



## Too much expected of section 172?

'Although the FRC's Guidance on Board Effectiveness states that in order to protect the company's long-term interests, difficult board decisions may "sometimes" adversely impact stakeholders, section 172 cannot prevent directors taking actions that are contrary to stakeholder interests or even the long-term interests of the company. No doubt such a company would not thrive. Nevertheless the section does not guard against bad business judgements taken in good faith.'

*Professors Joan Loughrey and Terry McNulty*

---

## More authenticity?

'Society and key stakeholders have more expectations than ever before in companies and they expect companies to be part of the solution within society, rather than the problem. The growing recognition that "good" business behaviour supports strong financial performance is becoming the norm.'

*Anne Kirkeby*

---

## Content

- |                      |           |  |
|----------------------|-----------|--|
| <b>News</b>          | <b>3</b>  | <b>The Female FTSE Board Report 2018</b><br>The latest annual Report from Cranfield School of Management criticises the lack of progress in improving gender diversity at the highest executive echelons of FTSE 350 companies, identifies the leading players in gender diversity in the FTSE 100 and highlights those companies that are lagging behind the rest |
| <b>International</b> | <b>4</b>  | <b>Global Compliance Complexity Index 2018</b><br>A new Report from TMF Group gives a detailed understanding of the changing picture of corporate compliance across 84 countries, ranking them in order of the complexity of regulatory compliance   |
| <b>Global News</b>   | <b>5</b>  | <b>Top boardroom concerns<br/>Implementing GDPR</b>  |
| <b>Features</b>      | <b>6</b>  | <b>Too much expected of section 172?</b><br><b>Professors Joan Loughrey and Terry McNulty</b> ask if the Government and the FRC are focusing on the wrong issue to restore trust in business   |
|                      | <b>8</b>  | <b>More authenticity?</b><br><b>Anne Kirkeby</b> considers the changing face of UK governance and reporting and the need to focus on long-term value creation and argues that what's needed in FTSE 100 annual reports is more authenticity  |
|                      | <b>10</b> | <b>The new UK CG Code</b><br><b>Anthony Fitzsimmons</b> looks at the new UK Corporate Governance Code and Guidance on Board Effectiveness which were both published last month   |

## Editorial Board

### Executive Editor

#### Michelle Edkins

Managing Director, Global Head of Corporate Governance & Responsible Investment, Blackrock

### Editorial Advisory Board

#### Jamie Allen

Secretary General, Asian Corporate Governance Association

#### David W. Anderson

President, The Anderson Governance Group

#### Philip Armstrong

Director of Governance, Gavi

#### Kit Bingham

Partner & Head, Chair & Non-Executive Director Practice, Odgers Berndtson

#### Peter Butler

Founder Partner, GO Investment Partners

#### Richard Davies

Managing Director, RD:IR

#### Stephen Davis

Associate Director, Harvard Law School Programs on Corporate Governance & Institutional Investors

#### Alison Gill

Director, Bvalco Ltd

#### Sandra Guerra

Founder Partner of Better Governance, Brazil

#### Robert McCormick

Partner, CamberView Partners LLC

#### Alan McDonnell

Principal, Good Governance Solutions Ireland

#### Colin Melvin

CEO of Hermes Equity Ownership Services Ltd

#### Paul Moxey

Visiting Professor in Corporate Governance at London South Bank University

#### Liz Murrall

Director, Corporate Governance and Reporting, IA

#### Sean O'Hare

Founder, Boardroom Dialogue

#### Chris Pierce

CEO, Global Governance Services Ltd

#### Geof Stapledon

Vice President Governance for BHP Billiton

#### Kerrie Waring

Executive Director at ICGN

### Publisher

#### Lesley Stephenson

Tel: +44 (0) 1278 793300

Email: [lesley@governance.co.uk](mailto:lesley@governance.co.uk)

### News Editor

#### Katharine Jackson

Email: [katharine.jackson@governance.co.uk](mailto:katharine.jackson@governance.co.uk)



**NON-EXECUTIVE  
DIRECTOR  
DIPLOMA**

## LEAD A SUCCESSFUL NON-EXECUTIVE CAREER

**Develop the skills and knowledge to secure non-executive positions and succeed in them.**

The Financial Times Non-Executive Director Diploma is a fully accredited postgraduate qualification that will improve your board effectiveness and contribution.

Available in London and Hong Kong, the course is delivered through a combination of face-to-face and online learning.

[non-execs.ft.com](http://non-execs.ft.com) | [contact@ft.com](mailto:contact@ft.com)  
**+44 (0) 207 873 4909**



## News

# The Female FTSE Board Report 2018

'Despite progress in female representation on non-executive board positions there is a lack of women in executive roles on boards of the UK's leading companies', according to a recent report, *The Female FTSE Board 2018: Busy Going Nowhere with the Female Executive Pipeline*.

Published by Cranfield School of Management, the Report criticises the lack of progress in improving gender diversity at the highest executive echelons of FTSE 350 companies, identifies the leading players in gender diversity in the FTSE 100 and highlights those companies that are lagging behind the rest. It also looks at how companies could better support senior women's executive careers.

