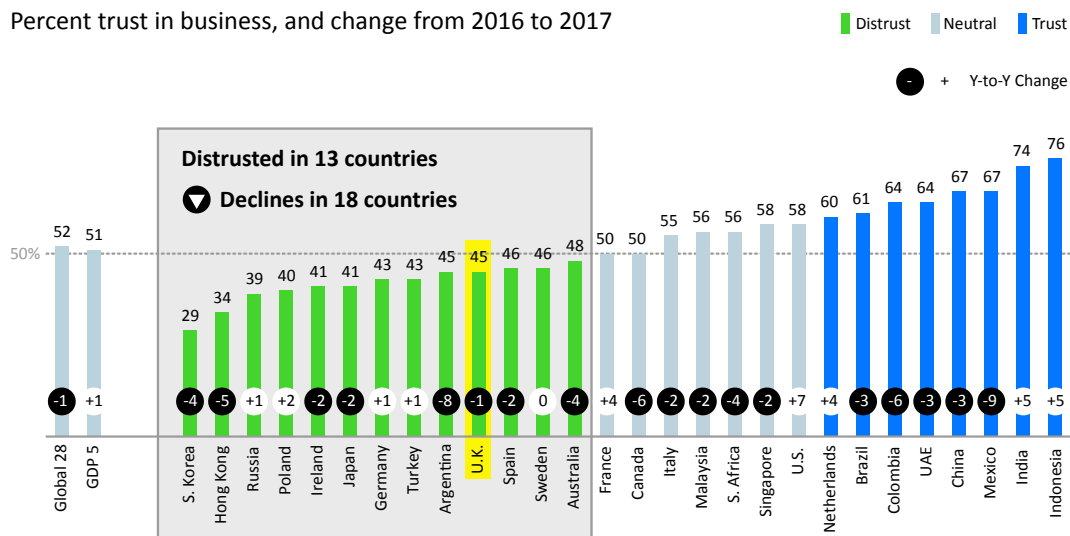
9 The Greenbury Report in 1995, following a review by the CBI, identified good practice in the determination of directors’ remuneration; the Hampel Report in 1998 resulted in a Combined Code (governance and remuneration) being established; the Turnbull Report, by the London Stock Exchange, refined the rules relating to financial reporting; the Myners Report in 2001, commissioned by the Government, considered the role of institutional investors and fund managers; in 2003 the Government-commissioned Higgs Report looked at the role of non-executive directors (NEDs); the Walker Review in 2009 made a number of recommendations for changes to corporate governance in banks and financial institutions.

environment and the rising expectations of society and stakeholders. The Government must help ensure that the UK stays ahead of the game in the light of changing business trends and practices.

Trust in British business

9. Whilst the underlying reasons may be varied and complex, there can be little doubting the recent loss of public trust in authority has affected business, Government and other institutions, in this country and globally. It is concerning that, despite the UK’s generally good reputation for corporate governance, evidence suggests that in this country, levels of trust in business are lower than in many other countries (as indicated in Figure 1). Surveys suggest that perceptions of unfairness on executive pay levels and payment of tax are the main contributory factors to this erosion of trust, an issue we consider in detail in Chapter 5.¹⁰ Further damage may have been done by recent high profile examples of apparent corporate governance failings, which have involved some major and high profile companies, including Rolls Royce, Tesco and BAE Systems. Companies should be careful to give due regard to the public’s expectations regarding the conduct of business and take seriously the need to address this issue proactively.

Figure 1: Levels on trust in business



Source: Edelman Trust Barometer 2017

Cultural change

10. The Corporate Governance Code describes how the culture of a company should be set:

One of the key roles for the board includes establishing the culture, values and ethics of the company. It is important that the board sets the correct ‘tone from the top’. The directors should lead by example and ensure

that good standards of behaviour permeate throughout all levels of the organisation. This will help prevent misconduct, unethical practices and support the delivery of long-term success.¹¹

11. As the Code makes explicit, to chair a corporate board is a hard task, taking into account constraints on time, individual knowledge and expertise, and the need to have mutual respect and openness between all executive and non-executive directors: “to achieve good governance requires continuing and high quality effort”.¹² Simon Fraser, Chairman of the Investor Forum, stressed that culture is driven by the executive and board of the companies, and culture can change quickly. He told us “It comes back to transparency and the description of how you display that you are managing all aspects of your business and have a good culture within your business. That is critical.”¹³ Baroness Hogg went further, describing the importance of imbedding the culture from the top to each facet of the organisation:

You can be getting a lot of good noises at the board level, but if the board is not taking the trouble to deep dive and discover if the words expressed in the boardroom are being performed against further down the organisation, then you can easily get a disconnect. It is an important part of the board’s responsibility to be thinking and engaging on the culture of the business.¹⁴

A recent study by the FRC on corporate culture reports evidence that companies are beginning to engage more with shareholders in discussions on culture and proposes a number of detailed practical ways in which companies can seek to ensure statements of values actually govern the way in which business is done.¹⁵

12. The culture of a company will depend on its context and core values, as determined by the board and its chair. One company’s culture may centre on equality and purpose, whereas another’s might be based around risk-taking and innovation.¹⁶ But the culture of every company should be based upon values and behaviours that are consistent with the intentions of the Code. **The fostering of a healthy culture in which to do business, particularly in terms of the means by which firms govern themselves and how they are accountable for the decisions they make lies behind the recommendations in this Report. Good company culture does not lend itself to easy measurement and cannot be enforced via a tick box exercise. Instead, the central tenets of good corporate governance should be embedded in the culture of all companies, so that it permeates activity at every level and in every sphere. It is cultural evolution, in line with the spirit of the Cadbury Report, that should be the long-term goal of Government, investors and companies.**

Changing shareholder structure

13. Recent trends in shareholder structure in UK listed companies illustrate the changing nature of the challenge to companies in balancing the different interests of owners and shareholders. The UK has a relatively dispersed model of ownership, with relatively

11 Financial Reporting Council, [The UK Corporate Governance Code](#), April 2016, preface, para 4.

12 Financial Reporting Council, [The UK Corporate Governance Code](#), April 2016, para 7.

13 Q398

14 Q397

15 Financial Reporting Council, [Corporate Culture and the Role of Boards](#), July 2016.

16 Q400 [Tom Gosling]

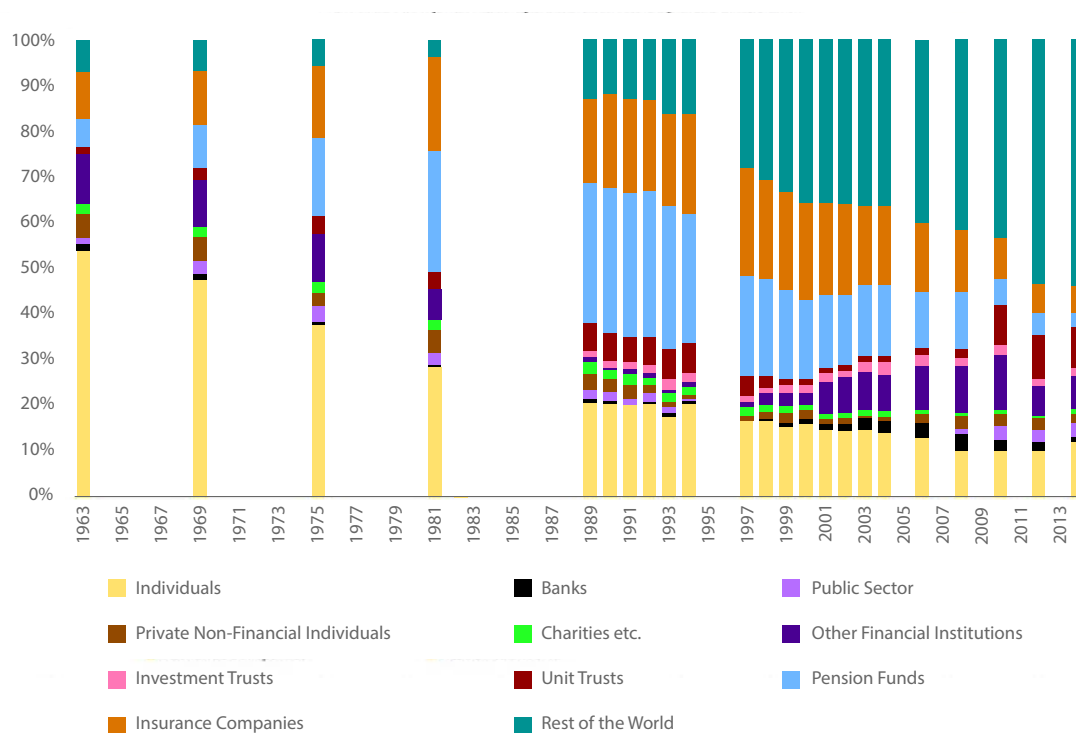
few large shareholders (or “blockholders”) able to exert considerable influence on the boardroom, a model which is more prevalent in parts of continental Europe. Institutional and other investors tend to have diverse portfolios, with small shareholdings in many companies, in order to spread the risks of their investments. The average period in which shares are held have also drastically reduced, from six years in 1950 to less than six months today. There has been a sharp fall in the proportion of shares held directly by individuals, from about half in the 1960s to little over ten per cent today. The nature of these holdings also tend in the modern age to be indirect, whereby individual shareholdings are held via nominee accounts and intermediaries.

14. Figure 2 shows how the proportion of shares owned by pension funds and insurance companies, and by individuals has fallen. We explore the consequence of these changes for engagement between companies and shareholders in Chapter 3.

15. The changes in shareholder structure have produced what have been described as “ownerless companies”, where no single investor has a sufficiently large stake in the business to act as a responsible owner, checking performance and behaviour. As Andy Haldane of the Bank of England has stated, “One consequence of a more dispersed and disinterested ownership structure is that it becomes harder to exert influence over management, increasing the risk of sub-optimal decision-making.”¹⁷

16. This situation contrasts with the position of employees and some suppliers, who are heavily reliant on a single company for their income and have a clear interest for that company to be successful over the long-term, but very often have little influence on decision making.

Figure 2: Shareholder structure in the UK



Source: Office for National Statistics

17 [Who owns a company?](#) Speech given by Andy Haldane, Chief Economist, Bank of England, at the University of Edinburgh Corporate Finance Festival, 22 May 2015.

Positive developments

17. Part of the process of improving trust lies in accentuating the generally high standards and good reputation of British business, and in acknowledging progress made. Witnesses pointed to recent improvements across a wide range of governance issues. The FRC reports that compliance with the Code remains high, with full compliance among the FTSE 350 companies increasing from 57 to 62 per cent and 90 per cent of companies reporting almost full compliance.¹⁸ Witnesses told us that attitudes were changing: some 57 FTSE 350 companies have established board-level committees that look at sustainability, behaviour, ethics and values. The Purposeful Company initiative,¹⁹ comprising a number of leading thinkers and businesses, has been producing reports on how best to pursue long-term shareholder value at the same time as society-related goals.²⁰ Investors told us that culture and values are increasingly becoming a part of conversations with companies.²¹ There have been recent improvements to the quality of reporting, notably companies' strategy reports, which now include better explanations of business models, culture and risk.²² Some companies already use high standards of environmental and social awareness, and other non-price factors, as a means of securing comparative advantage. Whilst there are signs that some investors are favouring these types of companies in response to client demands, there is much work to be done before these considerations become routinely considered in the dialogue between companies and investors.²³

Encouraging long-term decision making

18. One of the persistent problems in the UK economy has been relative low levels of investment in both infrastructure and research and development (R&D). These have been cited as evidence of a short-termist approach, by both Government and business. We explored some of the public policy solutions for encouraging a long-term approach in our Report on industrial strategy,²⁴ but it is important that the country's corporate governance framework is conducive to businesses taking a long-term approach.

19. There has been widespread concern for some time about the extent of a range of short-term pressures in the investment architecture and on decision making in boardrooms. The Kay Review of equity markets found, in 2012, "that short-termism is a problem in UK equity markets, and the principal causes are the decline of trust and the misalignment of incentives throughout the equity investment chain."²⁵ Witnesses in our inquiry suggested that an excessive focus on short-termism was in part responsible for relatively low levels of investment and referred to "an unhelpful tendency amongst listed companies to distribute cash flow to shareholders (through share buy-backs and dividends) rather than re-invest in innovation, training and long-term success".²⁶ This comment is supported by data from the Bank of England and its Chief Economist, Andrew Haldane, who cites "clear evidence"

18 FRC, [Developments in Corporate Governance and Stewardship 2016](#), January 2017, p6

19 This is a strand of work by the Big Innovation Centre, a think tank established in 2011

20 Q51 [Peter Montagnon] [Alex Edmans]

21 Q52 [Mike Everett]

22 FRC, [Developments in Corporate Governance and Stewardship 2016](#), January 2017, p25

23 The Investor Forum, [Review 2015–16](#), p7; FRC, [Developments in Corporate Governance and Stewardship 2016](#), January 2017, p25

24 Business, Energy and Industrial Strategy Committee, [Industrial Strategy: First Review](#), Second Report of Session 2016–17, HC 616

25 [The Kay Review of UK Equity Markets and Long-Term Decision Making](#), Final Report, July 2012

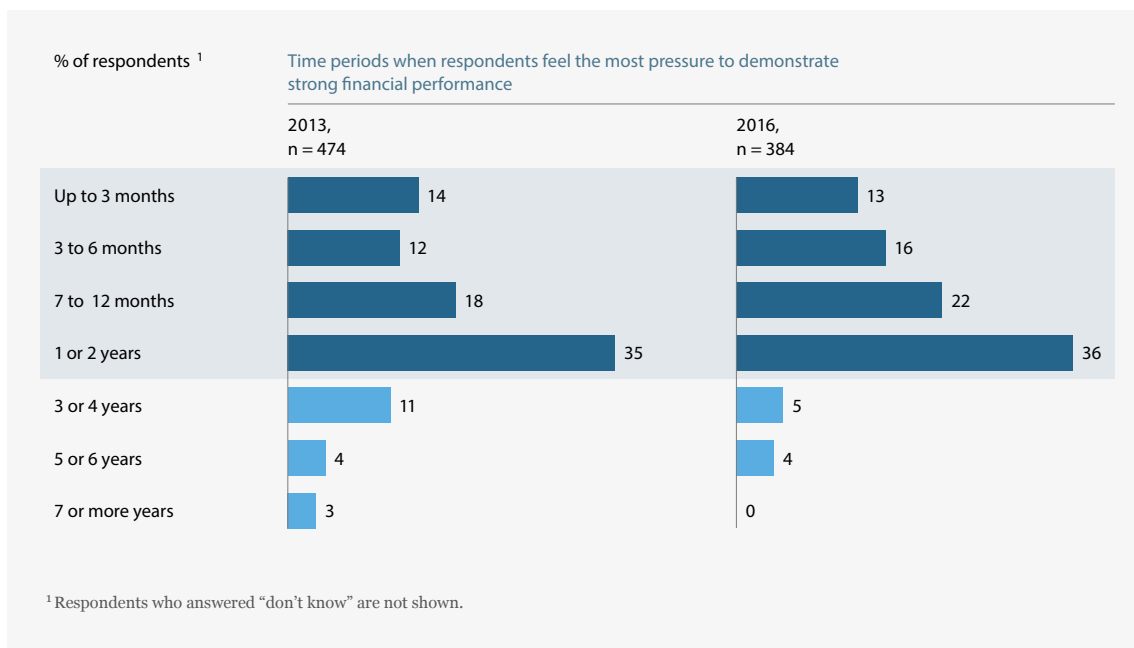
26 University College London ([CGV0032](#)); see also Sheffield Institute of Corporate and Commercial Law ([CGV0037](#))

of investor activity moving towards a short-termist approach. He argues powerfully that the “short-term quest for smoothing shareholder returns has come to dominate payout behaviour, almost irrespective of profitability” and notes that share buybacks had also risen in prominence.²⁷ Catherine Howarth, Chief Executive of ShareAction, argued that investors think that they have a single overriding duty to maximise short-term profitability, which produces “constant shortterm pressures” on companies.²⁸ The Investor Forum confirms this view:

As companies find it increasingly difficult to articulate the importance of long-term investments in sustaining their competitive advantage, incrementally there can be more dependency on the reliability of shorter term financial measures.²⁹

Survey evidence indicates that company directors felt more pressure to work towards a two year time horizon in 2016 than in 2013 and that executives were most likely to feel pressure to demonstrate strong financial performance over a 1–2 year period.³⁰

Figure 3: Pressure on executive to demonstrate strong financial performance



Source: Focussing Capital on the Long Term: Rising to the challenge of short-termism, 2016

20. Other witnesses argued that the notion of short-termism was itself difficult to define and also that not all short-termism is undesirable. Sometimes companies may need to focus on the short-term, merely to survive,³¹ or they may be established specifically for short-term purposes. Equally, apparently long-termist decisions to invest may not necessarily increase long-term productivity: investment decisions must be sound in themselves to add shareholder value.³² More broadly, activist investors who seek to restructure companies to

27 [Who owns a company?](#) Speech given by Andy Haldane, Chief Economist, Bank of England, at the University of Edinburgh Corporate Finance Festival, 22 May 2015.

28 Q77 [Catherine Howarth]

29 The Investor Forum, [Review](#) 2015–16, p32

30 FCLT Global, Focussing Capital on the Long Term: [Rising to the challenge of short-termism](#), 2016

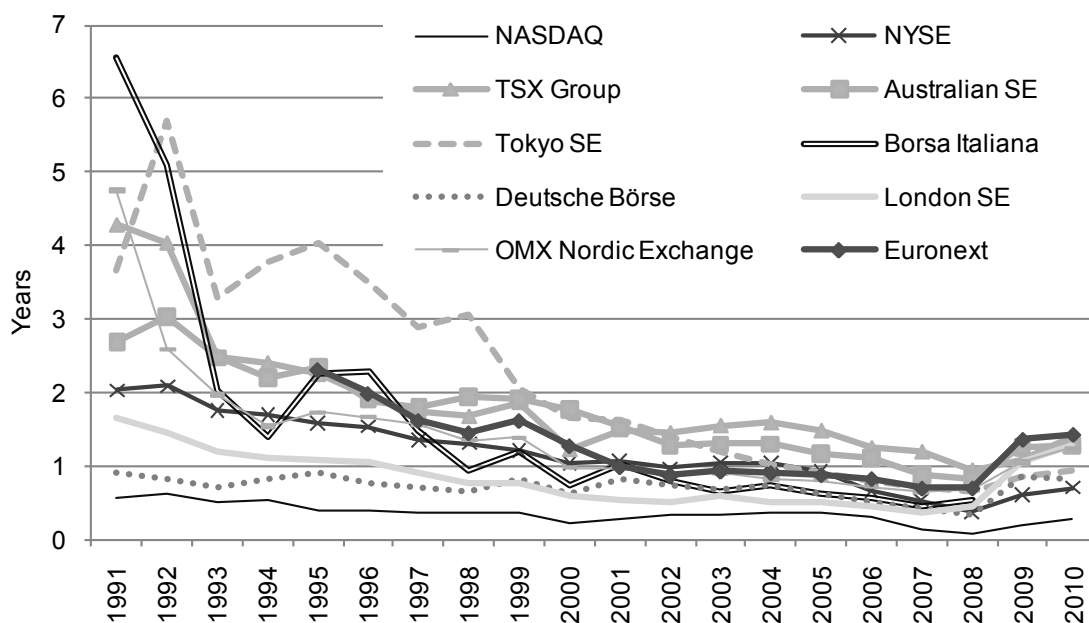
31 Q76

32 Manifest ([CGV0062](#))

make them more profitable can serve a valuable economic purpose, in generating higher levels of productivity, even at the expense of short-term turbulence. Another witness argued that evidence showed that shareholders were not short-termist in outlook and that shareholder-motivated changes do have positive effects on society.³³

21. Professor Kay argues that regulatory structures demonstrate little recognition of the change in the role of the markets from capital allocation to secondary trading on existing assets, a business model which he says “now mainly serves the interests of a bloated finance sector.”³⁴ Many of our witnesses pointed to this shift away from investment to trading, or “high frequency trading”, which has been made easier as technological progress and automation has brought down costs and improved access to the markets.³⁵ Fund managers are incentivised on a short-term basis and consequently are liable to apply pressure on boards for short-term results.³⁶ These pressures increase the difficulties for boards in balancing the interests of the different groups of shareholders—traders and long-term investors—with their own strategic vision.

Figure 4: Average holding period of shares between 1991 and 2010



Source: OECD, cited in the Purposeful Company, Interim Report, May 2016, p 70

22. The forces of globalisation and rising technological innovation are requiring companies to compete ever harder to prosper. This can unleash enormous tensions and trade-offs. In an employment market that is rapidly moving away from reliance on the traditional employer/employee relationship, and in which many individual workers are in a position of relative bargaining weakness with regard to employers, good corporate governance can play a part in protecting the interests of workers. But we recognise that some companies may only respond to legal remedies, as we explore in our inquiry into the Future World of Work.³⁷

33 Q52 [Professor Alex Edmans]

34 Professor John Kay ([CGV0174](#))

35 TUC ([CGV0156](#)), Spencer Stuart, ([CVG0092](#))

36 UK Share Association ([CGV0080](#))

37 [Future World of Work inquiry](#) launched October 2016.

23. By virtue of the requirements relating to consequences for the long term³⁸ of boardroom decisions in the Companies Act, corporate governance also has a leading role in combatting the growing pressures for short-term behaviour, which can constrain the ability of companies to invest for the benefit of their long-term future and that of the wider economy.

