

Corporate Governance Review 2019



2019 highlights



32%

Just 32% discuss the application of the Code principles in a meaningful way



50%

Only 50% clearly articulate their purpose beyond generating profit



20%

Just 20% see environmental risks as a principal threat to strategy and only 6% use environmental measures in executive remuneration



15%

Only 15% clearly explain how executive remuneration is linked to strategy and KPIs



45%

Culture attracting attention - 45% now providing good or detailed information, up from 33%



87%

87% give little or no insight into the succession planning for their senior management



35%

35% of those who report technology as a key risk still have no tech expertise on the board



22%

22% of companies have had their chair on the board for more than 9 years



44%

Shareholder engagement increases for the first time in four years: 44% now provide good or detailed disclosures



27%

Just 27% give good or detailed accounts of their review of internal control effectiveness

Methodology

This review, now in its 18th year, comprises a comprehensive analysis of the annual reports of the companies in the FTSE 350.

It assesses compliance with:

- the disclosure requirements of the UK Corporate Governance Code 2016
- the narrative reporting requirements set out in S414c of the Companies Act 2006, as amended.

As well as assessing compliance with the Code, the review considers the quality and detail of explanations and draws attention to best practice and emerging trends in narrative reporting.

This year's review covers 288 FTSE 350 companies (as of March 2019) 100 from the FTSE 100 and 188 from the FTSE 250, with years ending between April 2018 and April 2019. In 2018, our data covered 297 companies: 99 from the FTSE 100 and 198 from the FTSE 250.

Our analysis excludes investment trusts, as they are able to follow the AIC Code of Corporate Governance.

Full details of the questions can be provided on request from Alex Worters (alex.j.worters@uk.gt.com).

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Viewpoints

Simon would also like to give special thanks to Andrew Ninian, Director, Stewardship & Corporate Governance, The Investment Association; Pamela Coles, Chief Governance Officer, Rolls Royce plc and Maureen Beresford, Catherine Horton and David Styles from the Financial Reporting Council, for providing their contributions for this year's review.

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Executive summary



The debate on the need to restore trust in business continues unabated. With it comes calls for greater transparency; public pressure for action on major issues like climate change and financial inequality; discussion about the wider role of technology, and challenges in executing legal initiatives that extend company accountability beyond shareholders.

Simon Lowe, Chair, Grant Thornton Governance Institute

As annual accounts are still the single most reliable source of information about a company's performance, corporate reporting quality remains a key indicator of a board's commitment to transparency – and its sense of accountability to stakeholders.

The Financial Reporting Council's (FRC's) new 'shorter, sharper' UK Corporate Governance Code (the new Code) is at the forefront of the push to restore trust.¹ As a distillation of best practice, among other things, the new Code focuses on how a company applies its main principles; it has fewer provisions, and recognises the shared interests of boards, shareholders, employees and wider stakeholders.

The trust debate is also impacting the investment industry, which is rethinking the meaning of stewardship – putting greater focus on shareholder engagement and the need for behavioural change for all parties. Both regulators – the FRC and the Financial Conduct Authority (FCA) – want to build a stronger framework to encourage better stewardship. To do this, they are raising the standards expected of investors, and challenging them to devote more resources to evaluating the quality of company disclosures.

In this, our 18th annual Corporate Governance Review, we find encouraging evidence of companies that have seized the initiative. These organisations are driving best practice before regulatory change takes effect – but they are in the minority. Many others select the appropriate subject heading in their annual reports but, in many cases, their disclosures add to the page count, but not to reader understanding.

Of course, the new Code only took effect from 1 January 2019, so companies have a little longer before they must formally report against its principles. We hope that the early trends and practices we identify in this review will encourage organisations to reflect on the focus of the new Code; embrace its principles; and use their annual report to explain how their corporate governance really works.

¹ The UK Corporate Governance Code, FRC, July 2018 [frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF](https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF)



KEY FINDINGS

This year our research delivers some encouraging findings. Yet new areas of regulatory focus require greater consideration and fresh thinking.

Applying the new Code principles

In its new Code, the FRC has shifted the focus from the mantra of ‘comply or explain’ towards how companies apply the Code’s main principles – an established, but perhaps overlooked, requirement of the listing rules. Seventy-three percent of the FTSE 350 now declare compliance with the 2016 Code – a new high – but while 66% provide some sort of statement on applying the principles, less than half that figure (32%) discuss it in a meaningful way. It seems the rest are yet to fully embrace the Code’s new focus.

Business purpose and forward-looking reporting

The new Code emphasises company purpose; in other words, why an entity exists. The board should establish this purpose and set a strategy for delivering it.

There are signs that companies are responding to this challenge. This year, 50% clearly articulate the reason for their existence beyond the generation of profit, up from 40%. Yet a lot of words on purpose have merely been ‘retro-fitted’ into existing content on strategy and business model, with no clarity about how success will be measured, nor on the formal objectives or timings for the pursuit of their stated purpose.

Companies are generally reluctant to talk about strategic timetables; only 17% specify timeframes for all strategic priorities. At the same time 72% give good or detailed disclosures about factors affecting their future – for example, market trends, opportunities and Brexit. This is an improvement: in 2016, less than half (48%) provided good or detailed forward-looking statements.

With more than a quarter of the FTSE 350 (28%) not providing useful detail in their forward-looking statements, readers are largely in the dark about risks which could affect the achievement of strategy and even longer-term viability.

Long-term success and viability

Although the quality of viability reporting did improve somewhat this year, only 37 companies give the level of detail the FRC envisages – for example, the nature and range of key risks; the quantitative outcomes of scenario analysis; and the mitigating activities modelled in response. Forty-four percent of the FTSE 350 give little insight into how they assess long-term viability, including scenarios considered and how these link back to principal risks.

This backs up the main criticism from the Kingman review², namely that viability statements provide little insight for investors. The review suggests that the effectiveness of viability statements should be reviewed, and serious consideration given to abolishing them if they cannot be made much better.

Succession planning

Succession planning is an area for concern, with only 17% of companies providing good or detailed insight into how they secure high-quality future board members. Further, 87% give little or no insight into how they identify and develop people for their senior management positions.

The new Code places greater emphasis on the role and activities of the nominations committee in succession planning. Yet few nomination committees clearly explain how they ensure their company has the knowledge and experience to respond to future challenges – whether through future skills gap analysis, in-house development or recruitment.

Trends such as technological progress, market shifts, supply chain consolidation, product obsolescence and regulatory change are bringing new challenges and risks to many sectors. Yet reports rarely (2%) refer to how directors’ skills are relevant in the context of strategic objectives and regulatory change.

² The Independent Review of the Financial Reporting Council, John Kingman, December 2018 www.gov.uk/government/publications/financial-reporting-council-review-2018

The new Code sets a maximum board tenure for the chair of nine years. With 63 companies³ in our review exceeding that limit, and another 14 fast approaching this milestone, many nomination committees will be reaching out to head-hunters. With currently only 16 female chairs⁴, now is the time to redress the gender imbalance in the boardroom. To do so, nomination committees and head-hunters will need to look beyond the traditional criteria for selection. With very few women having held the roles of FTSE 350 CEOs or executive directors – where would-be chairs normally cut their teeth – companies must think more innovatively about what credentials make a great chair. For example, there are currently 59 female senior independent directors (SIDs).

Diversity

Diversity reporting is improving. Public pressure, reinforced by the Hampton-Alexander⁵, Parker⁶ and McGregor-Smith reviews⁷, is driving recognition of the benefits of diversity at all levels. Consideration of factors such as age, cognitive difference and social background as a means to reconnect companies with their markets and customers, is starting to affect boards and reporting.