### FTSE 100 companies

Two different pictures emerge in terms of women's representation on FTSE 100 and FTSE 250 corporate boards. The percentage of women on FTSE 100 boards has increased from 27.7% to 29% and in total 264 women hold 305 directorships on FTSE 100 boards. The percentage of female non-executive director (non-exec) positions is at an all-time high of 35.4%, whilst the percentage of female executive positions has flat lined at 9.7%. Female directors are on average nearly two years younger than their male counterparts, but serve for less time and have an average tenure of 3.7 years compared to 5.4 years for men.

At present 32 FTSE 100 companies have already reached the target of 33% women on their boards: Diageo holds top position with 55% women on their board, followed by Whitbread and Hargreaves Lansdown with 50% and GlaxoSmithKline and Royal Dutch Shell with 45% women on their boards.

There is no change in the number of women holding executive roles (25 in 22 companies), with seven women CEOs and ten women CFO/FDs. There has been better progress for women non-execs: not only are their numbers up, but also there are more women in Chair (seven) and Senior Independent Director (SID) (18) positions and a further 85 women hold 95 Chair roles on the various committees across FTSE 100 boards, compared to 253 men who Chair 293 committees. The majority of women (43) Chair remuneration committees and a further 23 Chair audit/risk committees.

In terms of gender pay gap, the top ten companies had a slightly lower average gender pay gap than the bottom ten companies (four of the bottom ten companies not reporting on their gender pay gap). The two best companies are Diageo and GlaxoSmithKline, with a gender pay gap of 4.1% and 2.8% respectively and both companies have a substantial percentage of women at all four levels/quartiles.

### FTSE 250 companies

There has been disappointing progress on the FTSE 250 boards: the percentage of women on the boards has only increased marginally from 22.8% to 23.7% and the number of companies with at least 33% women on their boards has increased from 53 in 2017 to 59. However, the number of women in executive directorships has dropped from 7.7% to 6.4% (38 to 30), even lower than the 9.7% on FTSE 100 boards; there are only five women holding CEO positions and 19 holding CFO/FD positions and the number of all male boards has increased to ten.

FTSE 250 companies should examine their female talent pipeline, identify the challenges and commit to improving the situation.

### Nurturing female leadership talent

Traditionally, functional heads (HR Director, General Counsel, Communications Director) on executive committees have not been considered for board roles, as they are seen as having narrow functions and lacking operational experience and business acumen, however they represent a significant pool of executive talent. Organisations seeking to support women's careers should not rely exclusively on those who 'naturally' claim leadership roles, but ensure that they recognise and respond to other individuals capable of stepping up to such roles.

Growth-orientated organisational cultures and formal talent processes emerged as more important in nurturing leadership aspirations for women. Sponsors, mentors, bosses and coaches, organisational cultures and talent processes are vital in forming and supporting leaders. Future corporate governance guidelines should address best practice in designing executive committees. The added value of functional heads in contributing to boards as an executive or non-exec is being increasingly recognised and functional heads represent an important pipeline of executive and non-exec board talent.

The Report contains some good news but also raises a number of issues of concern, particularly the complete lack of progress in developing the female executive pipeline. Organisations must better develop their female executive pipeline, targets must be truly embedded in the organisation and search consultants and Chairs must actively support women in their non-exec careers.

For the full report go to: <https://www.cranfield.ac.uk/som/expertise/changing-world-of-work/gender-and-leadership/female-ftse-index>

# International

.....

## Global Compliance Complexity Index 2018

'A large number of new international regulations have been implemented across the globe which, in general, promote visibility, but the way and speed in which they are implemented differs from country to country, meaning the overall complexity picture is far from uniform', according to a new report from the TMF Group, a leading global financial and business compliance services provider. The Report, *Compliance Complexity Index 2018: Meeting the global challenge of evolving corporate compliance*, gives a detailed understanding of the changing picture of corporate compliance across 84 countries, ranking them in order of the complexity of regulatory compliance (one the most complex and 84 the least).

### Asia Pacific

APAC has a very diverse range of languages, cultures and legal systems and, as a result, has the fewest region-wide compliance trends of any of the Report's three geographic groupings. Broadly speaking, jurisdictions in the region tend to have more time-consuming compliance requirements than elsewhere. Of the 100 countries committed to the global Common Reporting Standard (CRS), most Asian countries are late adopters and will begin, or have begun, in 2018.

China is the most complex jurisdiction in the region and 3rd worldwide. However, China's business environment is evolving quickly: the Chinese Government has begun streamlining its administrative processes and efforts have been made to increase government transparency and expand the application of e-government and online administration. Australia is one of the least complex jurisdictions, ranked at 15th regionally and 62nd globally. The regulatory requirements for incorporating a company in Australia are relatively straightforward however ongoing requirements in terms of corporate compliance are strictly enforced by the Australian Securities and Investment Commission. Failure to adhere to the compliance obligations could lead to severe penalties for both companies and officers.

### The Americas

North, Central and South America each have broad complexity trends. In recent years, North American countries have implemented a digital compliance infrastructure that supports and encourages a high degree of transparency, but this adds complexity. Many Central American and Caribbean countries had a poor reputation however most have built a strong set of principles and legal frameworks. Processes in many South American countries tend to be bureaucratic and several countries in the region are in the process of implementing global regulatory initiatives.