Conclusion on the case for further reform

24. Corporate governance in the UK is still strong and remains an asset to the country's reputation for doing business. We are conscious that a small number of highly damaging examples of corporate governance failure should not lead to a hasty and disproportionate response. We do not believe that there is a case for a radical overhaul of corporate governance in the UK. We do believe that there is scope for significant improvements in order to address the changing nature of company ownership in a globalised economy. We explore these in the remainder of this Report.

38 See Box 1; section 172 of the Companies Act 2006 requires directors to have regard to the likely consequences of any decision in the long-term.

3 Promoting good corporate governance

Directors' duties

25. The key requirements on company directors relating to corporate governance are set out in the Companies Act 2006. To a large extent, the Act served to clarify, or at least, codify, existing rights and responsibilities under the common law. During the passage of the Companies Bill, there was considerable debate about how the interests of shareholders and other stakeholders should best be balanced. The formulation that was arrived at was carefully crafted so as to enshrine the existing doctrine of shareholder primacy whilst also providing some protection to the interests of wider stakeholders. Under section 172 of the Act, a director is required to act “in a 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.”³⁹ In doing so, directors are required to “have regards to” a number of considerations, including the interests of employees and the likely consequences of any decision in the long term (see Box 1). This formulation provides a compromise around the extent to which the law should intervene on the decisions of companies: in effect it requires *consideration* of other factors in pursuit of the primary aim of company success, but it does not prescribe any *prioritisation* of these factors.⁴⁰

Box 1: Section 172 of the Companies Act 2006

172 Duty to promote the success of the company.

1. A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
 - a) the likely consequences of any decision in the long term,
 - b) the interests of the company's employees,
 - c) the need to foster the company's business relationships with suppliers, customers and others,
 - d) the impact of the company's operations on the community and the environment,
 - e) the desirability of the company maintaining a reputation for high standards of business conduct, and
 - f) the need to act fairly as between members of the company.
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.

39 Companies Act 2006, s. 172(1)

40 Employment Law Association ([CGV0065](#)) para 3.6

26. The vast majority of the evidence we received was supportive of the existing legislation. Professional bodies and lawyers in particular argued that the legislation was well understood, at least in the listed sector,⁴¹ worked well in practice and, according to the Institute of Directors (IoD), was “largely fit for purpose”.⁴² It was argued that good boards would naturally consider and balance the interests of different stakeholders: company success depended upon it. Witnesses warned of potential unintended consequences of any changes in terms of the accountability of directors to shareholders and the impact on the attractiveness of the UK as a place to invest.⁴³ Also cited was the difficulty in finding a legal formulation that actually added clarity.⁴⁴

27. Some witnesses were more critical of the wording of section 172, arguing that, in the absence of clarity, the interests of shareholders could in practice be pursued without regard to those of other stakeholders.⁴⁵ Provided directors acted “in good faith” (or it could not be proved that they did not), they were free to do so, according to Professor Andrew Keay from Leeds University School of Law. He argued that it would not be easy for the courts to question the motives of directors and noted that the courts have been cautious in granting shareholders permission to take action against a company.⁴⁶ We heard that there have been no reported cases of shareholders bringing actions against directors in respect of section 172.⁴⁷ Professor Keay pointed out that promised guidance on how directors should comply with section 172 was never published, leaving directors, shareholders and the courts with little clarity on how the requirement to have regard to a number of factors was to be met.⁴⁸

28. Janet Williamson, from the Trades Union Congress (TUC), argued that the original wording of section 172 was based on the understanding that there was a convergence between the interests of shareholders, the company and other stakeholders,⁴⁹ but that the increase in short-term trading had shifted the interests of shareholders to favour short-term share price over the promotion of “long-term organic growth”.⁵⁰ The TUC argued that section 172 should be amended to require company directors to promote the long-term success of the company as their primary aim and that directors should be required to “have regard to the interests of shareholders, alongside those of employees and the other stakeholder groups already included in section 172”.⁵¹ In another proposed move away from shareholder primacy, Helena Morrissey, the then CEO of Newton Investment Management, argued that directors be required to “give equal importance” to all stakeholders.⁵² Standard Life argued that the legal requirement should relate to reporting, suggesting that companies be required to state more explicitly that directors ‘must consider and report’ on how they have considered other stakeholder interests.⁵³

41 Q9 [Stephen Haddrill]

42 Q9 [Oliver Parry]

43 British Bankers’ Association ([CGV0085](#))

44 Company Law Committee of the City of London Law Society ([CGV0148](#))

45 Employment Lawyers Association ([CGV0065](#)), para 3.8

46 Professor Andrew Keay ([CGV010](#)). This provision does not engage the criminal law. Shareholders may apply to the courts to take a derivative action on behalf of the company against the company itself, under section 170(4) of the Act. Some 22 such actions had been instituted by September 2015, according to Professor Keay.

47 Qs 10, 61

48 Professor Andrew Keay ([CGV010](#))

49 As envisaged by the 2001 Company Law Review which led to the 2006 Act. See TUC ([CGV0156](#)) para 2.3

50 Q9

51 TUC ([CGV0156](#) para 2.7)

52 Helena Morrissey ([CGV0017](#))

53 Standard Life ([CGV0091](#))

29. We do not believe that weaknesses in corporate governance arise primarily from the wording of the Companies Act, in particular section 172. We nonetheless recognise that the requirement for directors to “have regard to” other stakeholders and considerations is lacking in clarity and strength and is not realistically enforceable by shareholders in the courts, even if they were minded to take action against their own company directors.⁵⁴ However, with negotiations on leaving the EU about to begin, now is not the time to introduce uncertainty to UK markets by seeking to reframe the law.

30. We have some sympathy with the argument that there are insufficient incentives for directors to consider seriously the interests of other stakeholders, such as employees, supply chains and pension fund members. This point was illustrated by the finding in 2016 by the Grocery Code Adjudicator that Tesco had seriously breached the code governing the grocery market by deliberately delaying payments to boost its profits. This might be considered a failure in compliance with section 172(c), namely the duty to “have regard to the need to foster the company’s business relationships with suppliers, customers and others.” It is this balancing of different stakeholder interests that section 172 was designed to address, so it is instructive that what looks on the face of it a failure of corporate governance was remedied, not under the Companies Act (which would have required action by shareholders), but by the regulator. A board following the principles of the legislation and the Code would not have allowed this to happen. This is but one example from a growing body of evidence that directors have not paid sufficient attention to the interests of wider stakeholders, whether it be those working for them, the local community or suppliers. Recent examples exposed in the media have included ASOS, JD Sports and IKEA. Improvements in corporate governance can keep issues out of the courts: prevention is better than cure by legal means. **We believe that more effective measures are required to ensure that directors demonstrably take seriously their duties to have regard to other stakeholders and the long-term consequences of decisions. This can best be achieved by requiring more specific and accurate reporting, supported by robust enforcement.**

Reporting

31. Listed companies are subject to a variety of reporting requirements relating to financial reporting and corporate governance, including those set out in the Code itself, Part 16 of the Companies Act 2006 and the Financial Conduct Authority’s Listing Rules and Disclosure and Transparency Rules.⁵⁵ Premium listed companies are subject to higher standards of disclosure. These requirements have expanded incrementally, so now companies are required to produce a whole range of discrete reports as part of the annual reporting process. By common consent, some of these reports have become increasingly defensive in nature and legalistic in tone, as companies seek to adhere to minimum requirements for reporting. Evidence referred to “boiler-plate” statements that lacked meaning but passed the test of compliance.⁵⁶ In cases of non-compliance, the quality of explanations have been described as “disappointing” by the FRC.⁵⁷ The Investor Forum reports that reporting seems “unable to cater for the rise in the importance of a wider stakeholder group”, nor has it adjusted to the increasing tendency of company value to be

54 Q10

55 FRC, [The UK Corporate Governance Code](#), Schedule B

56 IoD ([CGV0034](#)), Professor John Kay, ([CGV0174](#)), LGIM ([CGV0095](#))

57 FRC, [Developments in Corporate Governance and Stewardship 2016](#), 2017, p26

in the form of intangible assets, such as knowledge and intellectual property rather than physical assets.⁵⁸ It is clear that many companies are failing to communicate effectively with stakeholders via the reporting process, and are therefore missing an opportunity to enhance public confidence and inform investors.

32. As part of the reporting process, companies are required to provide a high level statement of how the board operates,⁵⁹ and must include in strategy reports an assessment of the position of the business against a number of specified criteria.⁶⁰ Companies are not required to explain specifically how they have fulfilled their section 172 duties, including how they have had regard to other considerations and the interests of stakeholders whilst pursuing the success of the company in the interests of its members. As a result, it is very difficult for shareholders to hold directors to account for the fulfilment of their legal duties or understand how they have balanced the interests of various stakeholders over the course of the year. Jonathan Chamberlain of the Employment Lawyers Association told us that

We are all in agreement that, to put it at its lowest, it is very difficult to evaluate the operation of Section 172 in the absence of any real disclosure as to how it is working in practice.

33. Stakeholders have a right to expect higher standards of reporting in respect of section 172 duties: this is essential to securing improved levels and standards of engagement with shareholders. We do not want to add to the volume of meaningless, boiler-plate statements that companies produce in response to requirements.⁶¹ Instead, directors should be required to report in an accessible, narrative and bespoke form on how they have complied with their duties under section 172. This will force directors to at least actively consider how they meet these requirements during the year and increase the prominence of these other factors throughout the company and also in the minds of shareholders. The Modern Slavery Act 2016 may provide a useful model, as suggested by the Employment Lawyers Association.⁶² That Act includes a requirement for companies with an annual turnover of at least £36 million to state what steps they have taken to ensure that their supply chains have not included trafficked people. Whilst such statements are themselves subject to “boiler-plating”—and we note that there was an ostensibly compliant statement published by Sports Direct when two individuals were convicted under that Act of trafficking people from Poland to work there⁶³—they have nonetheless served to raise the profile of the issue and force companies to take their responsibilities seriously. Stricter requirements in relation to section 172 can have a similar effect.

34. We do not underestimate the difficulties of establishing consistent standards of reporting, when compliance is with a duty to “have regard to” a number of factors and is subjective to an extent but it is possible to develop a common understanding of what companies should be required to do by way of informed reporting on how they have balanced different interests. For example, they should explain the rationale behind the allocation of funds between dividends, pension funds, capital investment and other

58 The Investor Forum, [Review 2015–16](#), p32

59 FRC, [The UK Corporate Governance Code](#), p28

60 These are listed in The Companies Act 2006 (Strategic Report and Directors’ Report) Regulations 2013, made under s.414C of the Companies Act 2006

61 Q154

62 Employment Lawyers Association ([CGV065](#)); Q52

63 BBC News, [Sports Direct modern slavery brothers jailed](#), 23 January 2017

categories. Companies should be required to provide better information on *how* they have looked after the interests of employees, fostered relations with suppliers and mitigated any environmental impacts. They should also provide an explanation as to the time horizon of decision making, with respect to the duty have regard for the consequences of decisions in the long term. ***We recommend that the FRC amends the Code to require informative narrative reporting on the fulfilment of section 172 duties. Boards must be required to explain precisely how they have considered each of the different stakeholder interests, including employees, customers and suppliers and how this has been reflected in financial decisions. They should also explain how they have pursued the objectives of the company and had regard to the consequences of their decisions for the long term, however they choose to define this. Where there have been failures to have due regard to any one of these interests, these should be addressed directly and explained.***

35. There is no intrinsic need for these new reporting requirements to be part of the already voluminous documentation contained in annual reports. At a time when companies are taking advantage of new technology to communicate in ever more sophisticated ways with their customers, the annual publication of large reports seems an increasingly old fashioned and unhelpful way of communicating. Baroness Hogg was among the witnesses who advocated better use of technology to improve reporting and engagement.⁶⁴ **The FRC should encourage companies to be more imaginative and agile in communicating digitally with stakeholders throughout the year and should actively push back on the use of boiler-plate statements in annual reports, using wider powers which we argue for in the next section.**

Enforcement

36. Existing requirements relating to corporate governance are currently enforced via the comply or explain regime governed by the FRC, backed up by a legal framework that includes, for the most serious offences, punishments such as the disqualification of directors.⁶⁵ It is important to make a distinction between two objectives: advancing best practice and improving transparency, primarily via the Code; and the taking of effective action in cases where minimum standards have been breached by individual companies. There are improvements to be made on both fronts.

37. The evidence presented to us was overwhelmingly supportive of the comply or explain principle underpinning the Code. There was almost no support for supplanting this approach with more regulation. Witnesses argued that further regulation would do little to influence individual behaviour and noted that not all company failures were the result of poor corporate governance: some boards simply made legitimate decisions that turned out to be poor.⁶⁶ More significantly, it was argued that greater regulation would shift the culture towards a rules-based, compliance one, encouraging a tick-box mentality, rather than seeking to embed high standards and cultural change across the board as a self-evidently desirable objective for companies.⁶⁷ Some witnesses, notably from legal practices, argued against any change at all, maintaining that the existing legal framework governing company behaviour was sufficient, covering a wide range of areas, including

64 Q399; Private investor (name withheld) ([CGV0105](#)); ICAEW ([CVG0116](#))

65 There have been between 1,034 and 1,453 directors per annum disqualified under the Disqualification of Directors Act 1986 since 2009–10, either as result of a disqualification order or an undertaking.

66 City of London Law Society ([CGV0148](#))

67 Investment Association ([CGV0109](#))

the treatment of employees, consumer protection bribery, pensions provision, health and safety, competition and insolvency.⁶⁸ But few argued that enforcement could not be improved. The tone of many witness submissions was captured by Sarah Wilson, Chief Executive of the proxy agents, Manifest, who told us

We have a misalignment between all the parties in the system. Yes, we have very good laws and the UK Companies Act and Governance Code is something to be very proud of. But I am not in favour of new law; I want the existing ones to be enforced correctly.⁶⁹

38. A minority of witnesses cited the absence of legal action in respect of section 172, as discussed in paragraph 26, as evidence that regulation was not working and advocated the establishment of a new independent supervisory body to monitor compliance and take action where necessary.⁷⁰ Most witnesses were content with the current system, and could see the value in the flexibility offered by a system of voluntary codes and guidance, under the auspices of the FRC, with other business organisations helping to drive up standards through advocacy and pressure. We do not see sufficient reason to depart from the comply or explain principle, which is well understood and widely emulated around the world. Nor do we believe that it is necessary for the Government to establish a new regulatory body.

A stronger enforcement body

39. However, we believe that enforcement is currently not strong enough. More pressure could and should be applied to companies to ensure they comply with their legal responsibilities, and those under the Code, relating to corporate governance. There are some encouraging recent developments. In 2016 the Institute of Directors published a ranking of the FTSE 100 companies according to a set of corporate governance metrics.⁷¹ The Financial Reporting Council told us that it is currently considering engaging in more direct contact with companies on poor reporting and publicising poor practice.⁷²

40. We welcome the sharper focus being applied by the IoD and FRC on corporate governance. The rigorous, transparent rating exercises should become an integral part of the business landscape, helping shareholders to engage with, and challenge, companies whose standards appear low. In the interests of simplicity and accessibility, this should be a simple red, yellow and green rating system for the FTSE 350. To achieve maximum credibility, it should be developed with the involvement of a regulator as well as business organisations, and to give it prominence and influence companies should be required to include the consequent rating in annual reports. In the first instance, it is logical for the FRC to take this forward, building on the work of the IoD and the CBI. Over time, this enhanced and simple system should incentivise companies to improve performance, assist investors and asset managers in making decisions and explaining them. Poor corporate governance should ultimately have an impact on share price—the most effective deterrent. ***We recommend that the Financial Reporting Council works with business organisations to develop appropriate metrics to inform an annual rating exercise. This***

68 Mazars ([CGV0134](#))

69 Q122

70 TUC ([CGV0156](#)), Sheffield Institute of Corporate and Commercial Law ([CVG037](#)), Professor Andrew Keay ([CGV0010](#))

71 IoD, [The 2016 Good Governance Report](#), 2016

72 [Letter from FRC](#), 30 November 2016; Q23

should publicise examples of good and bad practice in an easy to digest red, yellow and green assessment. Companies must be obliged to include reference to this rating in their annual reports.

41. Reporting examples of bad practice is not enough. At present, the FRC has powers to monitor a company's strategic report and financial statements but not in respect of other aspects of reporting. It can take action against directors only if they happen to be accountants, auditors or actuaries.⁷³ This is because the FRC is, as its name suggests, a regulator of financial standards which has acquired more responsibilities relating to other aspects of corporate governance. The FRC is seeking wider powers, via changes in legislation, to enable it to investigate and pursue potential breaches of existing duties under section 172 by any directors, not just those who happen to be auditors, accountants or actuaries. To do this properly, it will need new powers to secure information in order to take action directly with the companies. The frequent use of investigatory powers by other regulators, such as the Care Quality Commission, could provide a model for the enhanced FRC role. It could conduct a small number of spot checks each year, potentially using a risk based approach. The prospect of investigation by an expanded FRC in respect of section 172 duties is a much more effective deterrent than the remote prospect of legal action by shareholders. Such an enhanced role will no doubt require extra resources, which the FRC should pay for via a small increase in the levy which funds it.

42. We recommend that the Government brings forward legislation to give the Financial Reporting Council the additional powers it needs to engage and hold to account company directors in respect of the full range of their duties. Where engagement is unsuccessful, we would support the FRC in reporting publicly to shareholders on any failings of the board collectively or individual members of it. If companies were not to respond satisfactorily to engagement with the FRC, we recommend that the FRC be given authority to initiate legal action for breach of section 172 duties. Given the broader powers we have recommended in this Report, the Government should consider re-establishing, renaming and resourcing appropriately the FRC to better reflect its expanded remit and powers.

43. In cases of potentially serious bad practice or corruption, there are other tools available. Under the Companies Act 1985 the Secretary of State has a range of powers to send in inspectors to investigate the affairs of a company, where for example, the circumstances suggest grounds for suspicion of fraud, misconduct, conduct unfairly prejudicial to shareholders or of failure to supply shareholders with information they may reasonably expect.⁷⁴ Inspectors may also be sent in at the request of a specified percentage of shareholders and to investigate the membership of any company in order to determine for certain those financially interested in the success or failure of a company or able to control it. These powers have been used in respect of the Insolvency Services' ongoing inquiry into BHS, and should be exercised aggressively when there are grounds to do so. **Rather than seek to introduce any new legislation, we would urge the Secretary of State to be more prepared than is presently the case to use existing powers where there is any suspicion of serious wrongdoing that may be in breach of the law. A public statement by Ministers to the effect of being considerably more pro-active in this areas may also have a welcome deterrent effect.**

73 [FRC letter to Committee](#), 30 November 2016; Q23

74 Part XIV of the Companies Act 1985, as amended by [the Companies Act 2006](#); Companies (Audit, Investigations And Community Enterprise) Act 2004

Investor and company engagement

The objectives

44. Good engagement by investors with company management is essential to improving standards of corporate governance as well as company performance. Effective engagement allows shareholders to better judge the effectiveness of board members, to understand their long-term strategy and to assess whether they are fulfilling their duties with regard to all stakeholders, as required by law. Engagement is supported and promoted through the FRC’s Stewardship Code. This has served to drive improvements by requiring signatories to report on their stewardship activities, such as engagement with companies not just on pay, but on strategy, risk, culture and environmental issues.⁷⁵ There are a variety of forms of engagement, ranging upwards from private conversations with board members, through to more formal and collaborative engagement through the Investment Association or Investor Forum, with the ultimate possibility of voting against the re-appointment of directors or specific resolutions at annual general meetings (AGMs).

45. Shareholders will of course have diverse objectives and may not necessarily be expected to engage proactively, nor to press for any other objectives than increasing share prices. However, we believe that greater transparency and accountability throughout the investment chain is the best way to improve the quality of the dialogue between shareholders and company boards and ultimately serve to improve public trust and company performance. Ultimately, it is pension holders and individual savers who are—through a number of intermediaries usually—supporting the board in its decisions. The public relies on the stewards of its money to exercise judgement on its behalf. Institutional asset owners, such as insurance companies and pensions funds, must be required to explain their approach to stewardship and asset managers should similarly be required to account for the way in which their engagement with companies, through voting and less formal means, has been in line with this mandate. The aim should be for standards of both corporate governance and investor stewardship to become an ever sharper focus of attention and even competition, which will drive up standards and help embed a culture of excellence.