Gender diversity reporting has reached an all-time high (although that's not saying much), with 29% of the FTSE 350 giving good-quality, detailed reporting on their board gender diversity policy. However, policy and practice are still far apart, with women filling just 26% of senior management roles. In the basic materials and oil and gas sectors, this falls to 17%.

Ninety-four percent of companies mention other kinds of diversity. In 2018, the focus was largely on varied skills and experience, but other more specific areas became apparent this year: 42% mention ethnicity and 34% social background.

Culture

Corporate culture – and the role of boards in defining, embedding and monitoring it – has been a significant interest for the FRC, if not for many companies, in recent years. The new Code reflects that focus, with emphasis on the role of culture in a strong governance framework.

There are encouraging findings: 45% of the FTSE 350 provide good or detailed accounts of their company culture, up from 33% last year. More companies are considering how corporate culture contributes to value creation, for example, by promoting co-operative or sharing cultures, and focusing on unwavering customer service. This is in addition to more defensive measures, such as code of conduct compliance training to avoid value destruction.

Although the FRC said in 2016 that CEOs bear primary responsibility for promoting culture within a company, it is chairs that have picked up the mantle: 41% now provide clear messages about culture in their primary statements, rising from 35% in 2018. This compares to the 32% of CEOs who communicate clearly on culture, slightly up from 29% in 2018.

When it comes to assessing and monitoring culture, findings are less encouraging, with only 34% of the FTSE 350 discussing this field. Methods for gathering data vary: only 19 companies say they use a dashboard or scorecard of three or more metrics. Most companies that claim to monitor culture seem to reuse existing indicators, particularly employee surveys. Only three say they use an internal audit to test cultural consistency across the company.

Stakeholder engagement

The FRC's message is clear: engaging with shareholders and wider stakeholders is central to a board's leadership role.

This year is the first since 2015 to show an increase in the number of companies that provide good or detailed disclosures on shareholder engagement, rising from 31% to 44%. There is also evidence of more face-to-face communication.

The new Code puts a greater emphasis on engagement between committee chairs and shareholders. Here, nomination and audit committees lag behind remuneration. While executives and board chairs traditionally engage with shareholders the most, this year SIDs took over the leadership in the number of meetings with shareholders from remuneration committee chairs in 2018.

³ There are 84 companies exceeding that limit, and another 20 companies approaching it in the FTSE 350 including investment trusts.

⁴ There are 25 female chairs in the FTSE 350 including investment trusts.

⁵ FTSE Women Leaders: Improving gender balance in FTSE Leadership, Hampton-Alexander Review, November 2018 ftsewomenleaders.com/wp-content/uploads/2018/11/HA-Review-Report-2018.pdf

⁶ A Report into the Ethnic Diversity of UK Boards, The Parker Review Committee, October 2017 [ey.com/Publication/vwLUAssets/The_Parker_Review/\\$FILE/EY-Parker-Review-2017-FINAL REPORT.pdf](https://ey.com/Publication/vwLUAssets/The_Parker_Review/$FILE/EY-Parker-Review-2017-FINAL REPORT.pdf)

⁷ Race in the workplace, The McGregor Smith Review, February, 2017 www.gov.uk/government/publications/race-in-the-workplace-the-mcgregor-smith-review

Stakeholders remain firmly on the agenda, with 73% of the FTSE 350 discussing their engagement. Stakeholder considerations are increasingly seen as crucial to success, with companies stating, for example, who their key stakeholders are, how they engaged with major stakeholder groups, the key issues they raised, and how the organisation responded.

Most boards embrace the new requirement for employee engagement, with only 38 companies not mentioning some type of interaction. Yet only 37% have so far adopted one or more of the three approaches, or a combination of these, as specified in the new Code.

Risk reporting

Risk reporting has been one of the Code's successes, with 78% of companies now providing high-quality risk disclosures. Businesses are increasingly linking risks to company strategy, providing a barometer of trends and management concerns. But there is still work to do: 79% of the FTSE 350 link risks to strategy, but only 17% give meaningful explanations.

The new Code focuses more on the disclosure of emerging risk. Sixty-four per cent of companies say they assess this, but businesses talk more about their procedures and processes for identifying risks, rather than saying what their emerging risks are and how they will mitigate and manage them.

Remuneration

The new Code requires remuneration committees to address six key factors⁸ when determining their policy and practices: clarity, simplicity, risk, predictability, proportionality and alignment to culture. However, only 14 companies (5%) say how they have addressed these factors. With more investor attention on wider business purpose, it is surprising that, of those that link remuneration to strategy and KPIs, only 15% provide clear, understandable links between remuneration and strategic objectives and KPIs, and just 22% of remuneration committees review the alignment of executive rewards to culture.

Companies' choice of performance indicators is more worrying, with most still using only financial metrics. This is a significant omission: the new Code asks directors to consider their wider stakeholder responsibilities under section 172 of the Companies Act. Just 13% of the FTSE 350 disclose non-financial metrics in their long-term incentive plans yet, on average, companies have 5 financial and 4.5 non-financial KPIs. This suggests a disconnect between what companies say they value and how they reward management.

The requirement to name remuneration consultants reveals further cause for concern. Two of the largest audit firms provide remuneration consulting services to 55% of the FTSE 350. The combination of these firms' domination of the FTSE 350 audit market, the current flurry of auditor re-tendering and resultant rate of churn, and the length of time that remuneration policies and incentive packages typically cover, suggests that the potential conflict of interest will continue to grow, limiting auditor choice even further.

Expanding reports

In the ten years that this review has tracked page count, the average annual report has grown from 121 pages to 181, with the front end expanding by 75%. On average this translates into an extra 32,000 words, or two hours and 40 minutes extra reading. With so much more information in the front end of annual reports, it is hard to believe they are becoming more transparent and 'fair, balanced and understandable'.

This year's growth in annual report length reflects companies' first attempts to respond early to the new Code. Although such early adoption should be applauded, the results are not always successful. Instead of rethinking and optimising their reporting, some companies seem simply to be heaping more information on top of what is already there. Certainly, our research shows there is no strong correlation between the number of pages and quality of disclosures. This suggests that longer reports do not lead inevitably to greater insight.

If much of the FTSE 350 follow this approach in 2020, the average annual report page count, inevitably, will increase again. With investors increasingly using machine reading to extract information from annual reports, the risk is that the aim of increased transparency into how companies apply the principles of governance will be lost with algorithmic assessments.

8 The UK Corporate Governance Code, FRC, July 2018, Provision 40 [frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF](https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF)

The strategic report



181

The average annual report is now 181 pages, up by nine



3

Companies have not reviewed principal risks and mitigating actions, down from 81 in 2015



82%

Provide good or detailed business model disclosures



22%

Identify Brexit as a main risk; almost 40% of these are in consumer services



50%

Only 50% clearly articulate their purpose



35%

Of companies still have no technical expertise on the board



63%

Offer good or detailed disclosure of KPIs, up from 58%



22%

Only 22% companies consider the environment as a principal risk, up from 13%

Front-end growth accelerates

“The purpose of the annual report is to provide shareholders with relevant information that is useful for making resource allocation decisions and assessing the directors’ stewardship.”

[FRC Guidance on the Strategic Report 2018, 3.2]

The most effective annual reports deliver a company-centric yet balanced corporate narrative, giving specific insights with a focus on materiality. Achieving this balance becomes more challenging every year, as companies weigh regulatory demands for more information against user preference for brevity and conciseness.