Argentina is the most complex jurisdiction in the Americas and 4th globally. In 2017 the Argentinian Government adopted new measures aimed at saving costs, modernising and simplifying the country's corporate governance. From a compliance standpoint, Curaçao is the least complex business location

in the Americas (26th regionally and 82nd globally), partly because the government has begun to remove red tape around processes such as tax filing and applying for permits, making the tax filing system more user-friendly.

### Europe, Middle East and Africa (EMEA)

EMEA has a diverse mix of legal systems and these have an effect on compliance complexity: the two most complex countries in the 2018 Index (UAE and Qatar) have a legal system based on Sharia law. One of the biggest factors within EMEA is the European Union: in recent years, European Directives have harmonised aspects of compliance for EU members, at the same time increasing transparency.

The introduction of VAT in the UAE has impacted not only accounting practices but also company compliance requirements, resulting in this jurisdiction being ranked the most complex both regionally and globally in 2018. Many of the UAE's constituent Emirates have increased their filing requirements and are enforcing deadlines and penalties for late submissions. The UAE is also starting to introduce CRS and implementing more rigorous Know Your Client regulations (requiring companies to carry out due diligence on their customers).

Of all the countries surveyed, Ireland is the simplest from a compliance standpoint. All Irish registered companies must maintain an internal UBO Register in accordance with EU anti-money laundering legislation and the Irish authorities are currently in the process of transposing further EU legislation into Irish law requiring all registered companies to file their UBO Register in a Central Register; once implemented, companies will have three months to file. The Irish Companies Registration Office is now also commencing enforcement proceedings against companies and directors who fail to file annual returns within 180 days of a missed deadline.

### Conclusion

Complexity is a crucial factor and in order to effectively address increasing global complexity businesses should consider: understanding and mapping complexity using audits and compliance health checks and incorporating these into business strategy; ensuring a consistent and scalable global framework; and partnering for successful compliance – liaising effectively with regulators, partnering with professional service providers and aligning with stakeholders.

.....  
For the full report go to: <https://www.tmf-group.com/en/news-insights/publications/2018/the-compliance-complexity-index/>

# Global News

## Top boardroom concerns

‘Concerns around activist investors, lack of diversity, corporate reputation and disruptive technologies are raising increasingly tough questions in the boardroom’, according to WomenCorporateDirectors, the global membership organisation of women board members, drawing from discussions with more than 200 directors and governance experts from 20 countries worldwide.

Organisations are becoming increasingly compelled to listen to activist investors, giving new momentum to maintaining good communication. Recently activists have emerged with enormous financial, analytical and legal resources behind them, becoming much more effective in overcoming voting structures and cultural barriers to change, and now have much more underlying support from institutional shareholders. Many organisations are struggling with how to account for reputation in their business model and incorporating reputation into the bottom line, with many battling public perceptions about who they really serve. Organisations also need to identify weak links in the business, eg not having a strong, well-communicated long-term strategy; or general failure of board oversight.

Boards and management must be proactive, not only around strategy but also around board composition, including diversity and making changes to board skill-sets to meet business

needs. They should also cultivate a culture of innovation and consider new initiatives as if an investor, providing the rigour, focus and right governance structure needed for companies seeking to innovate. Directors should ensure that they are supporting decisions through sound processes: an increasingly important part of governance is recognising blind spots and innate biases that may detrimentally influence board discussion.

New technologies are now driving new business models, new customer engagement opportunities and new businesses. Boards have to become very adept in understanding new technology and what is out there; what is becoming possible; and create its own demand in the market. However, disruptive technology is affecting the workforce: those used to dealing with older-generation machines may adapt more easily to working with new generation machines, compared to highly-trained workers who may feel that they are no longer part of the useful decision-making process and can be more difficult to retrain.

There is also wider availability of digital data, a sharp fall in the cost of storing and processing that data, increased ability to process data and machine capabilities have accelerated, all of which have enabled organisations to make greater use of artificial intelligence.

## Implementing GDPR

‘Organisations have found GDPR to be a huge drain on resources’, according to a poll by ICSA: The Governance Institute and recruitment specialist The Core Partnership. The poll found that 78% of organisations have found becoming compliant with the EU’s General Data Protection Regulation (GDPR) to be a heavy burden on their resources; 9% were unsure and 13% felt that it had not been a heavy burden. Just 50% of organisations were fully compliant with GDPR when it came into force on 25 May, 27% admitted to not being fully compliant in time, with the remaining 23% unsure.

Challenges facing organisations introducing GDPR included: not having the internal resource and therefore having to employ additional staff or engage external solicitors, who themselves saw an increased workload, reducing their response time; and tech resources having to be diverted from business improvements, improving productivity and driving the business forward. Other challenges included: ‘getting face time from all parts of the organisation’; lack of clarity on some of the rules and requirements; misleading information from ‘expert’ consultants that muddied the waters; and issues with legacy systems not inherently designed to cope with the information protection, retrieval and deletion requirements of GDPR.