The practice

46. There were considerable concerns about the quality of shareholder engagement in the evidence we received. Ken Olisa, Deputy Chairman at the IoD, told us that in his experience “shareholder engagement is extremely poor”⁷⁶ and that the press did a better job of applying pressure to companies than shareholders.⁷⁷ The Chief Executive of ShareAction, Catherine Howarth, argued that while directors’ duties are clearly set out in law, there were no corresponding requirements on shareholders. She argued that a lack of transparency around conflicts of interest and voting by institutional investors had been major stewardship failings.⁷⁸

75 FRC, [Developments in Corporate Governance and Stewardship](#), January 2017, p25

76 Q417

77 Q442 [Ken Olisa]

78 ShareAction ([CVG0124](#))

47. On the other hand, Andrew Ninian, from the Investment Association, defended shareholders, asserting that they spent a lot of time engaging with companies and argued that engagement was becoming increasingly prevalent.⁷⁹ In recent years there has been a welcome increase in attention on the stewardship duties of investors, both internationally and domestically. The OECD has developed principles on engagement. At a European level, the Shareholder Rights Directive, which relies on the UK comply or explain model, is moving towards implementation. In the UK, the FRC reports regularly on compliance with its Stewardship Code,⁸⁰ flagging up examples of best practice, and has now begun a tiering exercise to differentiate the performance of different asset managers according to an assessment of their performance.⁸¹ The Investment Association argued for enhanced stewardship in its 2016 Productivity Action Plan and is engaged in a number of activities promoting better engagement.⁸² The establishment of the Investor Forum is a positive development and has helped to provide a space for such co-ordinated engagement to take place.⁸³ It reports that it now has 33 members with UK equity investments representing some 35 per cent of the value of the FTSE share index,⁸⁴ although it has so far limited its engagement to only the most serious cases.⁸⁵ The Forum is a welcome initiative but it has the potential to develop much further. *We recommend that the Investor Forum seeks to become a more pro-active facilitator of a dialogue between boards and investors by engaging in regular routine dialogue in order to pick up on any widespread concerns, for example those identified by the new FRC rating system.*

48. There are valid reasons why engagement remains a challenge, given the different objectives of the different players in the investment chain and the highly dispersed nature of share ownership and the trend towards passive rather than managed funds.⁸⁶ Given diversification of stock portfolios, few investors have sufficient “skin in the game” to justify the high costs of engagement. Effective engagement and monitoring of management actions and boardroom decisions can be a resource intensive activity. It may make more economic sense to be a “free rider”, relying on a small number of activist investors to monitor the board. One major institutional investor went so far as to claim that the high costs meant there was a market failure on engagement that warranted the imposition of a Government levy on business in order to fund it.⁸⁷ For index fund managers and for other passive investors, particularly those with relatively small shareholdings, there is little or no incentive to engage. For institutional shareholders as well as individuals, a decision to sell may be a more rational and immediate approach to securing value than expensive and unpredictable engagement.

49. In these circumstances, there are no easy answers to securing better engagement. Peer pressure, greater exposure of poor practice and leading by example are a start: reputational damage can be a powerful influence. There are signs that some of the major investment companies are flexing their muscles, particularly in respect of executive pay. In January

79 Investment Association, (CGV0109)

80 FRC, [The Stewardship Code](#), 2010

81 FRC, [Developments in Corporate Governance and Stewardship 2016](#), January 2017

82 Investment Association, [Supporting UK productivity with long-term investment](#), March 2016

83 Engagement is subject to the EU Market Abuse Regulations; Fidelity International (CGV0107)

84 The Investor Forum, [Review 2015–16](#), p7

85 The Forum reports 8 “comprehensive collective engagements” and a further 8 situations that involved discussions but did not lead to full engagement. For example, it helped investors in Sports Direct combine to apply pressure on the owners on issues of governance.

86 See for example, Financial Times, [Blackrock cuts ranks of stockpicking fund managers](#), 28 March 2017

87 Hermes Investment Management ([CGV0090](#))

2017 the US investment fund, Blackrock, reportedly wrote to 300 UK companies warning that they would be taking a tough stance on excessive pay increases, particularly those not linked to long-term performance.⁸⁸ ShareSoc and UK Shareholders' Association sought to present a resolution at the next RBS AGM to establish a Shareholder Committee. In response, the bank is proposing the establishment of stakeholder engagement panels.⁸⁹ There are signs that in the US there is an increasing focus on governance issues, with the publication of two Governance codes recently, which include stewardship responsibilities as well as company-related best practice.⁹⁰ These developments are encouraging although as yet unproven in terms of results.

50. It could be argued that provided there are some responsible active investors to exercise stewardship functions, a degree of “rational apathy” may not only be the right approach for many but also the most efficient use of resources, for both companies and investors. Too much engagement serves the interests of no-one. This model may be an acceptable goal, provided that there is an effective and accessible forum for active shareholders to explain their activities to other shareholders as necessary. This is a potential role for the Investor Forum, as outlined above, but in an increasingly complex investor environment with proxy voting agencies and foreign investors more to the fore,⁹¹ it will require a considerable amount of work to co-ordinate activity, and to develop the necessary degrees of trust and quality communication.

51. It is ultimately the responsibility of the asset owners—including the pension funds and insurance companies—to secure high quality engagement by those managing their investments as part of the mandate agreed between asset owner and manager. This point was stressed by the Executive Director of the International Corporate Governance Network, Kerrie Waring, in respect of agreeing environmental, social and governance (ESG) issues,⁹² although other witnesses maintained that some asset managers were reluctant to take on board these concepts.⁹³ The institutional investors need to articulate and justify their approach to engagement⁹⁴ and greater transparency is required on the role of asset managers and proxy agents in order to demonstrate how they are taking stewardship seriously.

52. There are a number of models for enshrining and promoting better engagement. The appointment of one board member with specific responsibilities for stakeholder engagement would be another approach, as cited in the Green Paper. Several witnesses highlighted the potential better use of more sophisticated, digital engagement via online forums.⁹⁵ We agree with the witnesses who emphasised that it is not about quantity but quality,⁹⁶ so simple requirements relating to number of meetings are not necessarily productive, and may tend toward the compliance mentality that can be the lazy alternative to genuine cultural change.

88 [World's largest fund manager demands cuts to executive pay and bonuses](#), The Guardian, 17 January 2017

89 RBS news story on [stakeholder engagement](#), 30 January 2017

90 [The battle of the US corporate governance codes](#), Financial Times, 5 February 2017

91 Q383

92 Q153 [Kerrie Waring]

93 Q122 [Sarah Wilson]

94 Q155

95 ShareSoc ([CGV0021](#)); John Davies ([CGV0003](#))

96 Eg Investment Association, Q419; Legal & General Group ([CGV098](#))

Stakeholder advisory panel

53. We heard strong support for the idea of stakeholder advisory panels, from the TUC, Tomorrow's Company and Blackrock amongst others.⁹⁷ An advisory panel would provide a more formal framework for directors to seek the views of stakeholders on specific issues, such as the company's executive remuneration policy and its strategy. This consultative body would not simply be a meeting at the end of the process, to endorse the decisions of the remuneration committee, but would be a forum for meaningful dialogue during the development of policies. It would generate greater trust, by offering more depth to the relationship between the board and its stakeholders, including employees, and, more important, help to alert the board to potential problems. We do not believe that such a panel, if handled correctly, would be a threat to the concept of the unitary board, which we strongly support.

54. The diversity of businesses militates against the imposition of a single route for conducting engagement, so we would not wish to see one particular model mandated. However, the establishment of a stakeholder advisory panel would provide useful, more formal, feedback for boards and would potentially be a powerful demonstration of a company culture that values broad engagement and a collaborative approach. All businesses should be required to facilitate engagement, by whatever means suits best, and to report on the steps they have taken. Failure to engage adequately would be subject to further investigation by the FRC. ***Stakeholder advisory panels can be a useful forum in which meaningful collaboration, consultation and dialogue with all stakeholders can take place. We urge companies to consider establishing such bodies. We recommend that the Code should be revised to require a section in annual reports detailing how companies are conducting engagement with stakeholders.***

55. A similar approach should be applied to stewardship. ShareAction produces a public ranking, assessing investors' performance in providing oversight on behalf of those that invest through them. The FRC's annual report on stewardship provides useful information on levels of compliance, but as a tool of enforcement, it is pretty limp. It highlights those companies doing a good job, and lists those that have been subject to significant minority votes at AGMs, but it does not single out specific companies for poor practices in a way which is capable of attracting attention and influencing behaviour. A more aggressive approach is required. To be effective, the Code also needs sharpening up. The principles it includes are worthy and unarguable, but too high level to be capable of effective enforcement in all but the most blatant cases. Investors must be required to explain *how* they have exercised their stewardship functions. We believe that stewardship—like other aspects of corporate governance—should be seen as an avenue for competition, which over time will help to drive up standards.⁹⁸ ***We welcome the assessments made and published relating to the performance of institutional investors in terms of their stewardship functions but believe that further action is required. We recommend that the FRC reviews its Stewardship Code with a view to providing: more explicit guidelines on what high quality engagement would entail; a greater level of detail in terms of requirements; and an undertaking to call out poor performance on an annual basis.***

97 [Bringing employee voice into the Boardroom](#), November, 2016. BlackRock; TUC ([CGV0156](#))

98 Q92

Transparency and the role of advisors

56. The relationship between investor and companies is complicated by a number of different intermediaries and advisors. The board will have advisors covering different aspects of company performance; the executive team will have advisors; individual directors may have their own advisors, for example on pay; the Remuneration Committee will take advice; fund managers will also have a network of advisors; proxy agents acting on behalf of investors may also have their own advisors. The complexity of the investment chain provides work for armies of lawyers, investment bankers, auditors, analysts and public relations advisors. In his review of the equity markets, Professor Kay sought to promote trust and a culture of stewardship throughout the investment chain by establishing good practice statements by participants. We have not seen evidence that these good practice statements have been effective, or even been taken much notice of, nor that the degree of cultural change that he sought has been achieved.

57. In evidence to us, many companies providing advice pointed to existing requirements around transparency, such as requirements in the Code to disclose the use of external consultants for the purposes of recruitment, external board evaluations and audit.⁹⁹ Some did not recognise a need for further transparency, as it was directors who ultimately made decisions.¹⁰⁰ Others suggested that the Takeover Code provided sufficient transparency requirements. It was also suggested that imposing more transparency may be counterproductive, as boards may be dissuaded from taking critical advice¹⁰¹ and that too much disclosure may make it harder “to see the wood for the trees”.¹⁰² Further concerns expressed were that more transparency might give a false impression that directors were transferring responsibility to advisors for their decisions,¹⁰³ and that disclosure of advisers’ fees might be misleading.¹⁰⁴

58. Others took a different view on the need for greater transparency. Business organisations generally expressed support for greater transparency and openness. From the perspective of the investor, the Investment Association said that while global figures for pay to listed advisors may not add much useful information. They had long argued in favour of more transparency on the fees paid to advisors in individual transactions, and the basis for those fees: for example, whether they are on a contingency basis (success fees) or whether the timing and amount payment depends upon other conditions.¹⁰⁵ Standard Life said

We believe that there are too many intermediaries involved in the stewardship chain. The use of advisors has become too commonplace and the incentives of many of these advisors are not aligned with good outcomes for companies, shareholders, employees or broader society. We are concerned that the use of advisors can be detrimental to clear communication and engagement between companies and their shareholders.¹⁰⁶

99 Equality and Human Rights Commission ([CGV0152](#))

100 ICSA: The Governance Institute ([CGV0111](#))

101 Q100

102 Professor Paul Moxey ([CGV0041](#))

103 Association of Chartered and Certified Accountants) ([CGV0100](#))

104 Q102

105 The Investment Association ([CGV0109](#))

106 Standard Life ([CGV0091](#)); Q67

Other investors agreed that greater transparency, particularly in terms of mergers and acquisitions, would serve the interests of protecting long-term value.¹⁰⁷ The IoD and FRC suggested that new requirements relating to disclosure around transactions should have some size threshold, to avoid undue burdens.¹⁰⁸

59. Advisors are an essential and inevitable part of the investment chain. They help all parties to obtain proper information and advice on the legal and financial implications of activity and assist in evaluating the risks. As a world leading provider of financial and business services, it is important that the UK takes a lead in establishing the highest possible standards. It is up to professional bodies to monitor and enforce professional standards in their respective fields, but transparency surrounding their involvement in the investment chain and in business transactions fall within the sphere of corporate governance. Transparency is essential to enabling investors to engage fully and, more broadly, to improving public trust. It also serves the interests of diversity: companies should justify the process of appointment, if not by competitive tender. During our inquiry into BHS, a private company, we saw the importance, in reviewing a transaction, of understanding who was being engaged by whom, and on what financial basis. It is of course up to directors to determine which advice to listen to, if any, but equally, those with an interest are entitled to know who has been involved. ***We recommend that the Government consults upon new requirements on listed and large private companies to provide full information on advisors engaged in transactions above a reasonable threshold, including on the amount and basis of payments and on their method of engagement.***

Voting records

60. We heard that disclosure of voting records by fund managers—established in the Stewardship Code as best practice—was not always complied with, and several witnesses called for greater transparency on this front.¹⁰⁹ We heard from ShareAction that asset managers are effectively competing against a benchmark on an annual basis.¹¹⁰ They are incentivised accordingly to pursue short-term gains in their investments rather than pursuing long-term value.¹¹¹ Some have pointed to a disconnect between voting records and stated intentions,¹¹² due in part to the presence of intermediaries.¹¹³ ***Increased transparency and accountability are the best routes to promoting better stewardship, high quality engagement and public trust. We recommend that the FRC includes in its revised Stewardship Code stronger provisions to require the disclosure of voting records by asset managers and undertakes to name those that subsequently do not vote.***

Non-executive directors

61. The legal duties of non-executive directors (NEDs) are the same as for executives and they share responsibility for any business failure. In reality, NEDs perform very different

107 LGIM ([CGV0095](#))

108 IoD ([CGV0034](#)); Q41

109 Mercer ([CVG0101](#)); Unite ([CGV0094](#))

110 ShareAction ([CGV0124](#))

111 Q84, Spencer Stuart ([CGV0092](#))

112 For example, ShareAction, [Press notice](#), 18 May 2015

113 Manifest ([CVG0062](#))

functions from executives. The Code sets out as a main principle that “non-executive directors should constructively challenge and help develop proposals on strategy” and sets out in more detail the requirements of the role:

Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing and, where necessary, removing executive directors, and in succession planning.¹¹⁴

62. The role of NEDs is also affected by an asymmetry of information provision: they will not generally have access to the full range of management information provided to the executive team, nor could they realistically expect to have time to consider it all.¹¹⁵ We heard that companies tend to allocate particular responsibilities to individual directors and the position of a “senior NED” is now well established and advised in the Code,¹¹⁶ but no such distinction exists in legislation. A minority of witnesses, including the IoD, argued that “There should be greater distinction” in law.¹¹⁷ In practice, the courts would be expected to take into account the particular circumstances and role of each director in apportioning responsibility.¹¹⁸

63. Witnesses pointed out that NEDs who tend to challenge may not always be welcome, or be retained on the board.¹¹⁹ A board must be able to be cohesive and supportive as well as genuinely challenging. This is no easy balance to strike; and achieving it is a crucial role for the chair. We saw in our BHS inquiry what can happen if it is not right: the consequences when NEDs do not provide the degree of constructive challenge required, or indeed participate at all in key decisions.¹²⁰ Investigations into the causes of the banking crisis were highly critical of the challenge provided by inexperienced non-executive directors. The Treasury Select Committee commented “Too often, eminent and highly-regarded individuals failed to act as an effective check on, and challenge to, executive managers, instead operating as members of a ‘cosy club’.”¹²¹

64. We are in no doubt about the vital role that NEDs have in company governance and are concerned about the impact of what we heard were ever increasing burdens on their ability to perform their role effectively, particularly if they serve on several boards. We believe that all directors, and particularly NEDs, should be given the training and professional development they need in order to allow them to fulfil their responsibilities

114 FRC, [UK Corporate Governance Code](#), April 2016, p9

115 Investment Association ([CGV0109](#)); FRC, [Corporate Culture and the Role of Boards](#), Report of Observations, July 2016, p11

116 NJMD Corporate Services ([CGV0028](#)); FRC, [UK Corporate Governance Code](#), April 2016, p9; Q31

117 Q32; John Davies ([CGV0003](#))

118 Q33

119 Chris Philp MP ([CGV0089](#))

120 [BHS](#), First Report of the Work and Pensions Committee and Fourth Report of the Business, Innovation and Skills Committee, Session 2016–17, HC54, para 135

121 Prudential Regulation Authority and Financial Conduct Authority, [The Failure of HBOS plc](#), April 2015; Treasury Committee, Ninth Report of Session 2008–09, *Banking crisis: reforming corporate governance and pay in the City*, [HC 519](#); see also First Flight Non-Executive Directors ([CGV0167](#))

with confidence and full effectiveness.¹²² We heard that while some companies provide comprehensive briefing to new directors and are prepared to pay for professional advice for NEDs, this is not universal practice. It is the responsibility of companies themselves—not Government—to ensure that their board members are well equipped for the role. There are commercial providers already, but there may be a role for the IoD, working with other bodies, to take a lead. ***We recommend that the FRC includes best practice guidance on professional support for non-executive directors when it updates the Code and that companies include training of board members as part of reporting on their people or human resources policy.***

65. We are also concerned that statute law has not kept pace with the evolution of their role, and that the courts are left to interpret the particular dynamics of a boardroom on a case by case basis. The Investment Association was not convinced a change in the law would add more than could be achieved by changes to the Code.¹²³ Any change in the law to recognise the different functions of NEDs would necessarily need widespread prior consultation to consider all the potential legal ramifications. We do not consider that this is necessary at this stage, but we do believe that there is a case for greater certainty, for the benefit of directors and shareholders alike (and in very rare instances, the courts). The effectiveness of NEDs should be considered carefully in annual director reviews, and also in the external board review required every three years. ***We recommend that the FRC updates the Code to provide guidance on how companies should identify clearly and transparently the roles of non-executive directors where they have particular responsibilities and how they should be held to account for their performance. We further recommend that NEDs should be required to demonstrate more convincingly that they are able to devote sufficient time to each company when they serve on multiple boards.***

122 This was advocated in the Higgs Report in 2003.

123 Q423

4 Private companies

66. In our joint inquiry with the Work and Pensions Committee into the collapse of BHS, we reported on how weak corporate governance enabled Sir Philip Green to use a network of private companies to channel profits to a family business located offshore. This was apparently legal, but without the transparency required of listed companies, it was difficult to follow the money and understand why the pension fund fell into substantial deficit. In the light of the alarming evidence we took from board members of Sir Philip's companies (where the chair of the board was not even invited to the meeting that determined the sale of BHS), we undertook to consider further whether private companies should be subject to more stringent requirements regarding corporate governance and reporting. The Government's Green Paper on Corporate Governance sought views on whether the corporate governance framework should be strengthened for the largest privately-held businesses, and if so, how?¹²⁴

67. Whilst the legal duties of directors are the same, regardless of company status, private companies are not subject to the same reporting requirements of public companies, nor listed companies. Instead, there are minimal requirements to report basic information regarding directors and to file accounts with Companies House. There are currently some 2,600 private companies in the UK with over 1000 employees. Trends over the last 20 years indicate a drop in the number of listed companies.¹²⁵ Explanations offered include the suggestion that some companies are delisting in order to avoid the additional scrutiny associated with listed companies, although the increasing availability of funds from sources other than equity markets may be more significant.

68. Much of the evidence we received agreed with the different treatment for corporate governance purposes of private companies and many argued that the imposition of greater regulatory burdens was not warranted. Witnesses argued that for most private companies there is little separation between ownership and control, so the company would in effect be reporting to itself about itself on governance principles that did not apply.¹²⁶ Furthermore, it was argued that the sheer variety of private companies would make it difficult for a single Governance Code to be applicable to all.

69. The arguments in favour of greater transparency and accountability for private companies are based on the premise that those with a significant presence in the community have wider social responsibilities too and should be required to report on non-financial matters for the benefit of employees and other stakeholders.¹²⁷ They should be subject to minimum standards of corporate social responsibility. Most of those who made this case acknowledged the potentially disproportionate nature of new requirements and argued that only those companies above a certain size should be subject to new requirements. The FRC proposed that qualifying companies should be based upon a minimum turnover or number of employees.¹²⁸

124 [Corporate Governance Reform Green Paper](#) p48

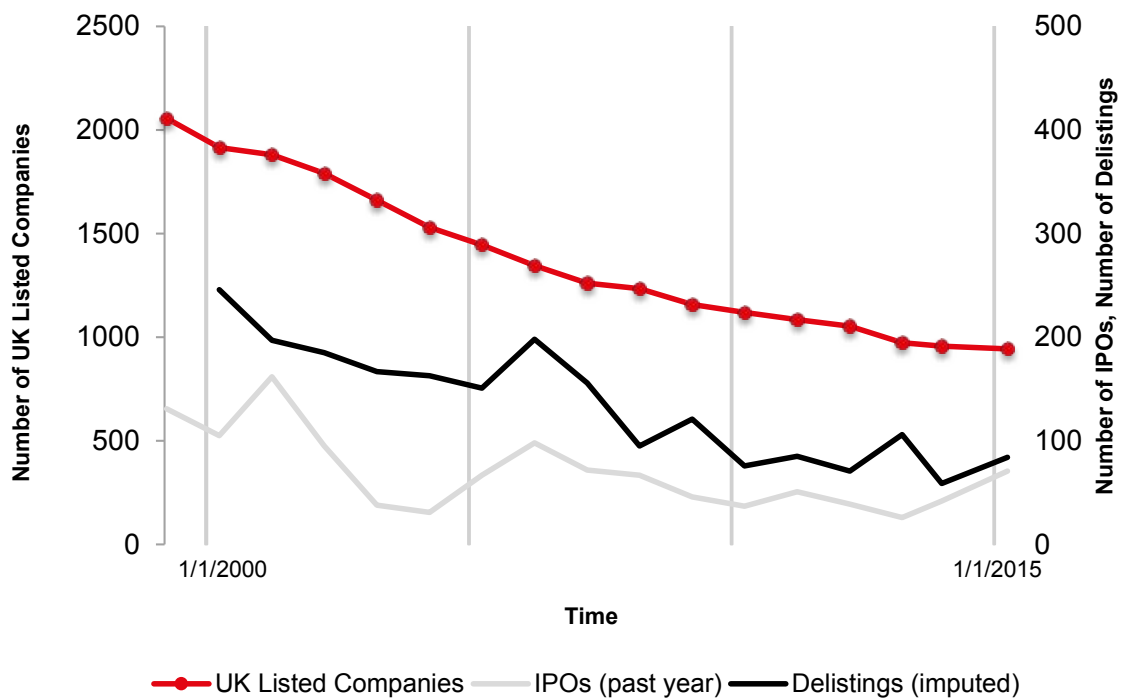
125 See figure 5 below

126 ICSA: The Governance Institute ([GCV0111](#)); Qs 65, 108

127 TUC ([CGV0156](#))

128 Financial Reporting Council ([GCV0078](#))

Figure 5: Number of new listing and delistings between 1999 and 2012 for the UK



Source: From Purposeful Company, Interim Report, May 2016 p 71 (Julian Franks and Colin Mayer (2016) based on data from the London Stock Exchange)

70. The trend in the number of UK businesses, particularly micro-businesses employing fewer than ten staff, is upwards and that of listed companies downward.¹²⁹ Regardless of whether these trends continue, we believe that large privately-owned companies with a significant footprint in society should be required to demonstrate that they adhere to certain minimum standards, not only to mitigate the risks of failure, but to increase engagement with, and the confidence of, the communities from which they draw their workforce and in which they seek to sell their goods and services. No law or governance code can eradicate the risk of serious failings of corporate governance, risks that are higher where there are small boards and dominant personalities involved, but a Code can serve to raise awareness of good practice and, over time, help to improve standards of corporate governance in private companies, large and small.