Annual reports have grown consistently for the past decade, and this year sees another sharp rise. The average publication now stretches to 181 pages, up nine. This year, companies with shorter annual reports have added more pages than their peers with longer accounts page 10. While both the front-end narrative and the financial statements have grown, the front-end increase is much more noticeable – up by 75% over 10 years. By comparison, the financial section, which made up just under half of the average annual report in 2009, has grown by just 21%.

Despite the leap in pages, the only extra piece of ‘assurance’ to guard against the inclusion of misleading or rose-tinted information is that boards should consider whether their annual report is “fair, balanced and understandable” page 11.

This year’s growth in the annual report is largely due to companies trying to respond early to the new Code.⁹ For example, there is more on engagement with stakeholders and on company culture, mainly in the strategic report. Yet there are few signs of significant integration in presenting this extra information: it is often not incorporated well into the rest of the report or with board activities, suggesting that little consideration has been given to the purpose of the changes.

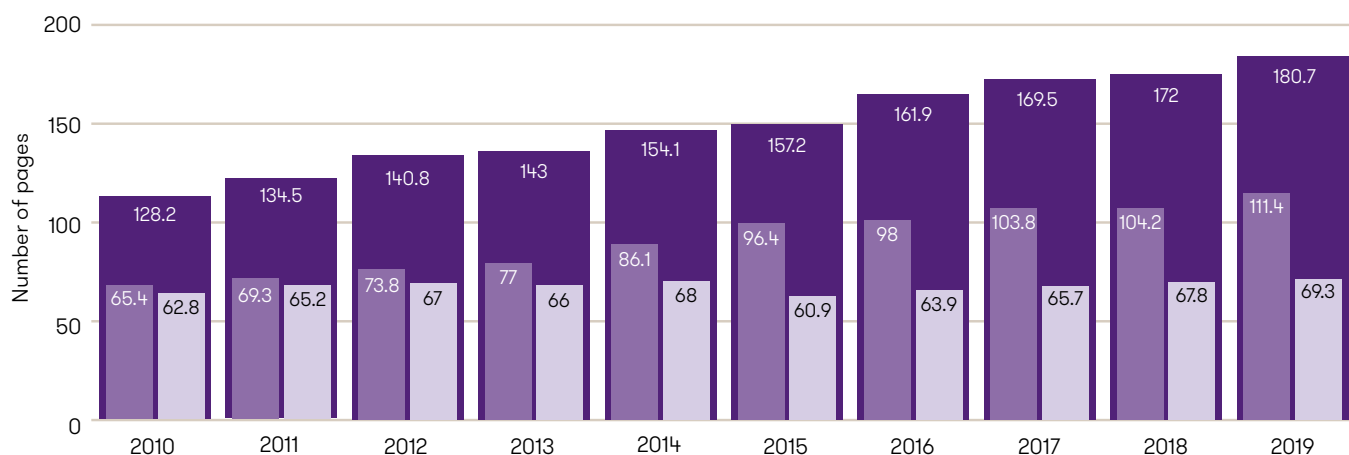


DID YOU KNOW?

The average length of annual report has risen by **60 pages in the last 10 years**

Average length of annual report

● Annual report ● Front end ● Back end



⁹ The UK Corporate Governance Code, FRC, July 2018 [frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF](https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF)

The average FTSE 100 annual report is now 211 pages (2018: 205), with the FTSE 250 at 165 (2018: 156). Unsurprisingly, given the weight of risk reporting and regulation affecting financial services, five FTSE 100 banks have some of the longest reports, averaging 323 pages (2018: 325). In other sectors, dual listing disclosures and detailed operational or divisional reviews are the main factors influencing publication length.

Among non-financial companies, Mediclinic International has the thickest report, at 308 pages. Overall, Investec has the longest (three volumes) at 488 pages – 71 more than 2018 leader RBS. For its part, RBS, like HSBC last year, has removed 150 pages. This is not a complete rewrite, but the company has clearly rethought what matters most, and how information can be integrated, best presented and in what order. BT, meanwhile, has taken out 123 pages, mostly relating to operational matters.

Consumer goods companies have the shortest reports, with an average of 162 pages (in 2018, it was technology companies with 140). J D Wetherspoon has the shortest FTSE 350 report, at just 60 pages (2018: Games Workshop Group, 64).

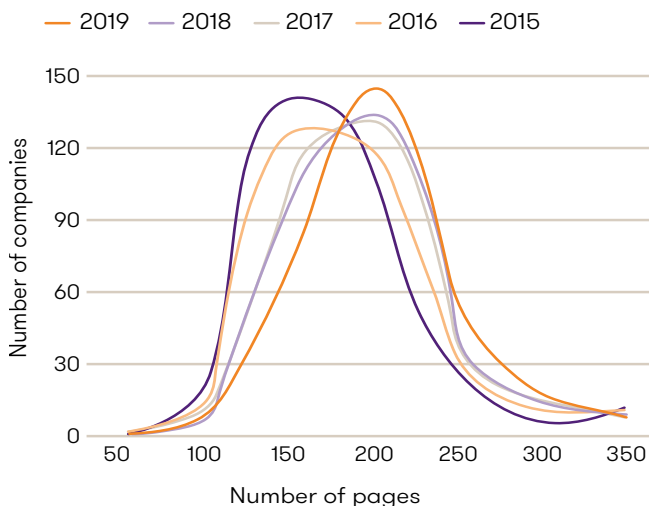
The total word count of annual reports has also risen. An analysis of 150 of companies' reports suggests that the average front end now has extra 32,000 words compared to 10 years ago – an increase of 2 hours and 40 minutes in reading time.

Length versus disclosure quality

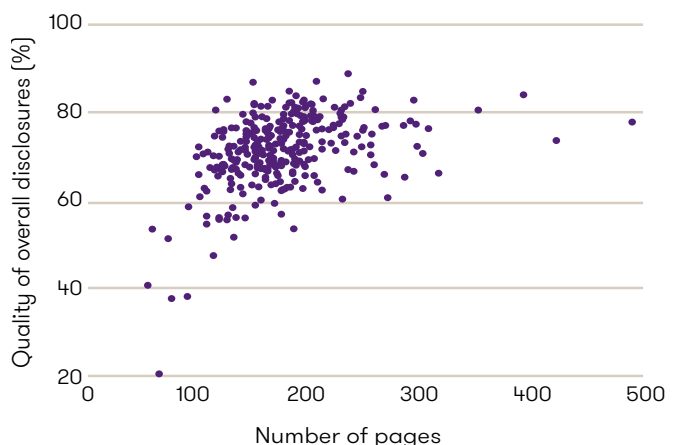
Instead of rethinking and optimising their reporting, most companies seem to have just added more information – and are likely to add even more next year to address the requirements of the new Code. This may not be the right approach: our analysis suggests that longer annual reports do not necessarily lead to greater insight and stronger financial performance¹⁰. We haven't found strong correlation between disclosure quality and page count, with good annual reports spread between 120 and 392 pages, and the three best being 153, 209 and 237 pages.

As investors are increasingly turning to machine reading functionality to cope with this explosion of information, there is a growing risk that the benefits of the hard work, increased transparency of governance practices will be lost with formulaic and algorithmic assessments.