However, some respondents were a little more pragmatic saying that significant change always places a burden on an organisation and external subject matter expertise is often required and that GDPR was no different to other significant change projects or regulatory change. Some organisations were also less affected as they do not hold much personal data and good practice was already in place. Others struck a more positive note, stating that: ‘It has taken a considerable amount of time, but has provided us with a good opportunity to review contracts and arrangements with external suppliers’ and ‘It will improve our approach to data handling and ensure that our housekeeping is much better’.

Achieving full compliance has been extremely time-consuming for many organisations and there is concern that ongoing compliance will continue to be a burden. Many of the areas seen as problematic – coordination between jurisdictions; group-wide solutions; third-party engagement and staff training – will continue to be important and will require processes and procedures to be reviewed on an ongoing basis.

For more information go to: <https://www.icsa.org.uk/knowledge/governance-and-compliance/indepth/comment/quick-question>



## Feature

---

# Too much expected of section 172?

**Professors Joan Loughrey and Terry McNulty** ask if the Government and the FRC are focusing on the wrong issue to restore trust in business.

The FRC's latest iteration of the UK Corporate Governance Code, published on 16 July 2018, together with new Guidance on Board Effectiveness contains a much stronger focus on the need for directors to take account of the impact of their decisions on stakeholders, pointing out the duty on directors in section 172 of the Companies Act 2006 to have regard to stakeholder interests.

This is to be welcomed. A series of corporate collapses – most recently Carillion – have hit suppliers, creditors, and customers hard, and damaged trust in business. The joint Work and Pensions and BEIS Report into Carillion questioned the extent to which Carillion's directors had regard to the considerations in section 172 in the light of a policy of short-term growth, late payment of suppliers, and failure to make up the pension deficit.

Section 172 of the Companies Act 2006 has received a great deal of attention lately. The Government's White Paper on Corporate Governance announced measures to require better reporting on section 172 as a means of encouraging directors to take account of stakeholder interests, but rejected calls to strengthen the role of stakeholders in holding directors to account.

Section 172 would not be breached in these circumstances even if, as with Carillion, the decision was disastrous and in fact harmed the company.

The section requires directors to act in good faith to promote the success of the company for the benefit of its members as a whole and in doing so 'have regard to' ... 'the likely consequences of any decision in the long-term', 'the interests of the company's employees', 'the need to foster the company's business relationships with suppliers, customers and others', and 'the desirability of the company maintaining a reputation for high standards of business conduct'.

Crucially while section 172 requires directors to have regard to stakeholder interests and the company's long-term success, this does not mean that they must take decisions that they judge will protect those interests.

Directors are free to close a factory even if this harms the interests of employees and suppliers, provided that they think about these matters first and honestly believe that the decision will nevertheless promote the success of the company for the shareholders' benefit. Section 172 would not be breached in these circumstances even if, as with Carillion, the decision was disastrous and in fact harmed the company.

This conduct could however breach a quite separate obligation: the duty to act with due care, skill and diligence under section 174 of the Companies Act 2006.

Although the FRC's Guidance on Board Effectiveness states that in order to protect the company's long-term interests, difficult board decisions may 'sometimes' adversely impact stakeholders, section 172 cannot prevent directors taking actions that are contrary to stakeholder interests or even the long-term interests of the company. No doubt such a company would not thrive. Nevertheless the section does not guard against bad business judgements taken in good faith.

Carillion demonstrates these limitations. It is common for company secretaries to ensure that the statutory factors are brought to boards' attention. In line with this, in December 2017, Carillion board minutes record the chairman reminding the board of their section 172 obligations, and they had sought legal advice on these. So it might be difficult to prove that they breached section 172.

What seems clear though is the decisions they took were disastrous, harming shareholders as well as other stakeholders. But again that, alone, is not relevant to section 172. This conduct could however breach a quite separate obligation: the duty to act with due care, skill and diligence under section 174 of the Companies Act 2006. This duty has been overlooked in recent debates, with the focus instead on the largely unenforceable section 172. Why is this?

The recent joint Work and Pensions and BEIS select committees' Carillion Report provides a clue. The committees commented that they were keen to guard directors from an 'unreasonable degree of legal exposure', noting that it should

# Feature

not be 'left to the courts to clear up the corporate mess'. No one could argue with this.

Business is all about risk-taking and sometimes risks materialise. It does not mean that directors should be dragged to court when this happens. Decisions might only look bad with hindsight. Suing directors could encourage defensive decision-making which would be bad for business; and deter capable people from taking board positions, particularly as non-executives; and judges do not have the expertise to review business judgements.

In fact our research has found that directors of the UK's large companies face little legal liability for business decisions that have adverse outcomes. Occasionally directors can be disqualified, as with some (but not all) of the BHS directors, but this usually occurs when a company has collapsed and may not be seen as a sufficient response when there are widespread losses to creditors and pension funds. In high profile cases legal accountability appears to have been replaced by accountability through the media and select committee inquiries.