71. It would not be sensible to simply apply the existing Governance Code to private companies for the reasons cited in paragraph 64.¹³⁰ An alternative is required and there are many models from which to choose. The IoD has developed guidance for unlisted companies;¹³¹ the big four accountancy firms have agreed on a voluntary basis to an FRC Code for audit firms; there is also a Code published by European Confederation of Directors' Associations.¹³² The private equity industry established a new association (the Private Equity Reporting Group) in 2008 to monitor and report annually on industry compliance with guidelines covering disclosure of information.¹³³ Annual reports by the independent association have indicated that compliance rates have generally been as high

129 There are nearly 10,000 private companies in the UK with more than 250 employees.

130 Q19

131 Institute of Directors, [Corporate Governance Guidance and Principles for Unlisted Companies in the UK](#)

132 [Corporate Governance Reform Green Paper](#) p46; Q108

133 The guidelines were drawn up following a review by Sir David Walker of private equity in 2007.

as those for listed companies, although there have been fluctuations. Whilst these annual reports are based on a sample of companies and do not tend to name companies failing to comply, the model itself appears to be an effective regulatory solution.

72. A new regime for private companies should aim to build public trust by improving transparency and confidence in private companies. It should serve to drive up standards of corporate governance and provide a mechanism for any potential failings to be flagged up and pursued with the company concerned. Our preference is for new requirements to be consistent with the existing comply or explain approach for listed companies and that they should be both proportionate and flexible, to reflect the diversity of companies potentially covered. New requirements to publish bulky annual reports are not the best way forward and we would not want to see large private companies burdened with additional onerous regulation. Instead, we favour the development of a new voluntary Code for large private companies. Depending on the number of companies covered, enforcement may be difficult for any organisation, as was pointed out by the IoD, who suggested that some form of sampling might be the most that could be expected.¹³⁴ That seems reasonable.

73. We advocate a light touch approach based on providing specified information, but potentially covering revenues, compliance with section 172 of the Companies Act 2006, company structure, executive pay, numbers of employees and pension scheme contributions. This information might best be provided on websites, rather than contained in published annual reports. It should be provided on a comply or explain basis, like the existing Code for listed companies. The FRC has offered to develop and oversee a Code for private companies.¹³⁵

74. In terms of the threshold for companies to participate, we would envisage starting with the largest employers, say those with over 2,000 employees.¹³⁶ This threshold may be lowered over time as the Code gains credibility and becomes something that private companies actively want to comply with for reputational reasons. High standards of corporate governance thereby become publicly linked to public confidence and company value. We would leave it to existing interested organisations to develop the details of the proposed Code, but it should be broadly in line with the existing Code in respect of reporting duties on section 172, but sufficiently flexible to provide meaningful requirements for the diverse range of large private companies. Depending on the numbers of companies involved, compliance might be monitored on the basis of a risk-assessed sample. Reporting on compliance by the new regulatory body should include the naming of companies if behaviour is particularly poor. ***We recommend that the Financial Reporting Council, Institute of Directors and Institute for Family Business develop, with private equity and venture capital interests, an appropriate Code with which the largest privately-held companies would be expected to comply. They should contribute to the establishment of a new body to oversee and report on compliance with the Code. We further recommend that the new Code includes a complaint mechanism, under which the overseeing body could pursue with the company any complaints raised about compliance with the Code. The scheme should be funded by a small levy on members. Should this voluntary regime fail to raise standards after a three year period, or reveal high rates of unacceptable non-compliance, then a mandatory regulatory regime should be introduced.***

134 Q20

135 [FRC, Letter to the Committee](#), 30 November 2016

136 Accurate statistics are not available, but this figure may cover up to around 100 companies.

5 Pay

Is the system working?

75. In her campaign speech before becoming Prime Minister, Theresa May criticised “an irrational, unhealthy and growing gap between what the companies pay their workers and what they pay their bosses.”¹³⁷ The overwhelming majority of respondents in our inquiry favoured some degree of reform on executive pay. Many considered the current system to be broken.¹³⁸ There was general agreement that remuneration packages have become too complicated. Many argued that executive pay was simply too high and could not be justified in terms of both the link to levels of performance and the growing gap with the pay of other employees.¹³⁹ This view chimes with public opinion. Nearly three quarters of employees believe that CEO pay in the UK is generally too high;¹⁴⁰ survey evidence also suggests that public anger over pay remains the biggest threat to the reputation of business.¹⁴¹ A number of recent reports have highlighted the pay gap: two thirds of FTSE 100 CEOs are paid over 100 times the average salary in the UK.¹⁴² The Government’s Green Paper refers to “a widespread perception that executive pay has become increasingly disconnected from both the pay of ordinary working people and the underlying long-term performance of companies.”¹⁴³ Even those respondents who were not against the current arrangements in principle thought that the public perception that executive pay is too high had to be addressed in the interests of restoring public trust and the implicit social contract between business and society.¹⁴⁴

76. There was an alternative view in submissions to us, mainly advanced by fund managers and remuneration consultants, that the current arrangements were working broadly satisfactorily. It was argued that pay rises for major company chief executives were not out of line with those in other sectors such as private equity, entertainment and sport.¹⁴⁵ Others argued that it was unfair to focus attention on only a small number of companies in the listed sector where pay was published¹⁴⁶ and that high levels of pay was not just an issue for public companies, but for other organisations too.¹⁴⁷ Some warned against any action that would harm the ability of leading companies to attract scarce talent in a highly competitive international market. They argued that the market for top executives was completely different to the employment market as a whole, where supply is generally not such an issue and where the potential impact on company performance is not as high.¹⁴⁸

137 Rt Hon Theresa May MP, [speech](#) 11 July 2016

138 Eg IoD ([CGV0034](#)), CIPD ([CGV0110](#)), Professor John Kay ([CGV0174](#))

139 Institute for Business Ethics ([CGV0016](#)), University College London ([CGV0032](#))

140 CIPD [Pulse Survey](#), December 2015. See also, for example data from the last British Social Attitudes Survey showing that 78 per cent considered the gap between high and low incomes to be too large, cited by Charlotte Villiers ([CGV0013](#))

141 IoD survey, quoted in The Modern Corporation Project ([CGV0165](#))

142 The Equality Trust, [Pay Tracker](#), March 2017

143 [Corporate Governance Reform Green Paper](#) p16

144 ICAEW ([CGV0116](#)), Modern Corporation Project ([CGV0165](#)); Q159

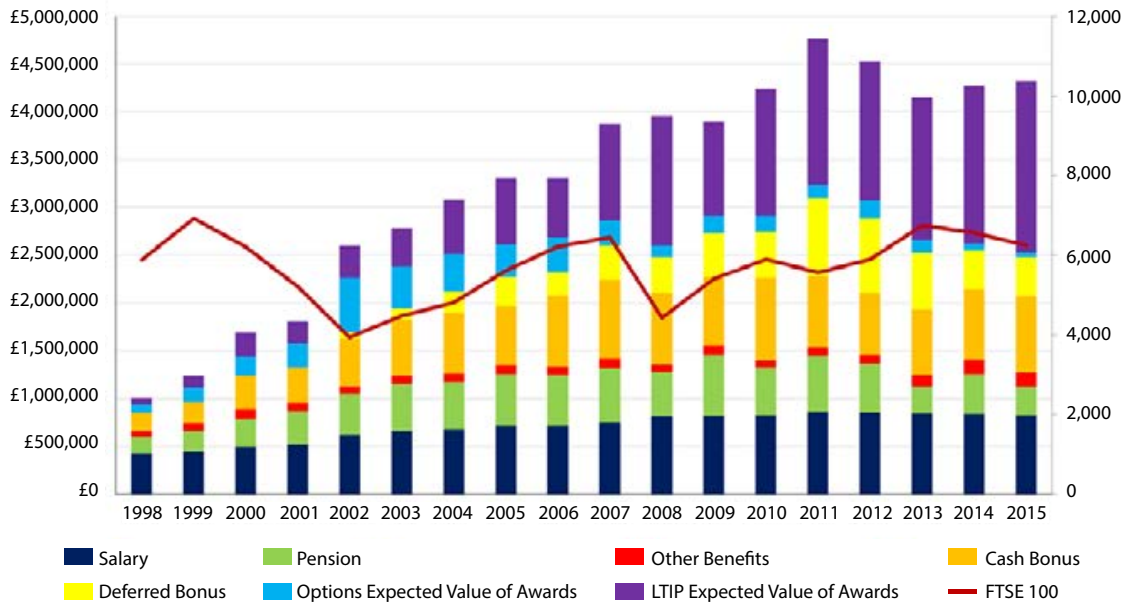
145 New Bridge St ([CGV0093](#))

146 New Bride St ([CGV0093](#)), ICSA: The Governance Institute ([CGV0111](#)), The Investment Association ([CGV0109](#))

147 ICSA: The Governance Institute ([CGV0111](#))

148 New Bridge St ([CGV0093](#))

Figure 6 Changing structure and levels of executive pay



Source: HM Government, Green Paper on Corporate Governance

Drivers of pay increases

77. There was a reasonable degree of consensus in the evidence we received on the factors contributing to increasing rates of executive pay. These can be summarised as:

- **Globalisation:** the size of multinational businesses has increased substantially, leading to higher rewards for more responsibility and financial impact;¹⁴⁹
- **Scarcity of talent:** a low supply of proven CEOs increasing their price and improving their position when renegotiating contracts;
- **Performance-related pay:** badly designed performance related pay sometimes has led to rewards that do not properly reflect performance;
- **Remuneration consultants:** they tend to benchmark from the median, leading to a ratcheting up of pay,¹⁵⁰ an effect that has, arguably, been assisted by the publishing of executive pay levels;¹⁵¹
- **Remuneration committees:** they are not able or willing to challenge excessive pay awards, due in part to the complexity of the structure or for reasons of mutual benefit;
- **Shareholder engagement:** a lack of engagement on pay or active support for high pay awards;

149 Qs 166 and 172 [Sir John Hood]

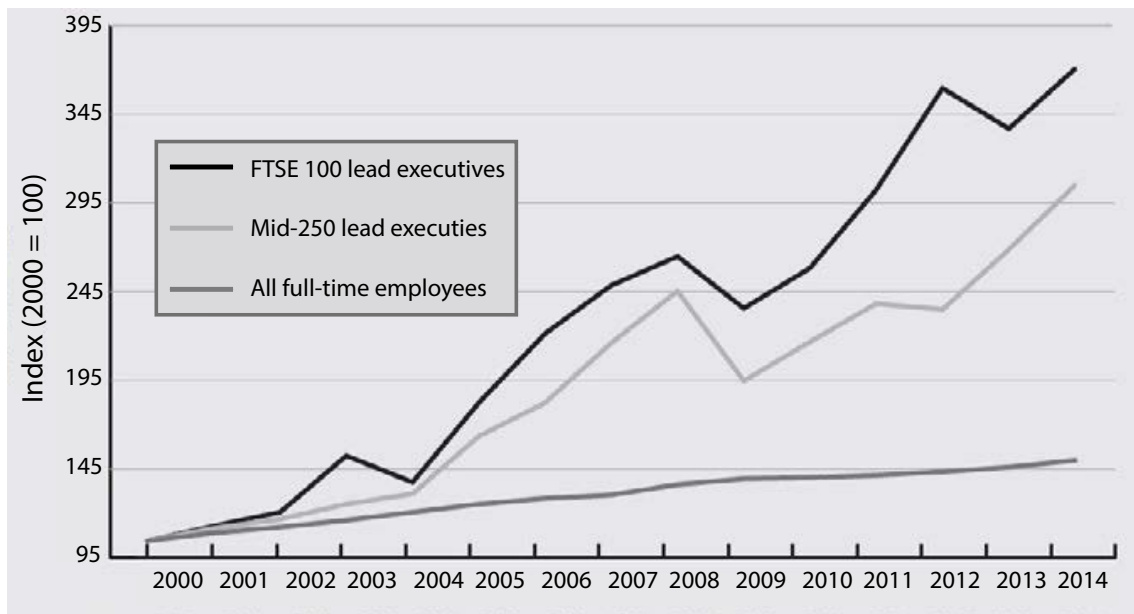
150 Q166 [Helena Morrissey]

151 Q167 [Amra Bilic]; Employment Lawyers' Association ([CGV0065](#)); ICA The Governance Institute ([CGV0111](#)), ICAEW ([CGV0116](#))

- **Weak boards:** ultimately boards are responsible and their governance arrangements are not always strong enough to resist upward pressures on pay, nor do they want to risk the disruption of a new CEO;¹⁵²
- **Executive greed/contagion:** no CEO will be advised to accept lower pay than the industry benchmark and high pay in one company or sector can “spill over” into others, contributing to the ratchet effect.

These causes were identified by many witnesses and supported by good evidence, although there were different views as to the degree of influence of each factor. Inevitably, the interaction of these different forces and influences will vary from sector to sector and company to company, but their combined impact on overall levels is inescapable. These different pressures also highlight the tensions between business interests and any wider societal concerns. Extremely high remuneration may well appear justifiable to shareholders on a purely business basis. Executive pay represents a tiny proportion of expenditure for large companies (an estimated 0.6 per cent in the FTSE 100).¹⁵³ If a CEO is thought to have added £500 million to company value, an additional £5m as a reward may be considered good value by shareholders and the board. It is up to boards to reconcile these tensions in a way which is consistent with company values, competitive drivers, expectations of wider society and internal reward structures.

Figure 7: Executive pay against employee pay



Source: IDS Executive Compensation Review

78. There are also different attitudes to pay in different countries, which large multinationals may not always take into account. Survey evidence suggests that in many countries there is a feeling that it is too high or otherwise unfair.¹⁵⁴ International comparisons on pay are difficult to make reliably due to inconsistencies in methods of measurement, but there is consistent evidence that the UK remains amongst the highest payers for CEOs in Europe, along with Switzerland and Germany, some way ahead of the

152 Q431

153 Professor Alex Edmans ([CGV0006](#))

154 [Edelman Trust Barometer 2017](#)

Nordic countries.¹⁵⁵ It is argued that the dispersed shareholder structure, such as that in the UK, gives executives more power relative to the board and contributes to higher remuneration.¹⁵⁶ All European countries are some distance behind the United States in terms of pay levels.¹⁵⁷

79. Under the reforms introduced by the Coalition Government in 2013, quoted companies are required to hold a binding vote on pay policy every three years and an advisory vote on executive pay every year. There is evidence that a combination of the financial crash of 2008 and the reforms of 2013 have seen an element of restraint on pay over the last six years. Figure 6 shows that average CEO pay in the FTSE 100 has come down from the 2011 peak and has risen only modestly since the new regime came into force.¹⁵⁸ However, as Figure 7 indicates, over the last 20 years the pay of leading executives has risen sharply while average earnings have been relatively flat, particularly since the financial crisis. Even since the new regime in 2013, a small number of CEOs have received exceptionally large awards, which have not only contributed substantially to the overall increased average, but undermined what might otherwise have been considered to be a fairly static, albeit high, average level.¹⁵⁹ More damaging in terms of public perception have been the instances when high rewards have been accompanied by poor company performance, leading to a perception that CEOs are too often being “rewarded for failure.”¹⁶⁰ For example, the pay of the Chief Executive of Pearson rose 20 per cent in 2016 while the company suffered its biggest ever loss and its shares fell to a seven year low.¹⁶¹ Some of the reasons for this are related to the structure of pay, which we discuss below, but this has no doubt contributed to an apparent disconnect between performance and reward at times.

Addressing pay concerns

80. In a global and market based economy in which UK companies compete for the best talent, we do not believe that it would be helpful for Government to intervene directly to limit the level of executive pay. Nor do we believe, as some witnesses argued, that the Government should seek to use the tax system to further redistribute income for the highest paid—in all professions, not just in business. High levels of taxation are liable to lead to elaborate avoidance mechanisms which do not result in a significantly higher tax take. They also are likely to act as a disincentive to working in the UK.¹⁶²

81. In spite of evidence of a flattening in rates of growth over the last few years, executive pay still remains fabulously high and increasingly far removed from the pay of ordinary workers. Total pay for the CEOs of FTSE 100 companies has increased from an average of around £1m in 1998 to £4.3m in 2015.¹⁶³ The rise in executive pay is a vivid illustration of how “ownerless corporations” have allowed executives to ratchet up pay in the absence of the proper scrutiny and challenge that good corporate governance should provide. The incentives and drivers pushing pay up are strong; those of restraint are weak. This

155 See, for example, Bloomberg, Global CEO Pay Index, 2016, [CEO index](#)

156 Vlerick Business School, [UK has highest paid CEOs in Europe](#), January 2016

157 Professor Paul Moxey ([CGV0041](#))

158 Most of the increase can be attributed to the pay for Sir Martin Sorrell, Chief Executive of WPP, who was paid £70 million 2015.

159 Manifest ([CGV0062](#))

160 Q434 [Sir Philip Hampton]

161 [Financial Times](#), *Pearson chief's pay rose 20% in 2016 despite record loss*, March 24 2017

162 EEF ([CGV0142](#))

163 [Corporate Governance Reform Green Paper](#) p16

imbalance needs to be corrected, in the interests of business and the broader interests of society. **We agree with the Prime Minister that high and unwarranted executive pay is an issue that needs to be addressed for the benefit of society as a whole. It is hardly consistent with her vision of an economy that works for everyone to see levels of pay for those at the top increasing at a rate that vastly exceeds increases for ordinary employees and which seemingly is at odds with the value created in the company.**

82. If the causes of high pay are many and varied, the solutions are none the less so. We believe that effective corporate governance is a better means of tackling excessive pay than government intervention. Prevention is better than cure. The tools of corporate governance are more subtle than blunt regulatory instruments, but they can nonetheless be effective. Whilst we acknowledge that self-regulation has a mixed track record, we believe that a combination of heavier and lighter pressures should be applied in order to exert greater control on executive pay. These comprise reforms to:

- a) the structure of executive pay,
- b) the process by which it is agreed, and
- c) reporting on pay.

We address each of these below.

Box 2: Principles of UK Corporate Governance Code relating to remuneration

Main Principle

Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.

Supporting Principles

The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in corporate and individual performance, and should avoid paying more than is necessary.

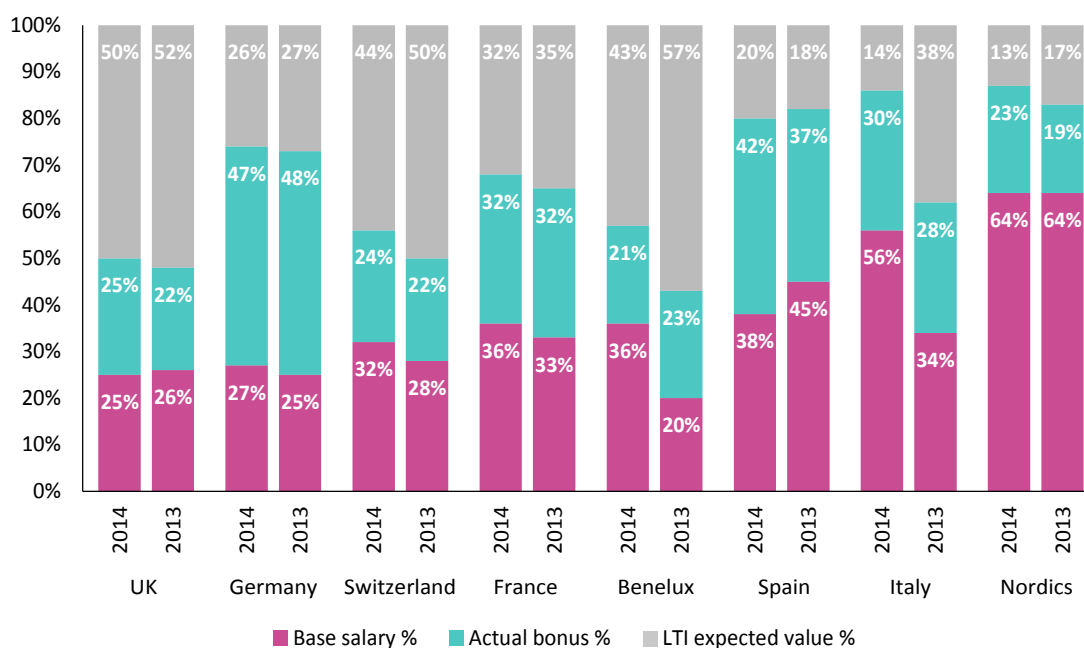
They should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.