Length of annual reports for the FTSE 350

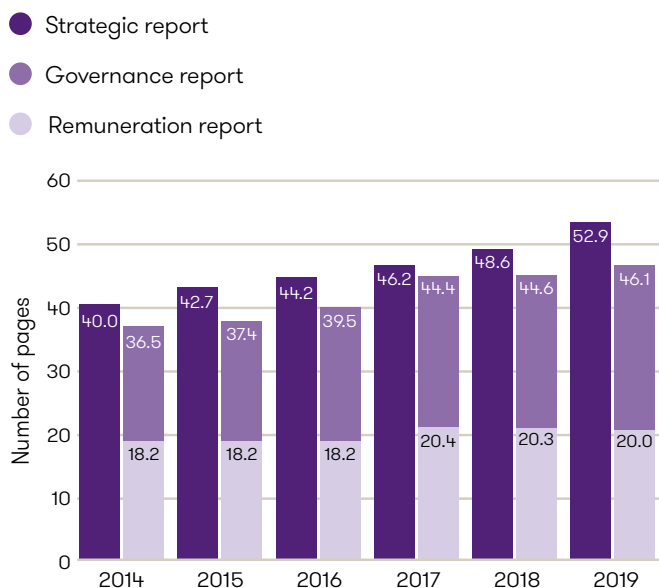


Length of annual reports and disclosure quality



¹⁰ Companies with strong governance generate 3.4 times more cash flow from their operations and are 29% more efficient at generating profits with the financial resources allocated to them. Corporate governance and company performance, 2019 <https://www.granthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/documents/corporate-governance-and-company-performance.pdf>

Average length of front end



The front end, section by section

“The Act envisages each component of the annual report to be a separately identifiable part of the annual report. Therefore, the strategic report, corporate governance report, directors’ remuneration report, financial statements and directors’ report should generally include only the content that is necessary to meet the objectives of those components.”

(FRC Guidance on the Strategic Report 2018, 3.14)

This year both the strategic report (up 4.3 pages) and the governance report (up 1.5 pages) contribute to the increased length of the front end. A closer look at the strategic report suggests that, as mentioned above, companies are simply adding more information, with culture and stakeholder engagement the main reasons for growth.

Chairs mainly limit themselves to two pages. The quality of their introductory statements has improved over the longer term, although there are no dramatic changes this year.

The longer governance report is mostly due to companies providing extra detail on board activities; there is also a growing focus on nomination committee reporting, which is now 2.5 pages long. The audit committee report increases by one page to slightly more than five over the past four years, reflecting improved commentary from audit committee chairs and other disclosures. Over the period, the remuneration report has increased slightly, from 18 pages to 20.

‘Fair, balanced and understandable’

The ‘fair, balanced and understandable’ process underpins good reporting. First introduced in the 2012 Code, and enhanced in 2014, the provision requires directors to make sure that their annual report “provides the information necessary for shareholders to assess the company’s position and performance, business model and strategy”. It aims to make sure that annual reports provide relevant and easily understandable insight on a consistent, even-handed basis that eliminates bias and aids analysis and transparency.

All FTSE 350 companies but two (2018: all but one) say they consider their report fair, balanced and understandable. The quality of explanations has improved slightly: 34% (2018: 29%) embrace the Code’s intent that they outline the specific procedures to support their statement. But most give little, or just generic, insight into how the board came to its conclusion.

As the amount of information reported in the front end of annual reports continues to grow, it becomes more important that the ‘fair, balanced and understandable’ process is effective. That said, the nature of the process used is open to wide interpretation and little external scrutiny. The opportunity for leadership bias therefore remains considerable.

Company purpose

“The board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned.”

[Corporate Governance Code 2018, Principle B]

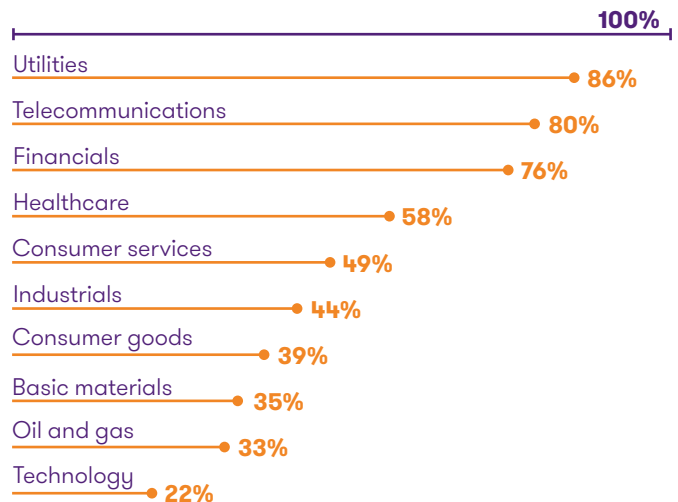
The new Code places much more focus on company purpose -, why the entity exists. The board should establish the company’s purpose, and satisfy itself that it aligns with its culture. The revised Guidance on the Strategic Report¹¹ stresses that purpose, business model and strategy are interconnected and provide the framework that underpins decision-making. According to the FRC, investors say company credibility can be undermined when the stated purpose bears little connection with the business model as disclosed, or with the rest of the strategic report.¹²

Companies seem to be reacting to this challenge, putting purpose at the heart of their business model and everything they do. Yet there is much work to be done on articulating purpose: only 50% clearly outline their purpose for existing beyond generating profit (2018: 40%).

Some companies seem to ‘retro-fit’ their purpose to existing reporting; in this scenario, discussions do not often extend to the goals necessary to achieve a company’s purpose, or the strategic outcomes that flow from it. It is unclear what success looks like or how it will be measured. Companies rarely present their purpose as an opportunity: in other words, how it can help them grow and succeed in the long term.

A closer look finds that the most articulate sectors are utilities, telecommunications and financials. Technology companies remain at the other end of the spectrum page 25.

Do companies define their purpose?



DID YOU KNOW?

Only 50% of companies clearly outline their purpose for existing beyond generating profit

¹¹ Guidance on the Strategic Report, FRC, July 2018, 7A.7 [frc.org.uk/getattachment/fb05dd7b-c76c-424e-9daf-4293c9fa2d6a/Guidance-on-the-Strategic-Report-31-7-18.pdf](https://www.frc.org.uk/getattachment/fb05dd7b-c76c-424e-9daf-4293c9fa2d6a/Guidance-on-the-Strategic-Report-31-7-18.pdf)

¹² Business model reporting; Risk and viability reporting: Where are we now? FRC, October 2018 [frc.org.uk/getattachment/43c07348-e175-45c4-a6e0-49f7ecabdf36/Business-Models-Lab-Implementation-Study-2018.pdf](https://www.frc.org.uk/getattachment/43c07348-e175-45c4-a6e0-49f7ecabdf36/Business-Models-Lab-Implementation-Study-2018.pdf)



Regulator viewpoint

David Styles

Director of Corporate Governance, FRC

Purpose

This finding is in line with the FRC's own independent analysis of FTSE 100 reports. In future reports we would like to see how and why the company arrived at its purpose and how the business will deliver the purpose by explaining how it drives their values and mission. An effective purpose should drive progress and is much more than a marketing tool or strap line.



Governance viewpoint

Pamela Coles

Chief Governance Officer, Rolls-Royce plc

Purpose

There has been a great deal of focus on establishing what is the purpose of a business. It would, however, be wrong to assume that any such consideration will then result in a complete change in direction or way of operating for that company. In fact, for us at Rolls-Royce it was anything but that. In light of the much-publicised challenges we faced we have undertaken a significant project to engage across the organisation in order to understand what employees in particular but also wider stakeholders see as our purpose. This was not altruistic but driven by a recognition that we could only return to success if all 55,000 employees of the company are working towards a common purpose.