This raises the question of whether the law, with its panoply of due process protections, is striking the right balance between holding directors' accountable for poor business judgements that cause widespread harm and protecting them from detrimental legal exposure? It is a question that the School of Law at Leeds and Management School at Liverpool are investigating as part of an Arts & Humanities Research Council funded project, Business Judgment and the Courts.

This cannot be answered by focusing on section 172 alone. Whatever one's position regarding whether directors should be accountable for business judgements, the debate around the legal accountability of boards must address the full range of directors' obligations, otherwise there is a risk that public criticism and disquiet in the wake of corporate collapses will continue, with consequent damage to trust in business. And as the Carillion Report concluded: another corporate collapse could happen again – and soon.

*Professor Joan Loughrey studied Law at Somerville College, University of Oxford, and qualified as a solicitor of the High Court of England and Wales and later of the Supreme Court of Hong Kong before entering academia. She is presently Deputy Head of School at the School of Law, University of Leeds.*

*Professor Terry McNulty is a leading academic researcher on governance, board behaviour and effectiveness. His research informed the work of professional bodies and government departments such as: the Law Commission; the Association of Chartered Certified Accountants; Institute of Company Secretaries (2011); Higgs Review and UK Code of Corporate Governance.*

## Business Judgement and the Courts

Professor Joan Loughrey is leading a two year independent interdisciplinary project 'Business Judgement and the Courts' examining how the courts of England and Wales deal with challenges to directors' business judgements, and investigating arguments for and against legal accountability for such decisions.

The project team (comprising Professor Andrew Keay and Dr Francis Okanigbuan, School of Law, University of Leeds and Professor Terry McNulty and Ms Abigail Stewart, Management School, Liverpool) have comprehensively analysed court decisions involving directors' judgements, and have been conducting interviews with directors and others about the courts' approaches to assessing director decisions in the UK and/or Australia and/or the US.

The project is funded by the Arts and Humanities Research Project (Project number AH/N008863/1).

*For further information or to be added to our mailing list contact [j.m.loughrey@leeds.ac.uk](mailto:j.m.loughrey@leeds.ac.uk) and see: <https://essl.leeds.ac.uk/law/dir-record/research-projects/268/business-judgment-and-the-courts>.*

## ICGN New York Event

The rise of populism across the continent and the US has meant it is certainly no longer 'business as usual' and many are questioning the future implications for corporate governance. As policy continues to evolve, our expert speakers will explore the corporate governance questions for companies and their boards and ask how these developments may affect global investors.

Registration will close on Monday 8th October 2018

<b>Date</b>	22 October 2018
<b>Venue</b>	Convene Conference Centre, 32 Old Slip, New York, NY 10005
<b>Rates</b>	ICGN Member rate: £380 CII Member rate: £420 Non-member rate: £530

## Feature

.....

# More authenticity?

**Anne Kirkeby** considers the changing face of UK governance and reporting and the need to focus on long-term value creation and argues that what's needed in FTSE 100 annual reports is more authenticity.

The legislative and regulatory regime in the UK is shifting. Back in June, the Government published the Companies (Miscellaneous Reporting) Regulations 2018, which introduced a new requirement to include a section 172 statement in the strategic report. The requirement is to explain how directors have considered wider stakeholders and the long-term in exercising their duty to promote the success of the company. The regulations also added new requirements for companies to discuss employee and wider stakeholder engagement in the directors' report, and added new remuneration reporting requirements.

Earlier this month, the FRC followed this up by publishing the new Corporate Governance Code, which emphasises the need for the board to set the purpose, culture, and longer-term strategy of the company while also increasing the focus on section 172. The FRC's Guidance on the Strategic Report, published in early August, is the latest element in a clear push to improve transparency around stakeholders' and directors' duties. The Guidance encourages directors to explain how their regard for the long-term and wider stakeholders has impacted their decision-making, and will also highlight additional areas of best practice for reporting.

These changes place greater emphasis on the board taking a longer-term perspective and a more holistic view of value creation. This expectation is grounded in a company's genuine consideration of its key stakeholders, which is particularly relevant in reflecting sound corporate governance and developing trust. Similarly, we are also finding that enlightened investors are placing more attention to long-term value when making their decisions.

For more than 13 years, Black Sun has been tracking the evolution of corporate reporting by examining how companies within the FTSE 100 are responding to the changing environment within reporting legislation and regulation. This year the focus of our 'Complete 100' analysis of FTSE 100 corporate reporting trends has revealed that this 'honest communication', warts and all, is essential in providing more authenticity within the Annual Report. In that light, we've aptly entitled this year's research report as *Less Perfection, More Authenticity*.

### The commodity of trust

New corporate reporting requirements are introducing concepts that will prove very powerful in generating corporate trust if companies truly embrace the spirit of them. However, they may equally serve as no more than a smoke screen for

those who do not apply them earnestly. Being able to evidence which of the two categories a company fits into will be vital, and authenticity will be absolutely key to doing so.

Maintaining the social licence to operate within local communities and operating successfully in the long-term is increasingly more difficult if employees and other stakeholders have lost trust in the company. Society and key stakeholders have more expectations than ever before in companies and they expect companies to be part of the solution within society, rather than the problem. The growing recognition that 'good' business behaviour supports strong financial performance is becoming the norm.