Structure

83. The structure of executive pay has become increasingly complex over the last 30 years, moving from a largely salary-based approach to one comprising of different categories of benefits, including bonuses and Long-term incentive plans (LTIPs), realisable over many years. Figure 8 shows the extent to which incentive-based pay now forms a higher proportion of executive pay than in most European countries. Concerns about pay have been raised on the basis of both level and structure: separate but very much related issues.

Figure 8: Structure of UK executive pay**CEO average pay mix by country**

Incentive pay is most significant in the German, UK and Swiss companies.



Source: Willis Towers Watson: CEO Pay in the Eurotop 100

Bonuses

84. There was general consensus that the changing structure has contributed to an overall increase in pay. Such a move, with a greater proportion of total remuneration consisting of bonus and share rights, was designed to align the interests and priorities of shareholders and managers. The TUC argued that public policy since the 1990s had encouraged remuneration committees to increase the proportion of incentive-related pay and that these elements had contributed most to the “growing gap between workforce pay and directors’” pay.¹⁶⁴ A few witnesses argued in favour of fixed salary only. The Institute for Business Ethics made the suggestion that where bonuses paid to executive directors exceed a given proportion, all employees should automatically be eligible for a bonus in the same proportion of salary as that paid to the chief executive.¹⁶⁵

85. We are supportive of the view expressed by some witnesses that there should be a move away from a heavy reliance on incentive pay back towards basic pay,¹⁶⁶ which has the virtue of simplicity and clarity. But we believe that there is a place for bonuses as part of a remuneration package, provided that they are used to incentivise performance, rather than provide an additional reward for routine achievement, and that they do not represent an unjustifiably high proportion of the package as a whole.

86. We agree with witnesses who suggested that bonuses should increasingly be awarded in respect of objectives other than share value, for example, in respect of customer

164 TUC ([CGV0156](#))

165 Institute for Business Ethics ([CGV0016](#))

166 Q434

service, safety, employment, or environmental issues.¹⁶⁷ These, like all bonuses, should be genuinely stretching though. We were surprised to hear, for example, that the Chief Executive and Chief Finance Officer of Rio Tinto were awarded over 100 per cent of their bonus—which included a safety element—in spite of the fact that there were four fatalities during the year.¹⁶⁸ To align stretching bonuses with targets related to section 172 duties or metrics relating to safety or customer service, would send a clear signal to investors and employees that a company took seriously its corporate governance responsibilities. ***We recommend that companies make it their policy to align bonuses with broader corporate responsibilities and company objectives and take steps to ensure that they are genuinely stretching. Policy in this respect would be considered by the FRC in their corporate governance rating system.***

Long-term incentive plans

87. Long-term incentive plans (LTIPs) were originally introduced as a way of linking pay to performance, in the longer term, with a set of metrics relating to different aspects of performance. They typically provide shares instead of pay for executives, which are realisable after a period of three years, although sometimes up to five, with quantity dependent on a number of different performance-related metrics. They have come under growing criticism for not delivering their original purpose, with inappropriate metrics adding both unpredictability and complexity to pay discussions.

88. This complexity of LTIPs has also made the process of negotiating pay awards incredibly difficult for remuneration committees and a whole team of advisors and consultants for the interested parties. We were told that it has become more difficult to understand the link between performance and pay as there are no agreed metrics on what represents good performance. Metrics can relate, not just to share value, but performance relative to a whole set of benchmarks involving industry averages and a range of external factors, the volatility of which can have an impact on reward that outweighs the impact of a CEO's actual performance. One witness told us that pay was now so complex that executives themselves do not always understand their own remuneration.¹⁶⁹

89. There is a concern too that LTIPs have been used to avoid publishing a headline figure for salary which would be widely thought unacceptable. Sir Philip Hampton told us

We have, to some extent, dressed up what we are really paying people through these incentive structures, as a big generalisation—but it is generally true—because a lot of these incentive schemes, frankly are designed to pay, or at least end up paying out, even if performance is quite indifferent.¹⁷⁰

We heard that LTIPs have a tendency to distort executive behaviour, with CEOs tailoring decisions to affect the share price around the time their shares are due to vest.¹⁷¹ Tom Gosling, from PwC, argued that academic evidence showed that pay plans with targets operating over 1–3 years “can encourage short-term behaviour or worse”.¹⁷² The Investment Association reports their increasing use, with share price appreciation and

167 Sheffield Institute of Corporate and Commercial Law ([CGV0037](#))

168 Q199

169 Q438

170 Q434

171 Q404 [Baroness Hogg]

172 Q402

executive demands for higher compensation to make up for uncertainty and contributing to high annual figures.¹⁷³ Because of the difficulty in setting meaningful metrics, too often LTIPs did not perform their function.¹⁷⁴ Given the extent of the reservations over their effectiveness it is perhaps surprising that they remain so prevalent. Andrew Ninian of the Investment Association explained that the Executive Remuneration Working Group found that “companies felt bound into the LTIP model. That was the FTSE model and they had to follow it” but that investors were in fact willing to support alternative models.¹⁷⁵

90. The Code provides guidance only and in general we do not advocate too prescriptive an approach to executive pay. We agree with the many witnesses who argued against a one-size-fits-all approach. Companies should be able to set their own objectives and incentives and explain them. However, given the disquiet within the general public about the issue of executive pay, and the lack of confidence in the effectiveness of attempts at restraint, we believe that more radical action is now needed to start restoring confidence and improving transparency. The guidance in the Code on remuneration has proved ineffective in curbing the trend towards higher pay and in promoting a clear link between pay and performance. LTIPs’ impact on incentivising performance is unproven at best, and, at worst, they can create perverse incentives and encourage short-term decision making. There are signs that some major companies are planning to move away from them.¹⁷⁶ **We conclude that LTIPs should be phased out as soon as possible. No new LTIPs should be agreed from the start of 2018 and existing agreements should not be renewed.**

91. Whilst there was considerable scepticism about the use of LTIPs, there was a general consensus in the evidence that pay incentives should focus on the long term, as is required by the Code.¹⁷⁷ Incentive-related pay is valued by many investors as a method of promoting long-termism and we agree with the principle of promoting long-term decision making through remuneration. Our preference is for these incentives instead to be provided by deferred stock options, under which a proportion of remuneration is given in shares which can only be sold after set periods of time. Crucially, the number of shares is not dependent on performance targets; instead a specified number is allocated as part of the remuneration package and their value is determined by share price at the time of vesting.

92. Deferred stock options have the merit of simplicity: there are no complicated performance metrics and they encourage decision making for the long term. They also should be less costly than LTIPs, as there would be less need to discount for the greater degree of uncertainty of most LTIPs. Versions of this approach are outlined in the Government’s Green paper and by the Big Innovation Centre report on executive remuneration.¹⁷⁸ Witnesses who commented in evidence to us were supportive of this option.¹⁷⁹ The Association of British Insurers has long argued in favour¹⁸⁰ and Tom Gosling

173 Investment Association ([CGV0109](#)); Q160 [Helena Morrissey]

174 Investment Association, [Executive Remuneration Working Group](#), Final Report, July 2016

175 Q437

176 Financial Times, [Backlash spurs blue-chips to rethink bosses’ pay schemes](#), 13 February 2013

177 See Box 1

178 Purposeful Company, [Executive Remuneration Report](#), February 2017

179 Q436

180 Association of British Insurers, [Principles of Remuneration](#) 2013

argued that evidence shows it is positively related to strong long-term performance.¹⁸¹ For example, one study found that CEOs with shareholdings of over £5 million deliver more than double the value to the company of those with shareholdings under this threshold.¹⁸²

93. The deferred shares should generally vest over a longer period of time than the typical LTIP period of around three years. We suggest this should generally be above five years but companies should decide this, according to the nature of their objectives.¹⁸³ An oil exploration company will have different time horizons than, say, a design agency. Similarly, the proportion of remuneration allocated by deferred stock will be for individual companies to determine and explain. A phased vesting period (15–20 per cent per year) would avoid the possible cliff edge vesting of LTIPs which have the potential to distort decision making according to a single vesting date.¹⁸⁴ But companies should retain some flexibility to explain their preferred schemes, subject to some overarching guidelines.

94. There is a trade off with the length of holdings and the strength of the link to executive performance: external factors may be far more influential on share price than decisions made by the Chief Executive, especially once departed. But the purpose is to incentivise decision making as well as reward performance. On balance, we believe that there are valuable benefits in the longer time horizons that share-based incentives should bring to the culture and mind-set of boards and they should, over time, replace LTIPs.

95. *We recommend that the FRC consults with stakeholders with a view to amending the Code to establish deferred stock rather than LTIPs as best practice in terms of incentivising long-term decision making. Overall, we recommend that this consultation should develop guidelines for the structure of executive pay with the following features:*

- *A simpler structure based primarily on salary plus long-term equity, to divest over a genuinely “long-term” period, normally at least five years, without large steps;*
- *Limited use of short-term performance-related cash bonuses, which should be aligned, where possible, to wider company objectives or corporate governance responsibilities;*
- *Clear criteria for bonuses: they should be genuinely stretching and be aimed to provide incentives rather than just reward.*

Pay and performance

96. The complex structure of pay is in part a result of attempts to link pay effectively to performance. The success of these efforts has been the subject of much dispute in the business community, and amongst interest groups and academics. We heard from the High Pay Centre, the TUC and individuals that the link was not proven and there have been a number of academic studies which provide evidence in support of that view.¹⁸⁵

181 Q402, See, for example, [CEO Ownership, Stock Market Performance, and Managerial Discretion, Journal of Finance](#) 69, 1013–1050

182 Pearl Meyer, [2016 UK CEO Value Index](#)

183 The Purposeful Company suggests an optimum timeframe of 5–7 years for the vesting and holding of equity awards in its Executive Remuneration Report, February 2017.

184 Q196 [Helena Morrissey], Q404 [Baroness Hogg]; HM Government [Green Paper](#) on Corporate Governance, November 2016

185 TUC ([CGV0156](#)), High Pay Centre ([CGV0040](#)),

The TUC states that “There is clear academic evidence that high wage disparities within companies harm productivity and company performance.”¹⁸⁶ This is supported by survey evidence on the demotivating impact of high pay differentials on employees throughout an organisation.¹⁸⁷

97. Other witnesses disagreed and cited recent research which provided evidence of a link between high pay differentials and good company performance. A recent report by PwC suggests that low pay differentials may not benefit the performance of companies and if anything may work in the opposite direction.¹⁸⁸ Professor Alex Edmans argued that there is a connection between performance and pay when wealth is taken into consideration, rather than just annual salary and bonuses.¹⁸⁹ One advisory company referred to research that suggests a clear link between realised CEO pay and performance in the UK.¹⁹⁰ With regard to the conflicting evidence, Tom Gosling said that “there will not be a one-size-fits-all answer that says high or low pay differentials are good.”¹⁹¹

98. At an overall level, CEO pay has increasingly outstripped performance of the FTSE 100 companies, as indicated by Figure 6. At a company level, the evidence on the link between pay and performance is mixed. Some evidence shows that highly differentiated pay can be linked to good company performance, but a causal link has not been clearly established. Indeed, it may be extremely hard to do so with certainty, given the complexity of pay deals and other influences on performance. Indeed, some witnesses voiced the suspicion that “the complexity is designed to frustrate clear identification of any link between pay and performance by shareholders or other interested parties.”¹⁹² What is certain is that, for various reasons, there have been examples of high rewards accompanying apparently poor performance, and it is this that serves to undermine public, if not investor, confidence. Jan du Plessis, Chair of Rio Tinto, acknowledged the importance of perception. He told us that while he would like decisions to be based on the link between performance and pay, “in the real world we live in, perception sometimes becomes the truth... You cannot ignore the perception. If there is a perception issue, that has to be addressed.”¹⁹³ We agree on the importance of public perception. It is difficult to explain convincingly how the salary of the CEO can reasonably be over 130 times that of the average worker.

99. The debate over the link between pay and performance, and how best the latter is incentivised, will continue as more evidence is produced. But whatever aggregate statistics may or may not demonstrate, it must be for every company to decide what structure and level of remuneration is right for its own circumstances, and explain the rationale clearly to investors and the wider public. In doing so, they must take into account a full range of factors, including levels of pay throughout the company and the wider workforce. **We recognise that the job of leading a major company is extremely taxing and requires great skill and commitment. These roles, given their importance, should be appropriately rewarded. But overall pay levels have now been ratcheted up to levels so high that it is**

186 TUC ([CGV0156](#))

187 Eg CIPD [The view from below: what employees really think about their CEO's pay packet](#) Pulse Survey, December 2015

188 PwC, *Paying for Performance – Demystifying Executive Pay*, 2017

189 Q72

190 Willis Towers Watson ([CGV0063](#))

191 Q401

192 Dr Rodion Skovoroda ([CGV0042](#))

193 Q182

impossible to observe a credible link between pay and performance. At a time when average pay has remained relatively stable, these increases have served to undermine public trust in business.

Process of agreement: Shareholder engagement on pay

100. The reforms of 2013 were designed in part to incentivise shareholders to engage on pay by giving them a more meaningful role. In the FTSE 100, only four annual reports on pay have been rejected in advisory votes and only one binding vote on pay policy has been voted down. Average votes in support of the remuneration reports and pay policies have been 93 per cent and 94 per cent respectively.¹⁹⁴ Some argued that this high degree of support indicated that “say on pay” was working and the binding policy vote and annual votes had secured better engagement on pay.¹⁹⁵ There is also evidence to indicate that companies have taken action following significant votes against in order to avoid problems the following year,¹⁹⁶ although this was not true in every case.¹⁹⁷ Whilst the reforms are only recent, they do not yet appear to have made a really significant change to attitudes. So far, shareholder opposition to pay awards does not appear to reflect the degree of public disquiet on pay. There remains a fundamental misalignment between the views of ordinary shareholders and the proxy agents and investment companies who exercise influence on their behalf.

101. Engagement does not begin and end at the AGM. In practice, there are, or at least should be, discussions between boards and key investors throughout the year in relation to the agreement on pay policies and remuneration packages. It is up to shareholders to exert influence in these extensive private discussions but, as the UK Shareholders Association asserted, they face difficulties in acting in concert on pay.¹⁹⁸ For example, thirty per cent of shareholders voted against the £70m remuneration package for Martin Sorrell, Chief Executive of WPP in 2015, following a similar protest vote the previous year. The Chair of the WPP Remuneration Committee, Sir John Hood, explained that the nature of long-term policies meant that rewards were dependent upon agreements dating back five years and could “create anomalies, as we have just seen.”¹⁹⁹

102. There are signs that major investors are beginning to respond, in advance of what will be the second vote on pay policies since the introduction of the current regime in 2013. Since the start of the year there have been regular warnings from shareholders about the tough stance they are prepared to take on remuneration and evidence that some companies are limiting pay awards in response.²⁰⁰ For example, shareholders in Crest Nicholson reportedly voted against a pay deal in March 2017 because of concerns that performance targets were too easy.²⁰¹ The Head of Blackrock’s stewardship team in Europe, Amra Balic, told us that “We will hold Chairmen of Remuneration Committees directly accountable for what happens with pay, if we feel the pay is not linked to performance, by voting against”²⁰²

194 [Corporate Governance Reform Green Paper](#) p20

195 Professor Charlotte Villiers ([CGV0013](#)), New Bridge St ([CGV0093](#))

196 The Purposeful Company, [Executive Remuneration Report](#), February 2017

197 Railpen ([CGV0119](#))

198 UK Shareholders Association ([CGV0080](#)); Sir Martin Sorrell’s pay in 2016 was around £42 million.

199 Q156 [Sir John Hood]

200 See, for example, Financial Times, [Safestore backs down over increase to executive pay](#), 20 March 2017; The Guardian, [Anglo American caps bonus payouts after shareholder revolt](#), 13 March 2017.

201 [The Guardian](#), [Crest Nicholson to pay bonuses despite shareholder revolt](#), 23 March 2017.

202 Q207

and, as mentioned earlier, she has since written to over 300 UK companies warning of them of this. Other major investment companies have stressed they are prepared to vote against the chairs of remuneration committees where necessary.²⁰³

103. These are positive signs, which we welcome. However, they may not translate into effective action; instead they may prove to be but a temporary response to the current political climate. In the longer term, greater shareholder engagement on pay will not necessarily, of itself, act as a force for restraint. Indeed, some witnesses considered that greater engagement might have the opposite effect, with passive shareholders content to support the board if it is delivering success.²⁰⁴ There is currently limited incentive for shareholders to engage on pay. Foreign investors, who own the majority of shares in UK companies, may not be too exercised about rising disparities of pay here. We also heard that pay is a lesser priority compared to other issues, such as strategic direction, and there was a claim from some witnesses that too much energy is already expended on remuneration. As a result, shareholders may indeed tend to acquiesce in, if not encourage, the ratcheting up of pay by executives and their advisors. **Deeper engagement alone may not be a powerful driver of pay restraint. We believe that the most effective remedy lies in the combined impact of the various measures we have outlined in this Report, including driving better stewardship through more transparency, better reporting, more employee involvement and tougher enforcement. If these measures and more responsible shareholder engagement does not have the desired effect, Government may have to consider more direct intervention.**

Shareholder votes

104. There are a number of ways to increase the influence of shareholders whilst not unduly impeding the ability of the board to manage the company. Perhaps the most straightforward measure, and one floated in the Green Paper, is to make the vote on executive pay binding rather than advisory. We heard conflicting views on this option. Some witnesses argued that these votes would provide better accountability and greater incentives for Remuneration Committees to consult more effectively in order not to risk a defeat.²⁰⁵ Others maintained that evidence from other countries indicated that such votes had very little effect in practice and were an unnecessary administrative hurdle.²⁰⁶ There may also be legal and practical issues to overcome with contracts being made subject to binding shareholder agreement, one reason why this option was apparently not pursued in 2013.²⁰⁷

105. The average vote in favour of both pay reports and remuneration policies in the FTSE 250 is over 90 per cent. **In our view, the current scale of opposition to remuneration reports and policies does not, at present, justify annual binding votes on pay levels.** In most cases, a binding vote would serve little purpose but potentially add uncertainty and a source of distraction. Instead, there should be a better focus on those few cases where there are significant concerns. In these cases, shareholders should have more power to not only register opposition but to force remedial action. We therefore agree with the principle

203 Eg Legal & General, the Pensions and Lifetime Savings Association, and Institutional Shareholder Services (ISS), Vanguard and State Street.

204 Charlotte Villiers (CGV0013); Deloitte (CGV0145); Stuart Spencer (CGV0091)

205 Railpen (CGV0119), CIPD (CGV0110)

206 New Bridge Street (CGV0093), Prism Cossec (CGV0066)

207 Investment Association, [Executive Remuneration Working Group](#), Final Report, 2016

of an escalatory process, as proposed in the Green Paper, under which a binding vote is triggered if there is a significant minority of opposition to pay awards in the previous year or previous two consecutive years.

106. To incentivise the engagement of the otherwise uninterested, and to force effective action, we favour a strict approach to implementing this principle. Our preference is for the threshold for triggering a binding vote should be low and that companies should have one chance to resolve concerns, not two. A 25 per cent threshold would be consistent with the threshold for votes on a special resolution and would strike a reasonable balance in terms of the degree of leverage given to a single minority shareholder. It is reasonable to expect companies to address any serious and widespread concerns on remuneration by the following year. We recommend that the FRC revises the Code to include a requirement for a binding vote on executive pay awards the following year in the event of there being a vote against such a vote of over 25 per cent of votes cast. This requirement should be included in legislation at the next opportunity.