The result has been a growing realisation that a lot of what we do aligns very much with both employees' goals and the exhortations of investors – reduced environmental impact, efficient engines, research and development in green technology. The problem was that we haven't explained this very well in the past. In short, what we do and what we say about what we do had become detached from each other.

It is evident from the research that there are at least 50% of companies in the FTSE 350, and from my contacts many more, who have probably not yet given much thought to purpose. Our experience is that it can have significant benefits for the business. But if real value is to be gained from such an exercise, it has to be done properly, that involves considerable time and a lot of listening.

However, such an exercise should not be considered in isolation. If purpose isn't clearly integrated with strategy and then linked into executive and employees reward, it will remain as a 1990's mission statement: sounding sort of appropriate but disconnected from what everyone is held to account for.

Business model

“The description of the entity’s business model should explain how it generates and preserves value over the longer term. The business model should be consistent with the entity’s purpose.”

[FRC Guidance on the Strategic Report 2018, 7B.15]

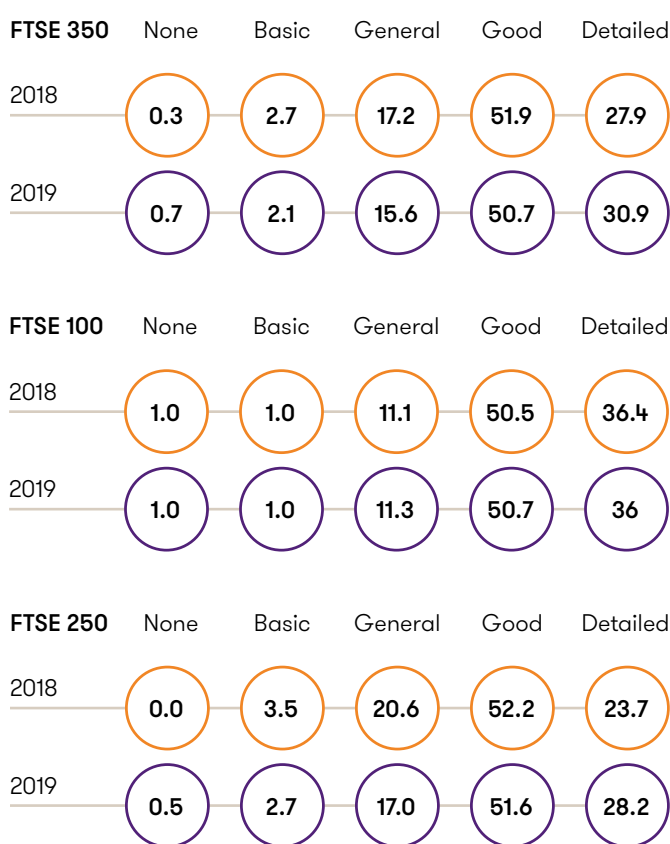
For several years, there has been a growing focus on the need to explain the business model. A company should be able to clearly articulate how it is structured and organised to generate returns, to make it easier for shareholders to understand both intangible and tangible sources of value, and to judge performance.

According to the FRC Financial Reporting Lab¹³, investors value business model disclosure – especially when it is in plain and clear language.

The number of companies who take a ‘value creation’ approach to business model reporting has increased over the past three years. This includes highlighting, for example, the resources and relationships that companies depend on; key revenue and profit drivers; and how profits are distributed.

The overall quality of information is largely unchanged, with 82% of the FTSE 350 providing good or detailed disclosures (2018: 80%). Yet there is a noticeable shift in the FTSE 250: almost 5% of the companies that gave good disclosures last year now provide more detail, with clearer explanations of their competitive advantage and value chain.

To what extent do companies describe their business model? (%)



DID YOU KNOW?

82% of FTSE 350 companies provided good or detailed disclosures

While companies increasingly discuss the value they create for wider society, few say clearly how this informs their strategy. Seventy-six percent (2018: 72%) of the FTSE 350 make this link, using signposting such as graphics – but despite extensive use of design features, many reports are still not providing clear explanations. Only 18% (2018: 14%) do so more meaningfully, with additional explanations.

¹³ Business model reporting; Risk and viability reporting: Where are we now? FRC, October 2018 [frc.org.uk/getattachment/43c07348-e175-45c4-a6e0-49f7ecabdf36/Business-Models-Lab-Implementation-Study-2018.pdf](https://www.frc.org.uk/getattachment/43c07348-e175-45c4-a6e0-49f7ecabdf36/Business-Models-Lab-Implementation-Study-2018.pdf)

Looking back

“The strategic report must contain... a fair review of the company’s business.”

[Companies Act 2006, s414C (2)]

While the new Code is encouraging companies to be more prospective in their reporting, eg in respect of purpose, strategy and horizon scanning for risks, inevitably annual reports continue to retain their bias to historic events.

Companies generally do a good job in reporting on past performance – celebrating successes or reflecting on challenges that influenced their performance. Eighty-seven percent give good or detailed reviews of past performance. They explain well their external environment, how they were influenced by market trends, and how they made use of strategic opportunities.

To what extent do companies provide a balanced and comprehensive analysis of their business? (%)



KPI disclosures

“The analysis in the strategic report must include financial and non-financial key performance indicators (KPIs).”

[FRC Guidance on the Strategic Report 2018, 7B.68]

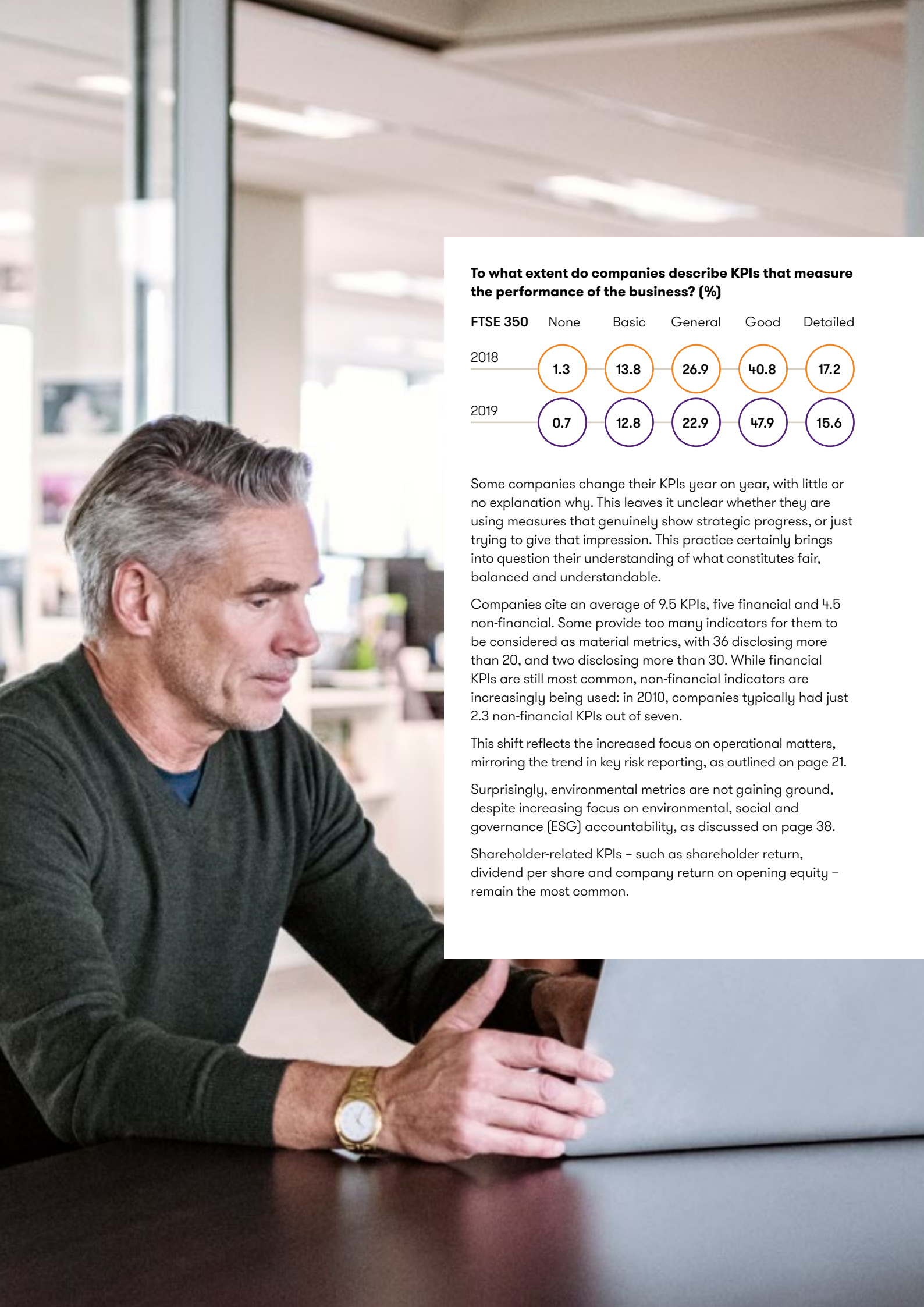
Key performance indicators (KPIs) should ideally be the measures boards use to monitor strategic progress, rather than opting for metrics which are easy to measure, show a positive trend, or are already required by legislation.