So, this 'commodity' of corporate trust and reputation is something that corporate value and value creation is being driven by, and the factors that have previously been considered as 'intangible' which often do not show up in the financial statements, are under more scrutiny and have gained more importance. This includes such factors as brand, customer experience, patents and R&D, which all emphasise the stress on companies to find better ways of communicating a full range of 'value drivers', and the various issues and risks impacting these drivers, in order to gain the trust of investors and other stakeholders in the short, medium and long-term.

### The principles of trust

Truthful and authentic communication plays an integral part in rebuilding corporate trust. This year, our research highlights six key principles of trust that individually and collectively contribute to corporate trust. They are linked, interdependent and essentially all rooted in long-term thinking, planning and preparedness. They build on the concept that trust can only develop when all parties in a transaction have a vested interest in the outcome over the long-term, which is when the full range of consequences of any actions may be felt.

Our research shows numerous improvements across the board within the FTSE 100 corporate reporting trends and dramatic improvements around topics that are driven by new or upcoming regulatory changes.

### Principle 1: Purpose

A company that communicates how it is 'part of the solution rather than the problem' is a more trusted company.

The number of companies that communicate a corporate purpose in their Annual Report continues to increase – 66% now communicate their purpose, up from 60% last year.



# Feature

Yet most do not go as far as to explain how their purpose is aligned with their values, culture and strategy – which is one of the key points of the proposed UK Corporate Governance Code update.

## Principle 2: Culture

A company with a healthy corporate culture is seen as a less risky and more attractive company to invest in, partner with and work for.

Reporting on culture, which saw a peak in 2016 but slowed slightly last year, has continued to plateau in certain areas, while gaining speed in new areas of strategic importance. An example is companies that discuss culture or values in relation to value creation, with 26% doing so this year, up from 13% last year.

## Principle 3: Stakeholder voice

Social licence to operate by securing the trust of key stakeholders is essential for long-term success.

Stakeholder engagement and the manner in which this process informs strategy and decision-making is an area that has developed somewhat within the FTSE 100 (19% discuss how stakeholder expectations have been considered in strategy), while reporting on stakeholders has moved up several gears in terms of how companies identify their key stakeholder groups and their expectations.

## Principle 4: Diversity

A diverse board and workforce that represents a wide range of stakeholder views will make a company more informed and ultimately, more trusted.

Reporting on diversity has increased as a consequence of new requirements, but companies continue to have stronger reporting on board diversity than on employee diversity, with 56% setting diversity targets for the board, while only 25% do so for wider employees. Equally, discussions on diversity rarely become very strategic.

## Principle 5: Wider value creation

Communicating the full range of value created and the actions taken to manage, sustain and develop these sources of value will make a company appear better prepared for the future.

The number of companies which explain the value they create for stakeholders beyond shareholder returns continues to increase, with more companies explaining the risks to their business model: 53% this year, up from 30% last year.

## Principle 6: Long-term thinking

Demonstrating long-term thinking and preparedness is the glue that holds the narrative together and makes it believable.

Companies are increasingly becoming better at using the market review to present future trends and impacts. They are now more likely to discuss how they are investing in the future – with 90% doing so this year, up from 82% last year – but are less overt about how these investments will support long-term value creation.

## Top tips for better reporting around the principles

*Purpose:* To make narrative more authentic, companies should consider if their statement of purpose is truly specific to the nature, culture, history and direction of the company, and whether it is aligned with how purpose is discussed internally.

*Culture:* To make this discussion more authentic companies should consider if the discussion of culture acknowledges geographical subcultures within the company and considers the nature of the industry in which the company operates.

*Stakeholder voice:* When trying to make the narrative on stakeholder voice truly authentic, companies should consider if there is sufficient discussion of how stakeholder feedback is used by the company and whether the report acknowledges when stakeholders' expectations were not met.

*Diversity:* In terms of authenticity, companies should consider whether the report explains how harnessing diversity within the company's value chain, geographical footprint and consumer audience provides opportunities to gain a new perspective on the company's business.

*Wider value creation:* To be authentic companies should consider if their discussion of resources and relationships truly reflect the key things the company needs to stay in business and if these are sufficiently covered throughout the report.

*Long-term thinking:* When attempting to make the report more authentic companies should consider, in particular, whether the report provides sufficient explanation of the key differentiators that cannot be easily replicated by competitors and set the company apart for the future.

Positively, many organisations have taken significant steps in preparation for next year. The FTSE 100 and global companies do have more ground to cover in reporting against all the new corporate reporting requirements, but for many, the main challenges will be around capturing – more accurately – what they are already doing and telling this story more effectively within the Annual Report.

.....

*Anne Kirkeby is Lead Corporate Reporting Consultant at Black Sun Plc. To get more information on the Black Sun Plc research or to request a full copy of the report, visit <https://bit.ly/2wohA6Y>*

## Feature

.....

# The new UK CG Code

**Anthony Fitzsimmons** looks at the new UK Corporate Governance Code and Guidance on Board Effectiveness which were both published last month.