Remuneration Committees

107. Remuneration committees are responsible for the formulation of pay policies and remuneration packages and for reporting on them each year as part of the annual report documentation. They are also at the heart of engagement with shareholders. Whilst in the evidence we took there was some recognition of the difficulty of their task, there was some concern that they could be too reliant on consultants and not always able to secure the necessary degree of engagement, including from company Chairs, to ensure board support.²⁰⁸ We heard the view from many witnesses that remuneration committees should take greater account of pay levels across the company, not just senior executives.²⁰⁹

108. The best way of ensuring that the voices of the workforce are heard in pay discussions is to have an employee representative on the remuneration committee itself. This option was advocated by a wide range of witnesses, who pointed to the beneficial effects on challenging debate and, more widely, on the culture of the company and its board.²¹⁰ The Chair of Rio Tinto, on the other hand, considered this would be unhelpful, on the grounds that it was undesirable to artificially separate discussions on rewards from the delivery of company strategy, as they are intrinsically linked.²¹¹ As we discuss further in the next chapter, we do not see it as a disadvantage for there to be greater involvement of workers with company strategy: quite the opposite. We believe that consultation with workers throughout the organisation is a vital element of improving trust and gaining support for proposals. We accept that this option may not work for all companies, particularly multinationals with very diverse workforces, so should not be mandatory. Companies themselves would determine the appointment process, potentially with the help of FRC guidance. **Employee representation on remuneration committees would represent a powerful signal on company culture and commitment to fair pay. This option should be included in the Code and we expect leading companies to adopt this approach.**

208 Q221 [Helena Morrissey]

209 TUC ([CGV0156](#))

210 Nestors Advisors Ltd ([CGV0117](#)), CIPD ([CGV00110](#)), TUC ([CGV0156](#)), Modern Corporation ([CGV0165](#)), Helena Morrissey ([CGV0017](#)), John Lewis Partnership ([CGV0099](#))

211 Q220 [Jan du Plessis]

109. The Executive Remuneration Working Group found that “one of the biggest obstacles to change in executive remuneration lies in the breakdown in trust between shareholders and remuneration committees.”²¹² To rebuild this trust, and if it is to balance the different and sometimes conflicting interests on remuneration,²¹³ any remuneration committee needs strong leadership. We are concerned that members have few incentives to consider wider political context of executive pay, its impact on public trust and levels of inequality. A lack of strong leadership has contributed to the rise in executive pay we have seen. Chairs should be accountable if they fail to deliver on effective engagement. The temptation for committees to take the easy option of working upwards from the median has been well articulated.²¹⁴ Incentives for restraint may be particularly weak when remuneration committee board members also serve on other boards,²¹⁵ given this approach based on benchmarking. The Chair should be both independent-minded and experienced enough on matters of pay within the company to ensure the confidence of shareholders and executives alike. To this end the Executive Remuneration Working Group recommended that the chairs should normally have served on the committee for a year prior to taking up the post. We heard that it was not always the case that the Chair had previously been a member of the committee.²¹⁶ **Chairs should also be responsible for driving discussions aimed at delivering simpler structures and justifiable levels of remuneration and shareholders should be prepared to hold them to account if they have not engaged sufficiently to secure support for pay policies and annual reports. We recommend that any Chair of a remuneration committee should normally have served on the committee for at least one year previously. To further incentivise strong engagement, we recommend that the Chair of a remuneration committee be expected to resign if their proposals do not receive the backing of 75 per cent of voting shareholders.**

Pay reporting

110. We discussed in the previous chapter the need for high quality and honest reporting in respect of the duties of directors. The same applies to pay. Whilst we recognise that remuneration is far from straightforward, reporting on pay is too complex, unclear and unhelpful for the purposes of wider comparison.²¹⁷ Reporting requirements were improved in 2013 to require the publication of information on relative pay increases, but we heard companies are complying in a limited way, by presenting information in unhelpful ways.²¹⁸ Sanctions in respect of poor quality reporting have not proved effective. For example, the FRC reports that not all companies improved the quality of reporting, or engagement, even when subject to significant minority votes against pay resolutions.²¹⁹ Greater clarity is required to improve comparability and accountability, and in turn to build trust. As mentioned in the previous chapter, reports should include detailed information on the use and remuneration of advisors involved in the process. This will assist shareholder

212 Investment Association, [Executive Remuneration Working Group](#), Final Report, 2016

213 Q251

214 For example, Investment Association, [Executive Remuneration Working Group](#), Final Report, 2016

215 Research for the Trades Union Congress found that two thirds of remuneration committee members share one member with another remuneration committee, [A Culture of Excess](#), February 2015, EEF ([CGV0141](#))

216 Q221 [Helena Morrissey]

217 PIRC Ltd ([CGV0154](#))

218 TUC ([CGV0156](#))

219 FRC, [Developments in corporate governance and stewardship 2016](#), 2017

engagement and make it more difficult for companies to hide high remuneration in complex reporting. Statistics should be presented consistently in such a way as to enable year on year comparisons and comparisons with other companies in the same sector.

Reporting on a people policy

111. It is important that reporting does not just focus on the outcome of decisions on remuneration; but that it provides an explanation of the strategy that underpins the remuneration policy for the whole company. It should set out the structure for rewards at all levels, not just at the executive level, setting out the approach to performance incentives as well as benefits, including pension provision. It should also provide assurances on working conditions and engagement. We were impressed on our visit to Sweden with the holistic approach companies took to pay: they considered it to be part of an HR strategy that placed a premium on investing in people. In an employment market that makes it attractive to reduce costs by making use of agency workers and self-employed people, often on very low pay, it is vital that companies explain why they choose the employment models they do, and what steps they take to ensure that all workers—whether direct employees or not—are paid properly and their working conditions reasonable. There have been recent examples where companies have fallen short in this regard.²²⁰

112. In an increasingly knowledge-based economy, where value lies more in human than capital assets, companies should be judged on the whole structure of their rewards, workforce and investment in people. Outline information should be provided on the breakdown of the workforce, including the proportion on fixed term contracts and zero hour contracts, the number employed via agencies and other intermediaries such as umbrella companies and personal service companies. We agree with the Chartered Institute of Personnel and Development (CIPD), who outlined a process of “human capital reporting” which includes a narrative on workforce composition, including diversity, recruitment and turnover; investment in training and development and measures of employee engagement and wellbeing.²²¹ As Helena Morrissey argued, there should be an opportunity for companies to set out: “‘This is what we believe in; this works for our company,’ and then sell it in to the shareholders and stakeholders, to earn trust properly.”²²² This wider responsibility for overseeing its people strategy might be overseen by the remuneration committee or taken on by the board itself, but it should form an integral part of pay reporting.²²³ ***We recommend that companies should set out clearly their people policy, including the rationale for the employment model used, their overall approach to investing in and rewarding employees at all levels throughout the company, as well as reporting clearly on remuneration levels on a consistent basis. The FRC should consult with relevant bodies to work up guidance on implementing this recommendation for inclusion in the Code.***

Publication of pay ratios

113. The publication of pay ratios has been advocated by many as a further means of increasing transparency and exerting downward pressure on executive pay. Many

220 Eg [The Guardian](#), Tesco to pay out nearly £10m to staff after payroll errors, 9 March 2017.

221 CIPD ([CGV0110](#))

222 Q196 [Helena Morrissey]

223 Nestor Advisors Ltd ([CGV0117](#))

submissions to our inquiry were supportive of this proposal.²²⁴ In addition, the Investment Association advocated the publication of pay ratios between the CEO and the executive team alongside that between the CEO and median employee pay.²²⁵ Others were cautious, on the grounds that CEOs operate in a completely different market to most employees,²²⁶ and the results may be misinterpreted, given the different nature of business models and pay structures.²²⁷ Some argued that the publication of pay ratios would risk unintended consequences, such as companies with low paid workforces choosing to outsource.²²⁸

Figure 9: Shareholder opposition and pay ratios

FTSE 100 CEO (received) to average employee 2002–2014		
Year	CEO total remuneration received as multiple of average employee earnings	Shareholder voting % dissent (abstain + oppose) on remuneration
2002	69.51	16.19
2003	77.08	12.83
2004	94.16	7.38
2005	97.62	5.19
2006	98.75	6.08
2007	139.16	7.14
2008	124.32	10.06
2009	151.68	9.38
2010	132.22	9.07
2011	117.50	11.34
2012	114.35	7.55
2013	125.38	9.08
2014	149.58	8.38

Source: Manifest, cited in High Pay Centre Report, Pay Ratios, Just Do It

114. We recognise the potentially limited impact of the mandatory publication of pay ratios on levels of pay inequality. It is already possible to obtain information relating to executive and average pay. The High Pay Centre reports that there is no correlation between CEO pay and shareholder discontent.²²⁹ The very different structures of companies may invite meaningless comparisons: a retailer might have relatively high ratios compared to a tax consultancy, but this would reveal little about relative pay levels between the two.

115. On balance, and given that figures are generally readily available and so easily published, we favour the publication of pay ratios, between CEO and both executive team and also median pay. Whilst these ratios need to be treated and interpreted with caution, especially when making comparisons across sectors, they will provide the public and investors with useful information on the direction of travel in terms of pay for individual companies or sectors over time and help to focus attention on those that are moving in what most would see as the wrong direction. To achieve this aim, ratios should be published on a consistent basis each year. In the interests of providing greater context to

224 Eg Fidelity ([CGV0107](#))

225 The Investment Association ([CGV0109](#)), Manifest ([CGV0062](#))

226 Professor Alex Edmans ([CGV0006](#))

227 New Bridge St ([CGV0093](#)), ICA: The Governance Institute ([CGV0111](#))

228 ICAEW ([CGV0116](#))

229 High Pay Centre [Pay Ratios, Just Do It](#), November 2015

these ratios and of bearing down on levels of inequality throughout society, we believe that the public and charitable sectors should also be obliged to publish similar statistics. *We recommend that the FRC works with other relevant stakeholders on the detail and amends the Code to require the publication of pay ratios between the CEO and both senior executives and all UK employees. We further recommend that the Government requires that equivalent pay ratios should be published by public sector and third sector bodies above a specified size.*

Conclusions on pay

116. We agree with the Prime Minister and the majority of respondents that executive pay is causing damage to the generally good reputation of British business. Too often pay awards appear impossible to justify in relation to performance and when set against pay levels lower down. This serves to undermine public trust in business, the engine of economic productivity and prosperity. There is a tension here between competitive businesses making rational business decisions in their own interests and the wider societal impacts of these awards. Government has a duty to monitor this tension and address it when it judges necessary in the public interest. But all parties need to be sensitive, and respond to, the shifting sands of opinion about fairness of rewards. There are some welcome signs that some businesses and investors are seeking to respond, but we do not have confidence that progress will be made without further pressure being exerted through the measures we recommend in this Report. It is now up to businesses to respond positively, in their own interests, to adjust to raised expectations in relation to executive pay.

6 Composition of boards

Board diversity

117. Boards of directors, made up of executive directors and non-executive directors, are responsible for the governance of their companies, and for providing the right checks and balances within businesses to strengthen decision-making and accountability.²³⁰ The job of a board director can be a hard one; as Oliver Parry from the Institute of Directors told us, “they are running global organisations where their decisions from second to second can have lifelong consequences for the business”.²³¹ But they are also individuals working together, interacting with each other, and challenging each other, for the benefit of the company. Our inquiry into BHS highlighted what can happen when individual board members do not act solely for the benefit of the company as a whole, but are unduly influenced by the interests of one dominant director. To mitigate this risk, we stressed the need for strong individual directors, who are prepared to challenge effectively.²³²

118. To be an effective board, individual directors need different skills, experience, personal attributes and approaches. They need the ability to know when to ask pertinent questions and to ensure all interested groups connected with the company are engaged. All boards need to mitigate the risks of group think. The benefits of diversity on the board are not obviously reflected in their make-up, which remain remarkably uniform. Currently, of 1,087 director positions in FTSE 100 companies, only 26.7% are women. There is one all-male board, Convatec Group plc.²³³ Statistics are also poor on ethnic diversity: only 8 per cent of executive and non-executive positions in FTSE 100 companies are held by people from BAME backgrounds.²³⁴ Describing board directors, the Prime Minister said in October 2016: “Too often the people who are supposed to hold big business accountable are drawn from the same, narrow social and professional circles as the executive team. And too often the scrutiny they provide is not good enough. A change has got to come”.²³⁵

119. The Code requires companies to include a description of the board’s policy on diversity, including the gender balance of the board, the measurable objectives that it has set for implementing the policy, and the progress made on achieving these objectives. However, these reporting requirements have not had the intended impact in tackling the homogeneity of board composition. Whilst the UK is a world leader in many facets of corporate governance, that is not the case on board diversity. Nigel Wilson, from the UK’s largest fund manager, told us that there is a huge gap in representation between men and women, between different ethnic groups, and spoke of a lack of constructive engagement with workers.²³⁶

230 [The UK Corporate Governance Code](#), para 2.5

231 Q30

232 [BHS](#), First Report of the Work and Pensions Committee and Fourth Report of the Business, Innovation and Skills Committee, Session 2016–17, HC54; Business, Innovation and Skills Committee, Third Report of Session 2016–17, paras 131 and 135

233 [Professional Board Forum](#).

234 [A Report into the Ethnic Diversity of UK Boards](#) Sir John Parker, the Parker Review Committee, November 2016, page 5.

235 The Prime Minister, [keynote speech](#), Conservative party conference, 5 October 2016.

236 Q315

Gender diversity

120. There is a growing body of empirical evidence that highlights a positive connection between the gender diversity of boards and board performance, although a causal link is difficult to prove.²³⁷ Dr Barnali Choudhury explains that this could be because the output produced by boards is mainly cognitive in nature, directly influencing board tasks and indirectly affecting firm performance.²³⁸ Helena Morrissey asserted that it is irrelevant that causality cannot be proved, and the smart companies just are fully aware of the importance of diversity: “There is no data around other forms of diversity but frankly the argument needs to be turned on its head—there is no business case for homogenous boards!”²³⁹ Denise Wilson, CEO of the Hampton-Alexander Review into improving gender balance in the FTSE 350 told us that in their discussions with chairmen and board directors “[t]hey said the atmosphere, dynamics and decision-making processes in the boardroom were better than when it was all males. Yet in 2010, I would say around a third of FTSE 100 chairmen were saying, ‘women will not make it; women do not have the skills; they are not quick.’”²⁴⁰

121. Lord Davies’ 2011 review sought to promote gender equality on boards of listed companies and to identify barriers that were preventing more women reaching the boardroom. He made the business case for gender diverse boards, citing: improving performance; accessing the widest pool of talent; being more responsive to the market; and achieving better corporate governance, and set the target of 25 per cent of boardroom positions to be held by women.²⁴¹ The number of women on boards duly increased from 12.5 per cent in 2010 to 26.1 per cent in October 2015, thereby meeting the target. Figure 10 shows the rise in percentage of women directors on boards from 1999 to this year and illustrates the rapid rise from 2012 onwards, albeit from a very low base.

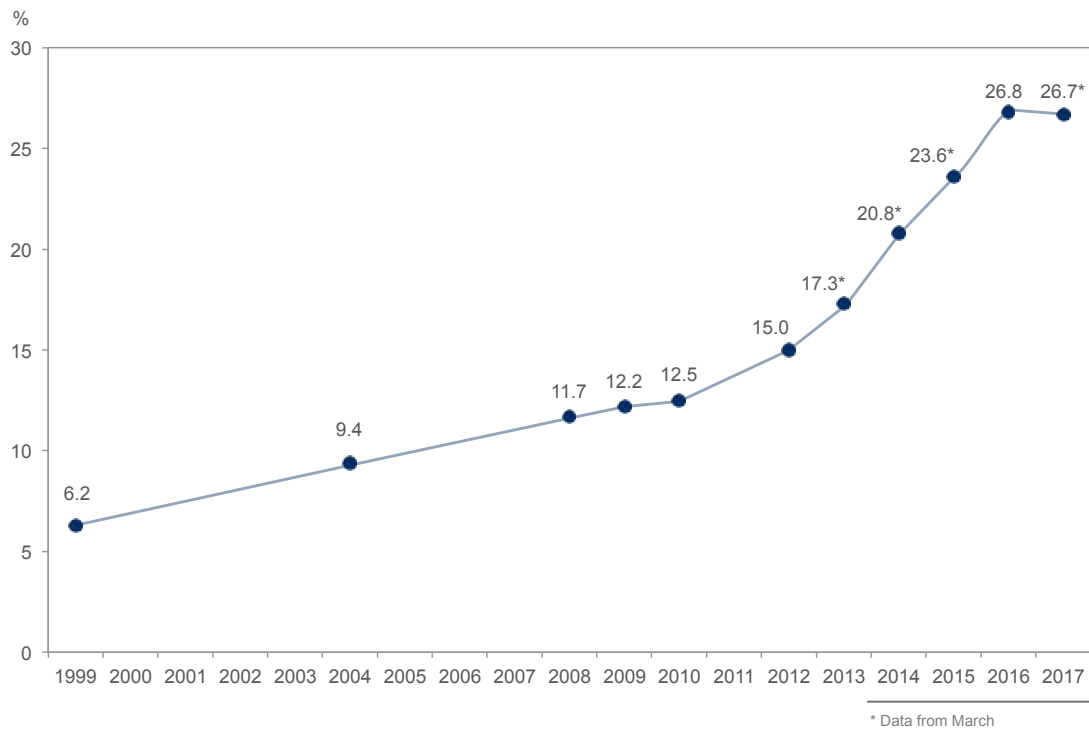
237 McKinsey, CSFB, Citibank, Citibank, SocGen are examples of analyses, showing a correlation between gender diversity and company performance, based on global, Australian and European companies. Written evidence from the Campaign for Merit in Business [0008] claims that there is a causal link between women board members and corporate financial decline.

238 Dr Barnali Choudhury ([CGV0160](#))

239 Helena Morrissey ([CGV00017](#))

240 Q267

241 [Women on Boards](#), February 2011.

Figure 10: History 1999–2017 FTSE 100: % women directors

Source: Professional Boards Forum BoardWatch
 Data provided by BoardEx and The Female FTSE Board Report.²⁴²

122. However, this welcome rise in the number of women on boards is deceptive: it combines both executive and non-executive directorship roles. In the FTSE 100, only 10.4 per cent of executive director positions are currently held by women, compared with 33.7 per cent of non-executive directors. Even more strikingly, the number of female CEOs has actually declined during the past three years: there were nine women CEOs in 2014; in March 2017 there were only six. In February 2016, the Hampton-Alexander Review was set up, headed by Sir Philip Hampton, chairman of GlaxoSmithKline, and Dame Helen Alexander, chairman of UBM, to continue with the work started by the Davies Review, focusing on improving the representation of women in the executive roles of FTSE 350 companies, with the target of having women hold 33 per cent of executive positions on boards by 2020. In hindsight, there might have been more merit in having the Hampton-Alexander Review *before* the Davies Review, to improve first the pool of executive senior managers. It is crucial that opportunities for women to progress through an organisation into executive positions are fully available and promoted.

123. Current legislation requires companies to disclose the gender balance among directors, senior managers and employees within companies' Annual Strategic Report, but the term 'senior manager' does not carry across companies easily, which makes it hard to assess progress on gender diversity. The Hampton-Alexander review highlights this point; that it is hard to quantify what it means to be a senior manager, and therefore hard to assess the gender diversity of senior managers. Once the definition of 'senior manager' is more uniform, it will be easier for companies to disclose the gender balances of their Executive Committees, which is another Hampton-Alexander recommendation that we support.

Furthermore, we agree with the Equality and Human Rights Commission's Chair, David Isaacs, who last year called for the Hampton-Alexander's aims to be set higher, proposing a new national target that half of all new appointments to senior and executive management level positions in the FTSE 350 and all listed companies should be women. As the EHRC states, "this will guarantee a strong pipeline of women for the top jobs".²⁴³

124. Much has been achieved in increasing the number of women directors on boards since Lord Davies' recommendations in 2011. However, there is still one board in the FTSE 100 that has no women directors, and the increase in women that has occurred has been primarily in non-executive roles. The number of women executive directors is still very low, with only six women CEOs in the FTSE 100. We support the current work by the Hampton-Alexander Review, especially its recommendation that the Government should, in consultation with business, consider how best to clarify or supplement the definition of 'senior managers' to have a more consistent, meaningful metric, based on the Executive Committee or its nearest equivalent in each company.

125. Companies need to ensure that women are encouraged from early on in their careers, through mentoring, meaningful work experience, and proper flexible working, to ensure they are equipped to progress to executive director posts. Firms also need to communicate how they are approaching the encouragement and engagement of women throughout the organisation. The FRC should take this into account as part of its rating system.

126. Also we support the Hampton-Alexander Review's recommendation that the FRC should amend the UK Corporate Governance Code, so that all FTSE 350 listed companies are required to disclose in their annual report the gender balance on the Executive Committee and direct reports to the Executive Committee.

127. We believe that the aims and targets of the Hampton-Alexander Review should go further and, in support of the Equality and Human Rights Commission's objective, we recommend that the Government should set a target that from May 2020 at least half of all new appointments to senior and executive management level positions in the FTSE 350 and all listed companies should be women. Companies should explain in their annual report the reasons why they have failed to meet this target, and what steps they are taking to rectify the gender inequality on their Executive Committees.

Ethnic diversity

128. The Corporate Governance Code has five references to gender, but only one to race (and that reference is in the preface).²⁴⁴ The statistics relating to the ethnic diversity of boards are startling: in FTSE 100 companies, only 8 per cent of positions are held by directors of colour, of which 1.5 per cent are UK citizens (despite that fact that 14 per cent of the total UK population is from a non-white ethnic group). Only 1 in 16 top management positions are held by a person from a BME background, and only 73 directors in FTSE 150 companies have a black, Asian or minority ethnic (BAME) background, and only 1.6 per cent of directors are UK BAME citizens.²⁴⁵

243 Equality and Human Rights Commission ([CGV0152](#))

244 [The UK Corporate Governance Code](#) preface.

245 Spencer Stuart, [2016 UK Board Index](#)

129. Sir John Parker's review into ethnic diversity on boards, [A Report into the Ethnic Diversity of UK Boards](#), published in November 2016, recommended a target of one in five Directors of FTSE 100 firms being from an ethnic minority background by 2020.²⁴⁶ Baroness McGregor-Smith led a review to complement the Parker review, looking at issues faced by businesses in developing black and minority ethnic talent from when people start work, to executive level. Her report made the following damning comment:

There is discrimination and bias at every stage of an individual's career, and even before it begins. From networks to recruitment and then in the workforce, it is there. BME people are faced with a distinct lack of role models, they are more likely to perceive the workplace as hostile, they are less likely to apply for and be given promotions and they are more likely to be disciplined or judged harshly.²⁴⁷

130. Perhaps the most shocking statistic is that only nine people from ethnic backgrounds hold the position of Chair or CEO in this country, and 53 out of the FTSE 100 companies do not have any BAME directors. Out of 1087 UK citizen director positions in the FSE 100 boards, only 1.5 per cent are BAME. Seven companies account for over 40 per cent of the directors with ethnic backgrounds, and five out of the seven companies have headquarters historically located outside the UK.²⁴⁸

131. The arguments for greater diversity, including ethnic diversity, often conflate the argument of social justice with competitive advantage. Ken Olisa, deputy Chairman of the Institute of Directors, told us that a diverse board gives competitive advantage because if the directors and non-executive directors do not look like the different stakeholders, "the people whom they are trying to employ, trying to sell to, trying to buy goods from and being regulated by, then those people in the supply chain are less likely to be empathetic to the needs and requirements of the company".²⁴⁹

132. For companies seeking a competitive advantage, the directors and non-executives running them, and those setting the strategic context in which they operate, should be empathetic to the needs and requirements of all those involved, including employees, workers, suppliers and customers. It makes business sense to recruit directors from as broad a base as possible, across the demographic of the UK. We recommend that the FRC embeds the promotion of the ethnic diversity of boards within its revised Code. At the very least, we recommend that wherever there is a reference to gender, the FRC should include a reference to ethnicity, so that the issue of ethnic diversity on boards is made explicit in the revised Code, and is given as much prominence as gender diversity.