FTSE 350 companies have improved how they map their progress. The number of companies linking their KPIs and strategic priorities through signposting or cross-referencing has increased to 68% (2018: 61%). But only 24%, as last year, offer extra explanation on this linkage; others are missing the chance to help investors measure management credibility against KPIs.

The percentage of companies providing good or detailed KPI disclosure has improved to 63% (2018: 58%), although the number giving extra detail on why the chosen indicators are relevant yardsticks of strategic progress, and how they are calculated, has decreased slightly.

A significant 36% still only say which KPIs they use and how these compare to the previous two to five years. In doing so, they miss the chance to show strategic linkage and help shareholders grasp why the measures are relevant – especially when these indicators differ from the highlights presented at the beginning of the annual report.

The use of targets is still rare across the FTSE 350, with companies apparently unwilling to commit themselves publicly to specific aims.



To what extent do companies describe KPIs that measure the performance of the business? (%)

FTSE 350	None	Basic	General	Good	Detailed
2018	1.3	13.8	26.9	40.8	17.2
2019	0.7	12.8	22.9	47.9	15.6

Some companies change their KPIs year on year, with little or no explanation why. This leaves it unclear whether they are using measures that genuinely show strategic progress, or just trying to give that impression. This practice certainly brings into question their understanding of what constitutes fair, balanced and understandable.

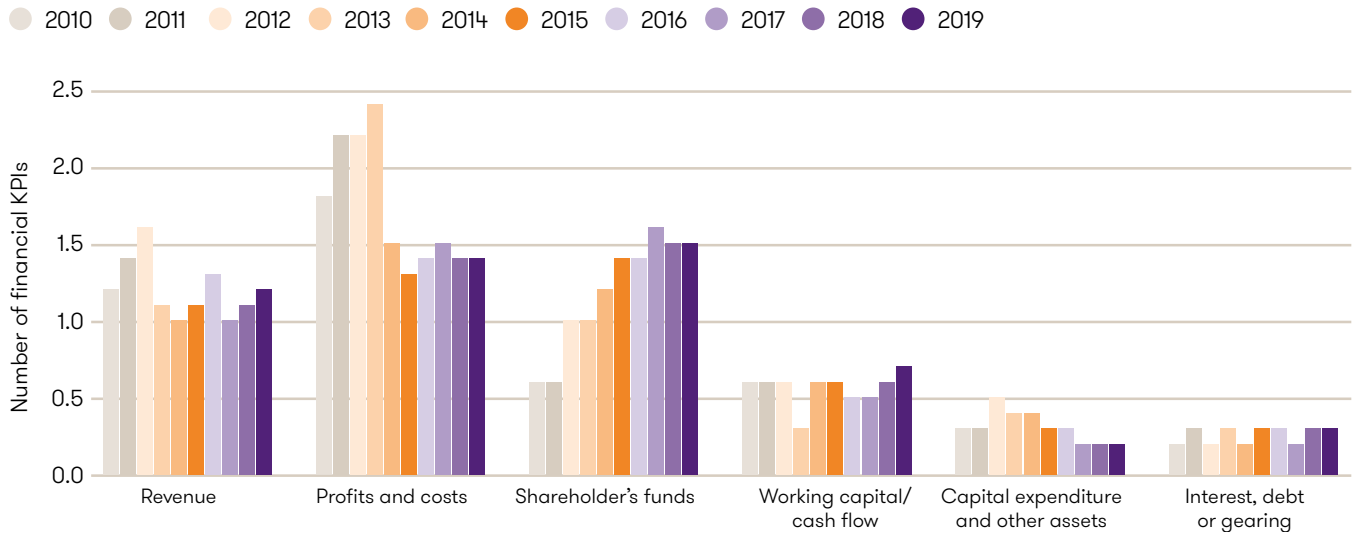
Companies cite an average of 9.5 KPIs, five financial and 4.5 non-financial. Some provide too many indicators for them to be considered as material metrics, with 36 disclosing more than 20, and two disclosing more than 30. While financial KPIs are still most common, non-financial indicators are increasingly being used: in 2010, companies typically had just 2.3 non-financial KPIs out of seven.

This shift reflects the increased focus on operational matters, mirroring the trend in key risk reporting, as outlined on page 21.

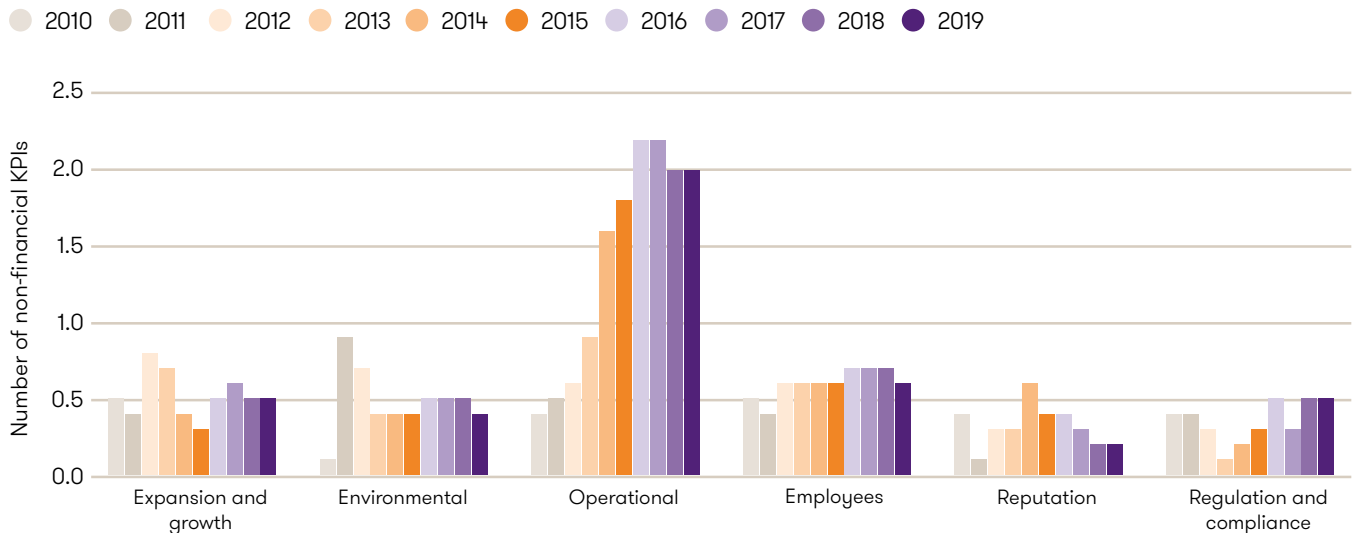
Surprisingly, environmental metrics are not gaining ground, despite increasing focus on environmental, social and governance (ESG) accountability, as discussed on page 38.