The FRC has delivered radical revisions of the UK Corporate Governance Code and Guidance on Board Effectiveness (the Code and the Guidance respectively, collectively Rules), which apply for accounting periods beginning on or after 1 January 2019. They tackle a large proportion of the behavioural, organisational and leadership risks that regularly cause organisations, and their boards, to collapse.

The Code has ‘long-term sustainable success’ (LTSS) at its heart: the Rules refer to ‘*long-term*’ over 40 times.

The Rules have been substantially recast, with a focus on making ‘tick-box’ approaches and boilerplate reporting more difficult. The Guidance is laced with 80 penetrating open-ended questions designed to make boards think about important questions.

Sir Win Bischoff has written to proxy advisers to encourage them to move away from encouraging tick-boxing as it ‘does not serve the needs of your clients or promote high standards of corporate governance in the UK’. Whether they will heed his request is moot.

Five important themes emerge from the changes:

1. Long-term sustainable success;
2. Board skills knowledge and experience;
3. Interacting with the workforce;
4. Whistleblowing and Speaking Up;
5. Remuneration.

### Long-term sustainable success

For years there has been trenchant criticism of short-termism and opportunism among UK company leaders and their shareholders at the expense of long-term success and sustainable growth. Some companies have borrowed to pay dividends or replaced equity with debt, increasing dividend yield or earnings per share but making their companies more vulnerable to adverse events. Others have put the future at risk by postponing investment, research or maintenance.

The Code has ‘long-term sustainable success’ (LTSS) at its heart: the Rules refer to ‘*long-term*’ over 40 times. Boards are expected to promote LTSS, thereby ‘*generating value for shareholders and contributing to wider society*’. They are

expected to align workforce policies and the company’s values with it, reporting to shareholders on how they have addressed the sustainability of their business model.

Despite an FRC open letter to institutional shareholders and the forthcoming review of the Stewardship Code, we believe that countervailing pressure from short-termist shareholders cannot be dealt with by the FRC alone. For success, the FCA must tackle the mismatch between the short bonus-driven time horizons of investment professionals and the far longer horizons of retail investors saving for the long-term towards retirement. This was highlighted by the Kay Report. Action is long overdue.

### Board skills knowledge, experience and character

The history of corporate disasters is littered with boards that lacked key skills, knowledge or experience, a pattern that persists. In an attempt to dam this river, the FRC has tackled board composition. They have three aims: to encourage non-executive (non-exec) teams that are fully competent; to encourage diversity of perspective; and to bring board member character into sharper focus.

As to skills, one of the questions the FRC poses nomination committees is: ‘Do we take account of the technical skills and knowledge required by the committees when recruiting members?’ For example, does our audit (or risk) committee need a non-exec who thoroughly understands the risk we face? Do nomination and remuneration committees need a non-exec with systematic knowledge and experience of how humans think and behave?

As to personal strengths, the Guidance has given greater emphasis to courage, openness, ability to listen and tact, adding strength of character to the qualities that nomination committees should seek. The boardroom should be ‘a place for robust debate where challenge, support, diversity of thought and teamwork are essential features’, with executives ‘welcom[ing] constructive challenge’ from non-execs. Whilst the FRC has highlighted ‘signs of a possible culture problem’ including dominance and arrogance, they have missed the opportunity to highlight signs of a possible leadership character problem such as bombast, hubris, egotism and greed.

Beyond acquiring the skills they need to do their own job, nomination committees are encouraged to use skills matrices to identify the skills knowledge and experience their board has before identifying what the board and its committees need to be effective. The Guidance also encourages structuring

# Feature

the recruitment process to explore the personal qualities, values and expected behaviours the post requires and what candidates will bring.

A well-deserved criticism of many boards is that they are drawn from a narrow stratum of society and dominated by particular backgrounds. Our research into FTSE 100 boards revealed them as heavily skewed towards current and retired CEOs, CFOs, financiers and, less-markedly, accountants. Evidence of diversity of perspective and background is rare. Skills matrices should help boards to recognise skewedness, but head-hunter methods and an aversion to people who might not 'fit' have also played a role. The FRC encourages selection and interview processes that do not put candidates with unusual backgrounds at a disadvantage. They should have given greater encouragement to using advertisements to bypass head-hunters whose methods appear to block diversity of perspective and unusual backgrounds.

## Interacting with the workforce

There has been a long-running debate around how boards should take account of relationships with stakeholders other than shareholders, and the workforce in particular.

The Code states that the board should have 'workforce policies and practices that are consistent with the company's values and support its [LTSS]' and that the workforce 'should be able to raise any matters of concern'.

To reinforce this boards are now expected to welcome a director appointed from the workforce; to establish a formal workforce advisory panel and/or to designate a non-exec to act as a structural bridge between board and workforce.

## Whistleblowing and Speaking Up

It is all too common to discover, after a crisis, that the workforce knew important things which they would not, or dared not, tell their leaders. This is the 'unknown known' problem.

Whistleblowing of bad behaviour has long been encouraged but whistleblowers are regularly persecuted. The FRC explicitly recommends that companies have a system that allows informants anonymity and protection against retaliation. 'Companies need to create an environment in which the workforce feels it is safe to raise concerns', adding that there is widespread fear of 'being negatively labelled, side-lined for promotion or bonuses, and even [loss] of employment'.