133. In accordance with the spirit of the McGregor Smith review, we recommend that the Government should legislate to ensure that all FTSE 100 companies and businesses publish their workforce data, broken down by ethnicity and by pay band.

Cognitive diversity, including social diversity

134. The update to the preface of the UK Corporate Governance Code in 2014 widened the definition of what the FRC would expect diversity to cover, in terms of the board:

²⁴⁶ [A Report into the Ethnic Diversity of UK Boards](#) Sir John Parker, page 9

²⁴⁷ [The McGregor Smith review](#), February 2017

²⁴⁸ [A Report into the Ethnic Diversity of UK Boards](#) p5

²⁴⁹ Q420

Essential to the effective functioning of any board is dialogue which is both constructive and challenging. The problems arising from ‘groupthink’ have been exposed in particular as a result of the financial crisis. One of the ways in which constructive debate can be encouraged is through having sufficient diversity on the board. This includes, but is not limited to, gender and ethnicity. Diverse board composition in these respects is not on its own a guarantee. Diversity is as much about differences of approach and experience, and it is very important in ensuring effective engagement with key stakeholders and in order to deliver the business strategy.²⁵⁰

135. Many respondents to our inquiry argued that diversity should be viewed in its broadest sense, with intellectual diversity and experience being as important factors as ethnicity and gender.²⁵¹ Rowena Ironside, founder and Chair of Women on Boards UK, told us “Diversity is the grit in the oyster”.²⁵² The Institute of Directors’ evidence states that more diverse boards perform better over the long term, and that fielding a team of top executives and board directors with varied cultural backgrounds and life experiences can broaden a company’s strategic perspective. In practice, there is likely to be considerable overlap between securing a cognitively diverse board and one that is diverse in terms of gender, ethnicity, and background.

136. The more similar that individual directors think, act, and look, the more likely it is that they are not going to challenge each other, or innovate, or think imaginatively. Directors should not be appointed to the board solely on the basis of one particular background or area of expertise. Greater cognitive diversity promotes more effective challenge and more informed decision-making and we recommend that the FRC works with others to provide improved guidance on this aspect of diversity in the context of board membership.

The Pipeline of talent

137. Directors appointed from within the organisation, working their way through the executive channel, have an intimate experience of the company and are usually also paid less than outsiders brought in to fill directorships.²⁵³ Janet Williamson from the TUC and Stephen Haddrill, from the FRC, both told us that nurturing people within companies can result in a more diverse group of people reaching the top of the corporate sector, and include people who are more likely to be focussed on the longer-term strength of the business.²⁵⁴ There is also evidence to suggest that CEOs appointed from within the company add more value than those recruited from the outside, and at a lower cost.²⁵⁵

138. We support measures to enhance the executive pipeline, ensuring that talented people within an organisation are encouraged and supported at an early stage of their careers, and beyond, into middle and senior management.

250 Para 3

251 For example, ACCA (CGV00), CBI CGV00)

252 Rowena Ironside [Q297]

253 Q30 [Stephen Haddrill]

254 Q37 [Janet Williamson] [Stephen Haddrill]

255 Pearl Mayer, [2016 UK CEO Value Index](#)

139. *The revised Code should have the issue of board diversity as a key priority and there should be a public explanation of the reasons why members are part of the board. The Code should require boards to cover in their annual reports information diversity on their boards and in the workforce, covering diversity of gender, ethnicity, social mobility, and diversity of perspective. Annual reports should be required to include a narrative on the current position, and an emphasis on what steps the company has taken, and will continue to take to enhance the diversity of the executive pipeline, with agreed targets. This narrative should include how accurately the board mirrors the diversity of both the workforce and the customer base.*

140. *The detailed narrative of board diversity in annual reports should be a working document throughout the year, informing the board, the Nomination Committee, middle and senior managers, and the workforce and other stakeholders, about the seriousness that companies are taking diversity and succession issues. The revised Code should make this requirement explicit.*

Worker representatives on boards

141. In July 2016, the Prime Minister said that the Government would publish plans to have consumers and workers represented on company boards. By November 2016, in her speech at the CBI conference, the Prime Minister had apparently watered down her views, with the resulting statement in the Green Paper: “As the Prime Minister has made clear, we are therefore not proposing to mandate the direct appointment of employees or other interested parties to company boards”.²⁵⁶ The Green Paper lists several obstacles against appointing a worker director: real decision making moving from the boardroom to less formal channels; a risk of tokenism; the difficulties of choosing a worker representative; the worker representative being constrained by the common directors’ duty to promote the success of the company and by the confidentiality of board discussions.²⁵⁷ Witnesses argued that boards should be cohesive governing bodies rather than forums for representatives of different interests to resolve their varied approaches.

142. There is mixed evidence on the impact that workers on boards have on a company. Some evidence shows that greater representation reduces long-term firm value.²⁵⁸ Professor Alex Edmans believes that mandating worker representation sends the wrong message: “It suggests that ‘consulting workers is bad for firm value, so we must pass a law to achieve it’.”²⁵⁹ Others disagree with this view, saying that a worker representative would be a director in his or her own right, chosen from the workforce, but not a conduit for representing its views.

143. The IoD and the FRC are both in favour of worker representation in principle, but Stephen Hadrill told us it would require primary legislation to implement the change; changes to the Code would not be sufficient.²⁶⁰ He went on to suggest that a worker representative need not be an employee of the company, but a director elected by employees

256 [Corporate Governance Reform Green Paper](#)

257 [Corporate Governance Reform Green Paper](#) paras 2.26 to 2.28

258 Gorton and Schmid (2004), cited in Professor Alex Edmans’ written submission [\[006\]](#)

259 As above

260 Q31

of the company: “In Holland, they often elect people from elsewhere. Someone might stand for election because of their empathy with the worker community but they might have great skills that are relevant to the business”.²⁶¹

144. The TUC argued strongly in favour of workers on boards: “Workers’ voice is the missing element of the UK corporate governance”.²⁶² They state that workers’ interests are best protected by company success, and the natural inter-dependency between workers and the companies they work for makes workers a natural group to participate in corporate governance.²⁶³ They cite evidence from Europe, with 19 out of 29 European countries having some provision for workers’ representation on company boards. We heard on our visit to Sweden how workers on boards had helped overcome a period of difficult industrial relations and was now taken for granted.

145. Having a single worker on a board will not address the fundamental issue of the company’s engagement with the workforce, and could risk being seen as a token nod towards employee participation at board level. However, we believe that employees can bring a different perspective and challenge to the board, and are more likely to encourage a long-term perspective. This issue needs to be seen in the context of recognising where success and value are created in an organisation, such as its staff, and having an HR function that is explicitly aligned with a firm’s strategic direction and has sufficient influence at the highest level.

146. We recommend that companies should be recruiting non-executive and executive directors from the widest possible net of suitable candidates, which should include recruiting internally. Successful companies, both here and abroad, have shown that this can work for the benefit of the company as a whole, and we encourage more companies to appoint workers on boards. We believe that, just as the drive for women directors has overcome initial doubts, it should become the norm for workers to serve on boards.

147. We are not minded to recommend the compulsory requirement for companies over a certain size to include a worker on board. There are numerous difficulties to overcome including, for example, how the term ‘worker’ is defined and how the post would be filled. However, there is nothing in law that prevents workers serving on boards, and the diversity of board members, including workers on boards, should be encouraged. There are already long-established boards where this is the norm, for example John Lewis, First Group, and the NHS Foundation Trust Boards. They do not appear to have suffered from some of the disadvantages that sceptics have suggested. Employees appointed to boards should be directors in their own right, with the necessary skills and aptitudes to play a part as a full board member rather than a representative of the workforce. They would not be a delegate, but would provide the same strategic evaluation and challenge that every director should bring.

Nomination committees and diversity

148. Normally headed by the Chair of the company, the Nomination Committee’s responsibilities include board succession. The Code stipulates that the company’s annual report should describe the work of the Nomination Committee, including the process it

261 Q34

262 TUC ([CGV0156](#) Para 4.12)

263 TUC ([CGV0156](#) Para 4.13)

has used when deciding on board appointments: “The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard to the benefits of diversity on the board, including gender”.²⁶⁴ It should include a description of the board’s policy on diversity, any measurable objectives it has set for implementing the policy, and progress on achieving the objectives, and an explanation if it has not used open advertising or an external search consultancy.²⁶⁵ Oliver Parry from the IoD said the head-hunters churn out the same names, and instead should be encouraged “to think about a more diverse portfolio of individuals, with different backgrounds, different cultures and different understandings of the business environment”, and gave the example of the current need for non-executive directors with cyber-security understanding and experience.²⁶⁶

149. The Code requires that, at least every three years, an external facilitator should review the effectiveness of the nomination committee, including the process it has set for implementing the policy, and progress on achieving the objectives.²⁶⁷ If done properly, this can highlight issues relating to group think, and to diversity of thinking.²⁶⁸ Edward Speed, from Spencer Stuart, recommended oversight of the external facilitator by the FRC to ensure minimum standards and consistency across companies. We agree with his proposal.²⁶⁹

150. Tomorrow’s Company advocates reform of the director nomination process, which it states is a closed process and has little connection between directors and the shareholders who elect them, and highlighted the Swedish nomination committee structure, where major shareholders come together to have a greater say in the nomination of directors. It is also a recommendation put forward in a recent report by Chris Philp MP.²⁷⁰ This proposal would produce stronger shareholder engagement and more diverse and challenging boardrooms.²⁷¹

151. The Nomination Committee is responsible for finding and appointing board directors based on merit, and against objective criteria. Given those responsibilities, it also has a crucial role in ensuring board diversity. ***We recommend that the revised Code states explicitly that the procedure for the appointment of new directors to the board should be by open advertising, and by an external search consultancy, and detailed explanations should be given if one or both of these requirements is not met.***

152. Currently, the Code requires that, at least every three years, an external facilitator should review the effectiveness of the board, which should check on poor habits, such as group think and complacency. ***We recommend that the FRC should be given the extra role of overseeing the rigour of the evaluation process to ensure that it is genuinely independent, thorough and consistent across companies. The FRC should highlight best and worst practice among Nomination Committees.***

264 [Corporate Governance Code B.2](#)

265 [Corporate Governance Code B.2.4.](#)

266 Q36

267 [Corporate Governance Code B2.4.](#)

268 Q290 [Edward Speed]

269 Q290

270 Chris Philp MP, [Restoring Responsible Ownership.](#)

271 [Bridging the UK engagement gap through Swedish-style nomination committees](#), Tomorrow’s Company, 2010

7 Conclusion

153. We fully support the Government's aim to make Britain one of the best places in the world to invest and do business, and agree that this means having a framework of corporate governance that is seen as setting the gold standard. We also agree with the Prime Minister's stated aim to improve levels of trust in business and to address the perception that too often big businesses operate without sufficient regard for the communities and environment in which they are based. We have made recommendations in this Report that are evolutionary in spirit, designed to improve further international confidence in UK corporate governance and as a place to invest; to improve public confidence in big business in the UK; and to promote a culture of long-term decision making by UK businesses, in the interests of the full range of stakeholders, including employees.

154. The objectives outlined above are not controversial in themselves. The challenge is to align the interests and incentives of all those in the investment chain to this orientation: that is, executive teams, asset owners, institutional investors, fund managers, advisors and agents. **These reforms are not intended to create onerous new requirements, but to establish arrangements to ensure that the better enforcement of the Companies Act 2006, to improve the voice of other stakeholders, including employees, and to require companies to engage in a more open and transparent manner with the public. Their aim is to ingrain permanently the values and behaviours of excellent corporate governance into the culture of British business.**

Conclusions and recommendations

Context and background

1. The UK's strong corporate governance regime is a considerable asset which enhances the reputation of the UK as a place to do business. The Government should therefore be very cautious about taking steps that risk adversely affecting the UK's attractiveness as a place to invest. However, although the UK has a high international reputation in this field, there should be no complacency, nor any sense that improvements cannot be made. Within this context, the challenge is for businesses and Government to keep improving standards, without the impetus of high profile corporate scandals, in order to minimise the risks of future failings and to reflect both changes to the business environment and the rising expectations of society and stakeholders. The Government must help ensure that the UK stays ahead of the game in the light of changing business trends and practices. (Paragraph 8)
2. The fostering of a healthy culture in which to do business, particularly in terms of the means by which firms govern themselves and how they are accountable for the decisions they make lies behind the recommendations in this Report. Good company culture does not lend itself to easy measurement and cannot be enforced via a tick box exercise. Instead, the central tenets of good corporate governance should be embedded in the culture of all companies, so that it permeates activity at every level and in every sphere. It is cultural evolution, in line with the spirit of the Cadbury Report, that should be the long-term goal of Government, investors and companies. (Paragraph 12)
3. Corporate governance in the UK is still strong and remains an asset to the country's reputation for doing business. We are conscious that a small number of highly damaging examples of corporate governance failure should not lead to a hasty and disproportionate response. We do not believe that there is a case for a radical overhaul of corporate governance in the UK. We do believe that there is scope for significant improvements in order to address the changing nature of company ownership in a globalised economy. We explore these in the remainder of this Report. (Paragraph 24)

Promoting good corporate governance

4. We believe that more effective measures are required to ensure that directors demonstrably take seriously their duties to have regard to other stakeholders and the long-term consequences of decisions. This can best be achieved by requiring more specific and accurate reporting, supported by robust enforcement. (Paragraph 30)
5. *We recommend that the FRC amends the Code to require informative narrative reporting on the fulfilment of section 172 duties. Boards must be required to explain precisely how they have considered each of the different stakeholder interests, including employees, customers and suppliers and how this has been reflected in financial decisions. They should also explain how they have pursued the objectives of the company and had regard to the consequences of their decisions for the long*

term, however they choose to define this. Where there have been failures to have due regard to any one of these interests, these should be addressed directly and explained. (Paragraph 34)

6. The FRC should encourage companies to be more imaginative and agile in communicating digitally with stakeholders throughout the year and should actively push back on the use of boiler-plate statements in annual reports, using wider powers which we argue for in the next section. (Paragraph 35)
7. *We recommend that the Financial Reporting Council works with business organisations to develop appropriate metrics to inform an annual rating exercise. This should publicise examples of good and bad practice in an easy to digest red, yellow and green assessment. Companies must be obliged to include reference to this rating in their annual reports. (Paragraph 40)*
8. *We recommend that the Government brings forward legislation to give the Financial Reporting Council the additional powers it needs to engage and hold to account company directors in respect of the full range of their duties. Where engagement is unsuccessful, we would support the FRC in reporting publicly to shareholders on any failings of the board collectively or individual members of it. If companies were not to respond satisfactorily to engagement with the FRC, we recommend that the FRC be given authority to initiate legal action for breach of section 172 duties. Given the broader powers we have recommended in this Report, the Government should consider re-establishing, renaming and resourcing appropriately the FRC to better reflect its expanded remit and powers. (Paragraph 42)*
9. Rather than seek to introduce any new legislation, we would urge the Secretary of State to be more prepared than is presently the case to use existing powers where there is any suspicion of serious wrongdoing that may be in breach of the law. A public statement by Ministers to the effect of being considerably more pro-active in this areas may also have a welcome deterrent effect. (Paragraph 43)
10. *We recommend that the Investor Forum seeks to become a more pro-active facilitator of a dialogue between boards and investors by engaging in regular routine dialogue in order to pick up on any widespread concerns, for example those identified by the new FRC rating system. (Paragraph 47)*
11. *Stakeholder advisory panels can be a useful forum in which meaningful collaboration, consultation and dialogue with all stakeholders can take place. We urge companies to consider establishing such bodies. We recommend that the Code should be revised to require a section in annual reports detailing how companies are conducting engagement with stakeholders. (Paragraph 54)*
12. We welcome the assessments made and published relating to the performance of institutional investors in terms of their stewardship functions but believe that further action is required. *We recommend that the FRC reviews its Stewardship Code with a view to providing: more explicit guidelines on what high quality engagement would entail; a greater level of detail in terms of requirements; and an undertaking to call out poor performance on an annual basis. (Paragraph 55)*

13. *We recommend that the Government consults upon new requirements on listed and large private companies to provide full information on advisors engaged in transactions above a reasonable threshold, including on the amount and basis of payments and on their method of engagement. (Paragraph 59)*
14. *Increased transparency and accountability are the best routes to promoting better stewardship, high quality engagement and public trust. We recommend that the FRC includes in its revised Stewardship Code stronger provisions to require the disclosure of voting records by asset managers and undertakes to name those that subsequently do not vote. (Paragraph 60)*
15. *We recommend that the FRC includes best practice guidance on professional support for non-executive directors when it updates the Code and that companies include training of board members as part of reporting on their people or human resources policy. (Paragraph 64)*
16. *We recommend that the FRC updates the Code to provide guidance on how companies should identify clearly and transparently the roles of non-executive directors where they have particular responsibilities and how they should be held to account for their performance. We further recommend that NEDs should be required to demonstrate more convincingly that they are able to devote sufficient time to each company when they serve on multiple boards. (Paragraph 65)*

Private companies

17. *We recommend that the Financial Reporting Council, Institute of Directors and Institute for Family Business develop, with private equity and venture capital interests, an appropriate Code with which the largest privately-held companies would be expected to comply. They should contribute to the establishment of a new body to oversee and report on compliance with the Code. We further recommend that the new Code includes a complaint mechanism, under which the overseeing body could pursue with the company any complaints raised about compliance with the Code. The scheme should be funded by a small levy on members. Should this voluntary regime fail to raise standards after a three year period, or reveal high rates of unacceptable non-compliance, then a mandatory regulatory regime should be introduced. (Paragraph 74)*

Pay

18. *We agree with the Prime Minister that high and unwarranted executive pay is an issue that needs to be addressed for the benefit of society as a whole. It is hardly consistent with her vision of an economy that works for everyone to see levels of pay for those at the top increasing at a rate that vastly exceeds increases for ordinary employees and which seemingly is at odds with the value created in the company. (Paragraph 81)*
19. *We recommend that companies make it their policy to align bonuses with broader corporate responsibilities and company objectives and take steps to ensure that they are genuinely stretching. Policy in this respect would be considered by the FRC in their corporate governance rating system. (Paragraph 86)*

20. We conclude that LTIPs should be phased out as soon as possible. No new LTIPs should be agreed from the start of 2018 and existing agreements should not be renewed. (Paragraph 90)
21. *We recommend that the FRC consults with stakeholders with a view to amending the Code to establish deferred stock rather than LTIPs as best practice in terms of incentivising long-term decision making. Overall, we recommend that this consultation should develop guidelines for the structure of executive pay with the following features:*
 - *A simpler structure based primarily on salary plus long-term equity, to divest over a genuinely “long-term” period, normally at least five years, without large steps;*
 - *Limited use of short-term performance-related cash bonuses, which should be aligned, where possible, to wider company objectives or corporate governance responsibilities;*
 - *Clear criteria for bonuses: they should be genuinely stretching and be aimed to provide incentives rather than just reward.* (Paragraph 95)
22. We recognise that the job of leading a major company is extremely taxing and requires great skill and commitment. These roles, given their importance, should be appropriately rewarded. But overall pay levels have now been ratcheted up to levels so high that it is impossible to observe a credible link between pay and performance. At a time when average pay has remained relatively stable, these increases have served to undermine public trust in business. (Paragraph 99)
23. Deeper engagement alone may not be a powerful driver of pay restraint. We believe that the most effective remedy lies in the combined impact of the various measures we have outlined in this Report, including driving better stewardship through more transparency, better reporting, more employee involvement and tougher enforcement. If these measures and more responsible shareholder engagement does not have the desired effect, Government may have to consider more direct intervention. (Paragraph 103)
24. In our view, the current scale of opposition to remuneration reports and policies does not, at present, justify annual binding votes on pay levels. (Paragraph 105)
25. To incentivise the engagement of the otherwise uninterested, and to force effective action, we favour a strict approach to implementing this principle. Our preference is for the threshold for triggering a binding vote should be low and that companies should have one chance to resolve concerns, not two. A 25 per cent threshold would be consistent with the threshold for votes on a special resolution and would strike a reasonable balance in terms of the degree of leverage given to a single minority shareholder. It is reasonable to expect companies to address any serious and widespread concerns on remuneration by the following year. *We recommend that the FRC revises the Code to include a requirement for a binding vote on executive pay awards the following year in the event of there being a vote against such a vote of over 25 per cent of votes cast. This requirement should be included in legislation at the next opportunity.* (Paragraph 106)