Shareholder-related KPIs – such as shareholder return, dividend per share and company return on opening equity – remain the most common.

Average number of financial KPIs disclosed



Average number of non-financial KPIs disclosed



Looking ahead

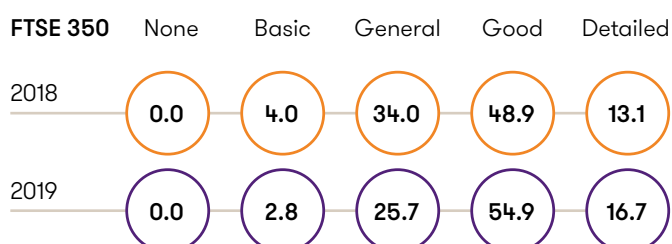
“In the case of a quoted company the strategic report must, to the extent necessary for an understanding of the development, performance or position of the company’s business, include...the main trends and factors likely to affect the future development, performance and position of the company’s business.”
[Companies Act 2006, s414C (7a)]

This year 72% of companies provide good or detailed forward-looking statements – a noticeable improvement over time (2016: 48%). Businesses now give better insights into future market trends, emerging risks and evolving business models.

Yet some companies are reluctant to discuss capital allocation or long-term objectives, possibly reflecting economic uncertainty, including over Brexit. At the same time, companies are trying to be more open about their uncertainties and concerns. As an example, just 22% identify Brexit as a principal risk, but most do discuss the UK leaving the EU in the context of future business development and expected market trends.

Only 17% quantify how future market drivers may influence or shape their strategy, specifying time frames for all strategic priorities. Even fewer companies outline how they have future-proofed themselves, or are currently doing so – through, for example, recruiting or developing the knowledge and experience to respond to future challenges, such as technological advances, market shifts, supply chain consolidation, or regulatory change.

To what extent do companies describe the likely future development of the business? (%)



Disclosing principal risks

“The strategic report must include a description of the principal risks arising in connection with the entity’s operations and.... a description of how it manages and mitigates the principal risks.”

[FRC Guidance on the Strategic Report 2018, 7B.27]

All companies now state their key risks, with only two providing no further details. All but one explain how they mitigate such risks.

Thirty-one percent give detailed accounts of their principal risks, providing useful content while not giving away competitive advantage or sensitive information. Disclosures are notably more specific to the company, and allow readers to assess how risks might affect the business model; this is a significant improvement over recent years (2014: 18%).

The most comprehensive reports offer information on the likelihood and possible impact of these risks, often using risk heat maps, gross or net of mitigating actions. They also disclose priority of risks, how exposure to them has changed, and whether their significance altered during the year.

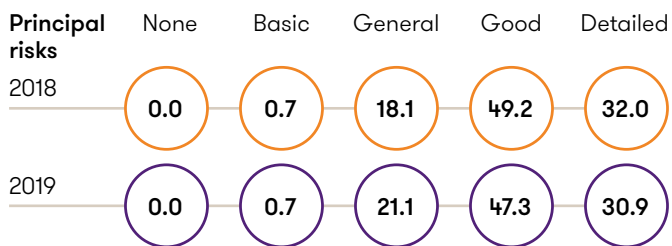
Links between corporate strategy and risks are often mentioned: 17% (2018: 10%) give meaningful explanations on linkage, while further 61% of companies (2018: 65%) align risks to strategy via signposting or cross-referencing. But according to the FRC, investors often question what this linkage to strategy means, especially where no definition is given or where the reader is required to follow icons.¹⁴

There is also room for improvement in the clear categorisation of principal risks; this would help investors differentiate between company-specific and general risks (for example, industry-wide issues), and to understand how organisations prioritise risks.

¹⁴ Business model reporting; Risk and viability reporting: Where are we now?, FRC, October 2018 [frc.org.uk/getattachment/43c07348-e175-45c4-a6e0-49f7ecabdf36/Business-Models-Lab-Implementation-Study-2018.pdf](https://www.frc.org.uk/getattachment/43c07348-e175-45c4-a6e0-49f7ecabdf36/Business-Models-Lab-Implementation-Study-2018.pdf)



Descriptions of principal risks and uncertainties



The average number of principal risks reported remains constant at 11, with most disclosing between eight and 13. Of the outliers, three report more than 20; these companies would benefit from revisiting their assessment of what constitutes a key risk.

In 2015, 81 companies did not appear to have reviewed their principal risks and mitigating actions; this year, that number dropped to three (2018: 10). This may reflect the influence of the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.¹⁵

Emerging risks

“The board should carry out a robust assessment of the company’s emerging and principal risks.”
(UK Corporate Governance Code 2018, Provision 28)

The new Code places much greater emphasis on disclosure of emerging risk – encouraging a shift to looking beyond the horizon. This feeds into the ongoing debate as to the balance between retrospective and prospective elements in the annual reports.

Sixty-four percent of companies mention assessment of emerging risks. That said, disclosure relates more to the procedures and processes they have in place to identify such risks, rather than giving greater clarity as to the specific nature of risks and how they will mitigate and manage them.

¹⁵ Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, FRC, September 2014 [frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf](https://www.frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf)

Risk trends

“Trends and factors affecting the business may arise as a result of the external environment in which the entity operates or from internal sources...they may give rise to risks that may affect the entity’s future prospects”
[FRC Guidance on the Strategic Report 2018, 7B.22]

Trends emerge when risks are analysed by category. In particular, since the financial crisis, operational risks have increased in comparison to financial metrics.

Macroeconomic risk reporting reveals a surprising trend. In 2017, in the wake of the EU referendum result, the number of macroeconomic risks disclosed per company increased by 55%; in 2018, there was a fall of almost 30%; and this year, a further drop of 8%.

At the same time, this year more companies refer to Brexit as a key risk to their business: this is just over one-third (64) of those which disclose different macroeconomic and political risks, compared to 46 companies in 2018. FTSE 250 companies report Brexit as a key risk slightly more often perhaps reflecting their more UK centric operations.

Almost 40% of those who have Brexit on their risk radars are in the consumer services sector. While outlining their mitigating actions – such as currency forward positions, collaboration with trade organisations, and monitoring of government reporting – these companies acknowledge the limits of such mitigation, due to uncertainty about the exit negotiations. No oil and gas companies, and only one each of technology, telecommunications and utilities companies, identify Brexit as a separate principal risk to their business.

Many companies, while not stating it is a principal risk, mention the UK’s departure from the EU in the context of other factors such as changes in the regulatory environment, taxation, import or labour costs or market trends. They often mention Brexit preparation next to the principal risks section.