But FRC Guidance now goes further, encouraging a culture that makes routine 'speaking up' on less high profile concerns. 'Speaking up' only works if employees believe it is risk-free and that leaders will both listen and act on what they are told.

## Remuneration

A crucial issue is the potential for executive reward systems to create incentives that encourage behaviour against an organisation's long-term interests. A long-running sore with the public and with politicians is the divergence between C-suite pay and workforce pay. The FRC has tackled both.

The remuneration committee's remit includes all aspects of reward in the company, including the relationship between workforce pay and executive pay.

The Code provides that the board's policies on remuneration 'should be designed to support strategy and promote [LTSS]', with executive pay packages 'aligned to company purpose and values' and 'clearly linked to the successful delivery of the company's long-term strategy'.

Remuneration committees are expected to 'focus on the strategic rationale for executive pay and the links between remuneration, strategy and [LTSS]', and to avoid 'pay structures based solely on benchmarking to the market, or the advice of remuneration consultants' in order to reduce the risk ratcheting executive pay upwards.

Remuneration committees are also expected to supervise workforce remuneration and the alignment of incentives and rewards with culture across the whole company and to '[take] these into account when setting the policy for executive director remuneration'. They are expected to explain to the workforce, every year, how executive pay relates to workforce pay.

When it comes to executive shareholdings, the *long-term* is again emphasised. Executive pay schemes should require 'long-term shareholdings by executive directors that support alignment with long-term shareholder interests': and the remuneration committee is expected to 'counteract the risk of incentives that are detrimental to the long-term success of the company'. Share awards should be '... subject to a total vesting and holding period of five years or more'.

Remuneration committees are now encouraged to develop formal policies for 'post-employment shareholding requirements encompassing both unvested and vested shares', forcing executives to hold shares until long after they have left. This is the simplest and probably the most effective way to discourage boosting short-term profit at the expense of long-term success. New CEOs will have a strong incentive to examine their predecessor's record.

The FRC has made valuable progress but many will remain unconvinced.

...continued on pg. 12

## Subscription form

Please complete this form and send by mail to:

Subscriptions Department Governance  
Publishing and Information Services Ltd  
The Old Stables, Market Street,  
Highbridge, Somerset TA9 3BP, UK

Tel: +44 (0) 1278 793300  
Email: [info@governance.co.uk](mailto:info@governance.co.uk)  
Website: [www.governance.co.uk](http://www.governance.co.uk)

(Please tick one)

- Yes! I would like to subscribe to Governance for one year
- Or, save with a 2 year subscription

Governance international subscription costs:

	£UK	Euro	US\$
1Yr	325	450	490
2Yr	585	790	855

Governance can accept cheques in other currencies but an administration fee of £15 will be charged.

<input type="checkbox"/> I enclose a cheque/bankers draft for
Currency                      Value
<input type="checkbox"/> Please invoice me
Specify currency:
Order reference:
Title:
First name:
Surname:
Position:
Company/Organisation:
Address:
Postcode:
Email:
Tel:
Fax:

If you see the changes to the Rules as unnecessary bureaucracy, our book *Rethinking Reputational Risk: How to Manage the Risks that can Ruin Your Business, Your Reputation and You*, will provide you with the perspective to understand most of the changes. Others will talk of the parable of motes and beams. Their criticisms will not be assuaged until the FRC has robustly applied its guidance to itself and fixed the weaknesses that outsiders perceive.

.....

*Anthony Fitzsimmons is an authority on reputational risk and the behavioural, organisational and board risks that underlie it. He is chairman of Reputability LLP and lead author, with the late Derek Atkins, of 'Rethinking Reputational Risk: How to Manage the Risks that can Ruin Your Business, Your Reputation and You'.*

## What our subscribers say

'Governance is a useful means of keeping up to date on developments in a field which is assuming greater importance by the day.'

'Governance is the leading monthly publication covering major corporate governance issues. A most valuable source of information for investors, financial advisors, corporate board members and executives.'

## Index

.....

<b>Organisations</b>		Prof Joan Loughrey	6
FRC	6, 8, 10	Prof Terry McNulty	6
WomenCorporateDirectors	5	<b>Companies</b>	
<b>People</b>		Black Sun Plc	8
Derek Atkins	10	Carillion	6
Sir Win Bischoff	10	Reputability LLP	10
Anthony Fitzsimmons	10	TMF Group	4
Anne Kirkeby	8		

.....

### Designed and printed by

**WithPrint**  
Riverside Studio, Gills Lane, Rooksbridge, Somerset, BS26 2TY  
[www.with-print.co.uk](http://www.with-print.co.uk)

### ISSN 1358-5142

© Governance Publishing 2018. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without written permission of the copyright holder.

**Governance Publishing and Information Services Ltd**  
The Old Stables, Market Street, Highbridge, Somerset TA9 3BP, UK  
Tel: +44 (0) 1278 793300  
Email: [info@governance.co.uk](mailto:info@governance.co.uk) Website: [www.governance.co.uk](http://www.governance.co.uk)