26. Employee representation on remuneration committees would represent a powerful signal on company culture and commitment to fair pay. This option should be included in the Code and we expect leading companies to adopt this approach. (Paragraph 108)
27. Chairs should also be responsible for driving discussions aimed at delivering simpler structures and justifiable levels of remuneration and shareholders should be prepared to hold them to account if they have not engaged sufficiently to secure support for pay policies and annual reports. *We recommend that any Chair of a remuneration committee should normally have served on the committee for at least one year previously. To further incentivise strong engagement, we recommend that the Chair of a remuneration committee be expected to resign if their proposals do not receive the backing of 75 per cent of voting shareholders.* (Paragraph 109)
28. *We recommend that companies should set out clearly their people policy, including the rationale for the employment model used, their overall approach to investing in and rewarding employees at all levels throughout the company, as well as reporting clearly on remuneration levels on a consistent basis. The FRC should consult with relevant bodies to work up guidance on implementing this recommendation for inclusion in the Code.* (Paragraph 112)
29. *We recommend that the FRC works with other relevant stakeholders on the detail and amends the Code to require the publication of pay ratios between the CEO and both senior executives and all UK employees. We further recommend that the Government requires that equivalent pay ratios should be published by public sector and third sector bodies above a specified size.* (Paragraph 115)
30. We agree with the Prime Minister and the majority of respondents that executive pay is causing damage to the generally good reputation of British business. Too often pay awards appear impossible to justify in relation to performance and when set against pay levels lower down. This serves to undermine public trust in business, the engine of economic productivity and prosperity. There is a tension here between competitive businesses making rational business decisions in their own interests and the wider societal impacts of these awards. Government has a duty to monitor this tension and address it when it judges necessary in the public interest. But all parties need to be sensitive, and respond to, the shifting sands of opinion about fairness of rewards. There are some welcome signs that some businesses and investors are seeking to respond, but we do not have confidence that progress will be made without further pressure being exerted through the measures we recommend in this Report. It is now up to businesses to respond positively, in their own interests, to adjust to raised expectations in relation to executive pay. (Paragraph 116)

Composition of boards

31. Much has been achieved in increasing the number of women directors on boards since Lord Davies' recommendations in 2011. However, there is still one board in the FTSE 100 that has no women directors, and the increase in women that has occurred has been primarily in non-executive roles. The number of women executive directors is still very low, with only six women CEOs in the FTSE 100. We support the current work by the Hampton-Alexander Review, especially its recommendation

that the Government should, in consultation with business, consider how best to clarify or supplement the definition of ‘senior managers’ to have a more consistent, meaningful metric, based on the Executive Committee or its nearest equivalent in each company. (Paragraph 124)

32. Companies need to ensure that women are encouraged from early on in their careers, through mentoring, meaningful work experience, and proper flexible working, to ensure they are equipped to progress to executive director posts. Firms also need to communicate how they are approaching the encouragement and engagement of women throughout the organisation. The FRC should take this into account as part of its rating system. (Paragraph 125)
33. Also we support the Hampton-Alexander Review’s recommendation that the FRC should amend the UK Corporate Governance Code, so that all FTSE 350 listed companies are required to disclose in their annual report the gender balance on the Executive Committee and direct reports to the Executive Committee. (Paragraph 126)
34. *We believe that the aims and targets of the Hampton-Alexander Review should go further and, in support of the Equality and Human Rights Commission’s objective, we recommend that the Government should set a target that from May 2020 at least half of all new appointments to senior and executive management level positions in the FTSE 350 and all listed companies should be women. Companies should explain in their annual report the reasons why they have failed to meet this target, and what steps they are taking to rectify the gender inequality on their Executive Committees.* (Paragraph 127)
35. *For companies seeking a competitive advantage, the directors and non-executives running them, and those setting the strategic context in which they operate, should be empathetic to the needs and requirements of all those involved, including employees, workers, suppliers and customers. It makes business sense to recruit directors from as broad a base as possible, across the demographic of the UK. We recommend that the FRC embeds the promotion of the ethnic diversity of boards within its revised Code. At the very least, we recommend that wherever there is a reference to gender, the FRC should include a reference to ethnicity, so that the issue of ethnic diversity on boards is made explicit in the revised Code, and is given as much prominence as gender diversity.* (Paragraph 132)
36. *In accordance with the spirit of the McGregor Smith review, we recommend that the Government should legislate to ensure that all FTSE 100 companies and businesses publish their workforce data, broken down by ethnicity and by pay band.* (Paragraph 133)
37. *The more similar that individual directors think, act, and look, the more likely it is that they are not going to challenge each other, or innovate, or think imaginatively. Directors should not be appointed to the board solely on the basis of one particular background or area of expertise. Greater cognitive diversity promotes more effective challenge and more informed decision-making and we recommend that the FRC works with others to provide improved guidance on this aspect of diversity in the context of board membership.* (Paragraph 136)

38. We support measures to enhance the executive pipeline, ensuring that talented people within an organisation are encouraged and supported at an early stage of their careers, and beyond, into middle and senior management. (Paragraph 138)
39. *The revised Code should have the issue of board diversity as a key priority and there should be a public explanation of the reasons why members are part of the board. The Code should require boards to cover in their annual reports information diversity on their boards and in the workforce, covering diversity of gender, ethnicity, social mobility, and diversity of perspective. Annual reports should be required to include a narrative on the current position, and an emphasis on what steps the company has taken, and will continue to take to enhance the diversity of the executive pipeline, with agreed targets. This narrative should include how accurately the board mirrors the diversity of both the workforce and the customer base.* (Paragraph 139)
40. *The detailed narrative of board diversity in annual reports should be a working document throughout the year, informing the board, the Nomination Committee, middle and senior managers, and the workforce and other stakeholders, about the seriousness that companies are taking diversity and succession issues. The revised Code should make this requirement explicit.* (Paragraph 140)
41. Having a single worker on a board will not address the fundamental issue of the company's engagement with the workforce, and could risk being seen as a token nod towards employee participation at board level. However, we believe that employees can bring a different perspective and challenge to the board, and are more likely to encourage a long-term perspective. This issue needs to be seen in the context of recognising where success and value are created in an organisation, such as its staff, and having an HR function that is explicitly aligned with a firm's strategic direction and has sufficient influence at the highest level. (Paragraph 145)
42. *We recommend that companies should be recruiting non-executive and executive directors from the widest possible net of suitable candidates, which should include recruiting internally. Successful companies, both here and abroad, have shown that this can work for the benefit of the company as a whole, and we encourage more companies to appoint workers on boards. We believe that, just as the drive for women directors has overcome initial doubts, it should become the norm for workers to serve on boards.* (Paragraph 146)
43. We are not minded to recommend the compulsory requirement for companies over a certain size to include a worker on board. There are numerous difficulties to overcome including, for example, how the term 'worker' is defined and how the post would be filled. However, there is nothing in law that prevents workers serving on boards, and the diversity of board members, including workers on boards, should be encouraged. There are already long-established boards where this is the norm, for example John Lewis, First Group, and the NHS Foundation Trust Boards. They do not appear to have suffered from some of the disadvantages that sceptics have suggested. Employees appointed to boards should be directors in their own right, with the necessary skills and aptitudes to play a part as a full board member rather than a representative of the workforce. They would not be a delegate, but would provide the same strategic evaluation and challenge that every director should bring. (Paragraph 147)

44. *We recommend that the revised Code states explicitly that the procedure for the appointment of new directors to the board should be by open advertising, and by an external search consultancy, and detailed explanations should be given if one or both of these requirements is not met. (Paragraph 151)*
45. *We recommend that the FRC should be given the extra role of overseeing the rigour of the evaluation process to ensure that it is genuinely independent, thorough and consistent across companies. The FRC should highlight best and worst practice among Nomination Committees. (Paragraph 152)*

Conclusion

46. These reforms are not intended to create onerous new requirements, but to establish arrangements to ensure that the better enforcement of the Companies Act 2006, to improve the voice of other stakeholders, including employees, and to require companies to engage in a more open and transparent manner with the public. Their aim is to ingrain permanently the values and behaviours of excellent corporate governance into the culture of British business. (Paragraph 154)

Formal Minutes

Thursday 30 March 2017

Members present:

Mr Iain Wright, in the Chair

Peter Kyle	Anna Turley
Michelle Thomson	Chris White
Amanda Milling	

Draft Report (*Corporate Governance*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 154 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for publishing with the Report (in addition to that ordered to be reported for publishing on 1, 15, 22 November, 20 December, 10, 17 January, and 21 February).

[Adjourned till Wednesday 19 April at 9.00 am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the [inquiry publications page](#) of the Committee's website.

Tuesday 15 November 2016

Question number

Janet Williamson, Senior Policy Officer, Economics and Social Affairs Department, Trades Union Congress, **Oliver Parry**, Head of Corporate Governance, Institute of Directors, and **Stephen Haddrill**, Chief Executive Officer, Financial Reporting Council

[Q1–47](#)

Alex Edmans, Professor of Finance, London Business School, **Mike Everett**, Governance and Stewardship Director, Standard Life Investments, **Peter Montagnon**, Associate Director, Institute of Business Ethics, and **Jonathan Chamberlain**, Employment Lawyers Association

[Q48–72](#)

Wednesday 23 November 2016

Professor Vanessa Knapp, Queen Mary University of London, **Elizabeth Wall**, City of London Law Society, and **Catherine Howarth**, Chief Executive, ShareAction

[Q73–114](#)

Paul Lee, Head of Corporate Governance, Aberdeen Asset Management, **Cliff Weight**, Director, ShareSoc, **Sarah Wilson**, Chief Executive, Manifest, and **Kerrie Waring**, Executive Director, International Corporate Governance Network

[Q115–156](#)

Tuesday 6 December 2016

Amra Balic, Managing Director, Head of EMEA, BlackRock Investment Stewardship, BlackRock, **Sir John Hood**, Chair, Compensation Committee, WPP, **Jan du Plessis**, Chair, Rio Tinto, and **Helena Morrissey**, Executive Remuneration Working Group, The Investment Association

[Q157–223](#)

Dr Hans-Christoph Hirt, Executive Director, Hermes, **Stefan Stern**, Director, High Pay Centre, **Professor Charlotte Villiers**, Professor of Company Law and Corporate Governance, University of Bristol Law School, and **Andrew Page**, Partner, New Bridge Street

[Q224–260](#)

Tuesday 20 December 2016

Denise Wilson, CEO, Hampton/Alexander Review, **Tom Shropshire**, Steering Committee, Parker Review, **Rowena Ironside**, Founder and Chair, Women on Boards UK, **Edward Speed**, Global Chairman, Spencer Stuart, and **Laurie Fitzjohn-Sykes**, Head of Research, Tomorrow's Company

[Q261–313](#)

Nigel Wilson, CEO, Legal & General Group, **Mick Barker**, Group Employee Director, FirstGroup, **Tim O'Toole**, CEO and Board Member, FirstGroup, and **Frances O'Grady**, General Secretary, Trade Union Congress

[Q314–371](#)

Tuesday 24 January 2017

Baroness Sarah Hogg, Lead Independent Director, HM Treasury, Chairman of the Audit Committee, John Lewis plc, and non-executive director, Financial Conduct Authority, **Tom Gosling**, Partner, PwC, and **Simon Fraser**, Chair, Investor Forum

[Q372–411](#)

Ken Olisa, Deputy Chairman, Institute of Directors, Chairman of Independent Audit, Chairman of the Shaw Trust, President of Thames Reach, and non-executive director, Thomson Reuter, **Andrew Ninian**, Director, Corporate Governance and Engagement, Investment Association, and **Sir Philip Hampton**, Chair, Hampton-Alexander Review

[Q412–442](#)

Published written evidence

The following written evidence was received and can be viewed on the [inquiry publications page](#) of the Committee's website.

CGV numbers are generated by the evidence processing system and so may not be complete.

- 1 30% Club ([CGV0126](#))
- 2 Aberdeen Asset Management plc ([CGV0102](#))
- 3 ACAS ([CGV0146](#))
- 4 ACCA ([CGV0100](#))
- 5 Allen & Overy LLP ([CGV0071](#))
- 6 B LAB UK ([CGV0083](#))
- 7 Baillie Gifford ([CGV0108](#))
- 8 BlackRock ([CGV0097](#))
- 9 Board Intelligence ([CGV0125](#))
- 10 British Bankers' Association ([CGV0085](#))
- 11 Building Societies Members Association ([CGV0162](#))
- 12 Caerus Consulting Ltd ([CGV0122](#))
- 13 Campaign for Merit in Business ([CGV0008](#))
- 14 Campaign for Triple Purpose Capitalism ([CGV0059](#))
- 15 Campaigner, Artist and Inventor Bob Goodall ([CGV0052](#))
- 16 Campaigner, Artist and Inventor Bob Goodall ([CGV0140](#))
- 17 Carillion ([CGV0168](#))
- 18 Chartered Institute of Internal Auditors ([CGV0143](#))
- 19 Chris Philp ([CGV0089](#))
- 20 CIMA ([CGV0014](#))
- 21 CIPD ([CGV0110](#))
- 22 City of London Law Society ([CGV0148](#))
- 23 ClientEarth ([CGV0104](#))
- 24 Commonwealth Businesswomen's Network ([CGV0131](#))
- 25 Communication Workers Union ([CGV0072](#))
- 26 Confederation of British Industry (CBI) ([CGV0069](#))
- 27 Co-operatives UK ([CGV0158](#))
- 28 Council for Work and Health ([CGV0019](#))
- 29 DAC Beachcroft LLP ([CGV0079](#))
- 30 David Chivers ([CGV0103](#))
- 31 Deloitte ([CGV0145](#))
- 32 Director and Founder of Consulting company Steven Phillips ([CGV0064](#))
- 33 DLA Piper LLP ([CGV0115](#))

- 34 Dr Amama Shaukat ([CGV0087](#))
- 35 Dr Barnali Choudhury ([CGV0160](#))
- 36 Dr Ewan McGaughey ([CGV0149](#))
- 37 Dr Konstantinos Stathopoulos ([CGV0027](#))
- 38 Dr Rodion Skovoroda ([CGV0042](#))
- 39 Durham University/Leeds University ([CGV0038](#))
- 40 EEF, the manufacturers' organisation ([CGV0142](#))
- 41 Emeritus Professor of Corporate Governance Laura Spira ([CGV0024](#))
- 42 Employment Lawyers Association ([CGV0065](#))
- 43 Equality and Human Rights Commission ([CGV0152](#))
- 44 Eric Chalker ([CGV0135](#))
- 45 Fidelity International ([CGV0107](#))
- 46 Financial Reporting Council ([CGV0078](#))
- 47 Financial Reporting Council ([CGV0172](#))
- 48 First Flight Non-Executive Directors ([CGV0167](#))
- 49 FirstGroup ([CGV0170](#))
- 50 FIT Remuneration Consultants ([CGV0005](#))
- 51 Hampton-Alexander Review ([CGV0106](#))
- 52 Hermes Investment Management ([CGV0090](#))
- 53 High Pay Centre ([CGV0040](#))
- 54 Howard Kennedy LLP ([CGV0112](#))
- 55 ICAS ([CGV0139](#))
- 56 ICSA: The Governance Institute ([CGV0111](#))
- 57 Inspiration for Success ([CGV0138](#))
- 58 Institute for Family Business ([CGV0054](#))
- 59 Institute of Business Ethics ([CGV0016](#))
- 60 Institute of Chartered Accountants in England and Wales ([CGV0116](#))
- 61 Institute of Directors ([CGV0034](#))
- 62 Institute of Directors ([CGV0175](#))
- 63 International Corporate Governance Network ([CGV0025](#))
- 64 International Institute for Self-governance ([CGV0012](#))
- 65 International Integrated Reporting Council ([CGV0164](#))
- 66 IPA ([CGV0161](#))
- 67 John Kay ([CGV0174](#))
- 68 John Lewis Partnership ([CGV0099](#))
- 69 Legal & General Group Plc ([CGV0098](#))
- 70 Legal and General Investment Management Ltd ([CGV0095](#))
- 71 M Garsdale ([CGV0105](#))

- 72 Manifest ([CGV0062](#))
- 73 Mazars LLP ([CGV0134](#))
- 74 Mercer ([CGV0101](#))
- 75 MobiCycle Ltd ([CGV0155](#))
- 76 Mr Charlie Geffen ([CGV0030](#))
- 77 Mr Daniel Hibbert ([CGV0001](#))
- 78 Mr David Offenbach ([CGV0057](#))
- 79 Mr Dowshan Humzah ([CGV0130](#))
- 80 Mr Francois Knuchel ([CGV0129](#))
- 81 Mr Guy Jubb ([CGV0011](#))
- 82 Mr JOHN DAVIES ([CGV0003](#))
- 83 Mr John Mills ([CGV0121](#))
- 84 Mr Michael Nisbet ([CGV0136](#))
- 85 Mr Michael Nisbet ([CGV0137](#))
- 86 Mr Michael Romberg ([CGV0002](#))
- 87 Mr Ryan Turner ([CGV0074](#))
- 88 Mrs Helena Morrissey ([CGV0017](#))
- 89 Ms charlotte valeur ([CGV0123](#))
- 90 Ms Joy Allen ([CGV0051](#))
- 91 National Federation of SubPostmasters ([CGV0163](#))
- 92 Nestor Advisors Ltd ([CGV0117](#))
- 93 New Bridge Street (Aon Hewitt Ltd) ([CGV0093](#))
- 94 NJMD Corporate Services Limited ([CGV0028](#))
- 95 Oxfam GB ([CGV0133](#))
- 96 Patrick Andrews ([CGV0004](#))
- 97 Pensions and Lifetime Savings Association ([CGV0141](#))
- 98 People Innovation Ltd Jane Williams ([CGV0058](#))
- 99 Phoenix Group Holdings ([CGV0096](#))
- 100 PIRC ([CGV0169](#))
- 101 PIRC Limited ([CGV0154](#))
- 102 PricewaterhouseCoopers LLP (PwC) ([CGV0159](#))
- 103 Prism Cosec ([CGV0066](#))
- 104 Professor Alex Edmans ([CGV0006](#))
- 105 Professor Alex Edmans ([CGV0173](#))
- 106 Professor Andrew Keay ([CGV0010](#))
- 107 Professor Charlotte Villiers ([CGV0013](#))
- 108 Professor David Kershaw ([CGV0120](#))
- 109 Professor Lorraine Talbot ([CGV0044](#))

- 110 Professor Michael Gold ([CGV0075](#))
- 111 Professor of Finance Grzegorz Trojanowski ([CGV0047](#))
- 112 Professor of Finance Grzegorz Trojanowski ([CGV0055](#))
- 113 Professor Paul Moxey ([CGV0041](#))
- 114 Professor Ruth Sealy ([CGV0043](#))
- 115 Professor Vanessa Knapp ([CGV0031](#))
- 116 Public Concern at Work ([CGV0073](#))
- 117 PwC ([CGV0176](#))
- 118 Quoted Companies Alliance ([CGV0056](#))
- 119 Recruitment and Employment Confederation ([CGV0153](#))
- 120 Rosemary Greaves ([CGV0127](#))
- 121 Royal London Asset Management ([CGV0076](#))
- 122 RPMI Railpen ([CGV0119](#))
- 123 RSA (Royal Society of Arts, Manufactures and Commerce) ([CGV0113](#))
- 124 Severn Trent Plc ([CGV0070](#))
- 125 ShareAction ([CGV0124](#))
- 126 ShareAction ([CGV0171](#))
- 127 ShareSoc, The UK Individual Shareholders Society ([CGV0021](#))
- 128 Sheetal Radia ([CGV0150](#))
- 129 Sheffield Institute of Corporate and Commercial Law ([CGV0037](#))
- 130 Short Richardson and Forth LLP ([CGV0007](#))
- 131 Simon Witney ([CGV0114](#))
- 132 Society for the Environment ([CGV0039](#))
- 133 Spencer Stuart ([CGV0092](#))
- 134 Standard Life plc ([CGV0091](#))
- 135 TBP2 Limited ([CGV0048](#))
- 136 The Alternative Investment Management Association ([CGV0077](#))
- 137 The Association of Investment Companies ([CGV0053](#))
- 138 The Durham Company Law Project ([CGV0029](#))
- 139 The Equality Trust ([CGV0033](#))
- 140 The Go-Ahead Group plc ([CGV0020](#))
- 141 The Investment Association ([CGV0109](#))
- 142 The Modern Corporation Project at Cass Business School and Frank Bold ([CGV0165](#))
- 143 TLT LLP ([CGV0026](#))
- 144 Tomorrow's Company ([CGV0118](#))
- 145 Trade Union Share Owners ([CGV0068](#))
- 146 Trades Union Congress ([CGV0060](#))
- 147 Trades Union Congress ([CGV0156](#))

- 148 UK Policy Governance Association ([CGV0067](#))
- 149 UKSIF ([CGV0157](#))
- 150 Unite the Union ([CGV0094](#))
- 151 United Kingdom Shareholders' Association ([CGV0080](#))
- 152 University College London ([CGV0032](#))
- 153 University of Southampton Brenda Hannigan ([CGV0045](#))
- 154 Usdaw ([CGV0035](#))
- 155 Vocational Rehabilitation Association ([CGV0023](#))
- 156 Which ([CGV0144](#))
- 157 Willis Towers Watson ([CGV0063](#))
- 158 Women on Boards UK ([CGV0050](#))
- 159 WWF-UK ([CGV0015](#))
- 160 Yixi Liao ([CGV0166](#))

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the [publications page](#) of the Committee's website.

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2016–17

First Report	Access to finance	HC 84 (HC 980)
Second Report	Industrial Strategy: First Review	HC 616
Second Special Report	The Government's Productivity Plan: Government Response to the Business, Innovation and Skills Committee's Second Report of Session 2015–16	HC 931
Third Special Report	The Digital Economy: Government Response to the Business, Innovation and Skills Committee's Second Report of Session 2016–17	HC 930
Fourth Special Report	The energy revolution and future challenges for UK energy and climate change policy: Government Response to the Energy and Climate Change Committee's Third Report of Session 2016–17	HC 945
Fifth Special Report	Access to finance: Government Response to the Committee's First Report	HC 980