Environmental risk reporting has grown by 53%, but from a very low base. Given the heightened focus on the environment’s impact on long-term business, it is surprising that this year only 58 companies (2018: 38) – and no technology or telecommunications firms – think of it as a key threat. This must be a major concern: climate change is one of the most significant, and perhaps most misunderstood, risks organisations face.¹⁶ As climate change presents global markets with an escalating threat, investors increasingly are expecting to see how environmental risks and opportunities are being integrated into mainstream financial decision-making. See more on this discussion on page 38.

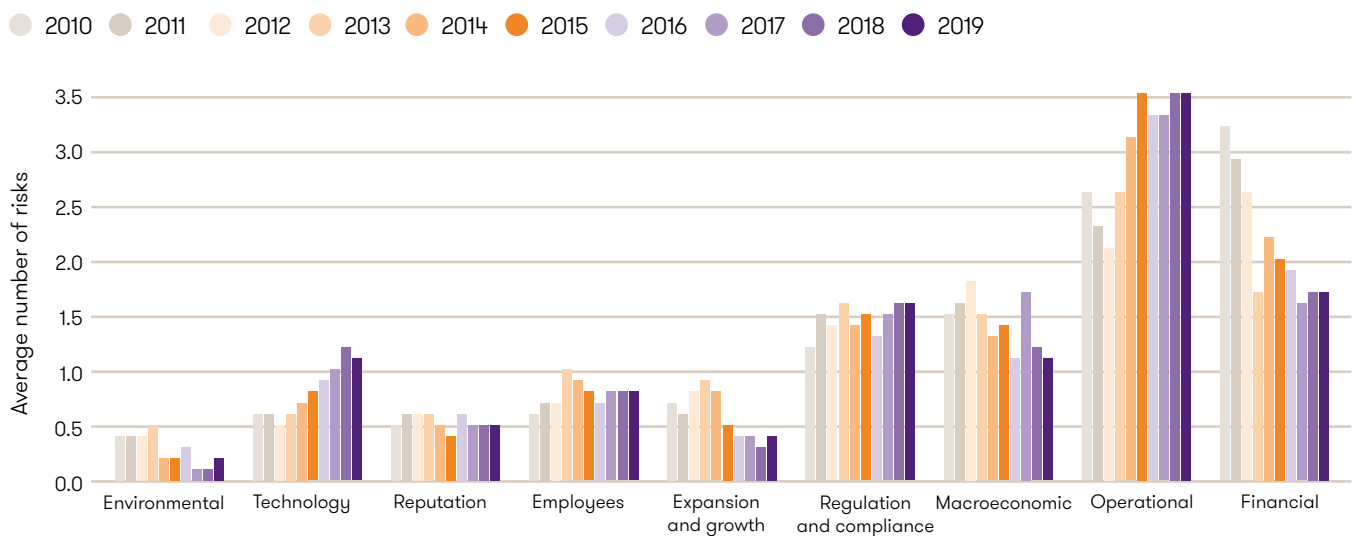


DID YOU KNOW?

Only 20% of companies consider environment issues to present a significant risk to their business.

¹⁶ Recommendations of the Task Force on Climate-related Financial Disclosures, Financial Stability Board, June 2017 [fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf](https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf)

Categories of principal risks



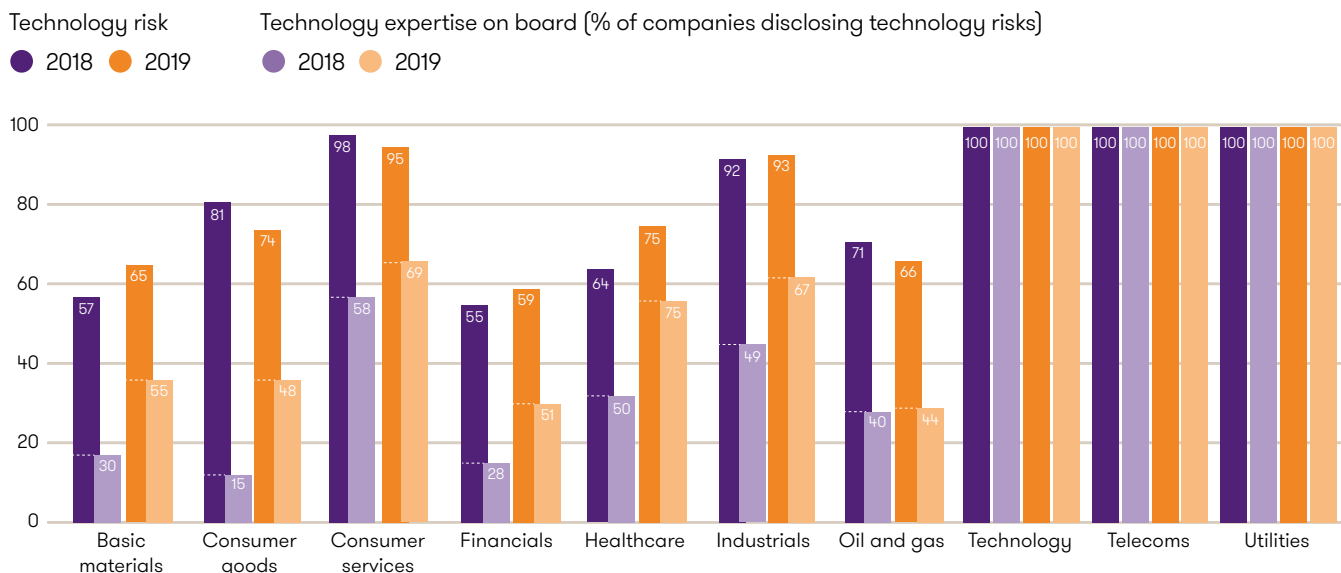
Technology is a powerful enabler of both change and opportunity, but it brings new and complex risks. For the first time in 10 years, technology-related risks have fallen slightly. All utilities, telecommunications and technology companies and all but one consumer services company, disclose technology, including cyber risk, as a key threat. Still, 21% of the FTSE 350 (2018: 21%) report no technology risks. Surprisingly, fewer companies now believe that their exposure to cyber risk is increasing. Net reported increases in spending on mitigating cyber risk may partly explain this.¹⁷

Technology risk has for a long time not been reflected in the typical composition of boards. Of the 79% of companies which reported IT and technology risks in 2018, more than half did not disclose technology expertise on their board. This year sees a significant shift in this statistic among those who report technology as a key risk: the number of companies with no board technology expertise has reduced to 35%. Two sectors of concern last year – consumer goods and financial – saw a rise in board appointments of directors with technology expertise in 2019.

Still, more than one-third of the FTSE 350 do not have directors with relevant expertise; this rises to half or more when it comes to the oil and gas, consumer goods and financial sectors. It is a concern that the scarcity of tech-savvy directors receives little coverage in annual reports. Scant attention is paid to how expertise can be strengthened through recruitment, bespoke training, or using resources such as advisory panels to enable effective strategic board conversations on technology. The new Code's focus on the nomination committee's role in monitoring succession and future fit development may change this.

17 FT-ICSA Boardroom Bellwether survey Summer 2019; ICSA, 2019 [icsa.org.uk/knowledge/research/ft-icsa-boardroom-bellwether-survey-summer-2019](https://www.icsa.org.uk/knowledge/research/ft-icsa-boardroom-bellwether-survey-summer-2019)

How many companies disclose technology as a key risk? (%)



The viability statement

“Taking account of the company’s current position and principal risks, the directors should explain in the annual report how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.”

(UK Corporate Governance Code 2018, Provision 31)

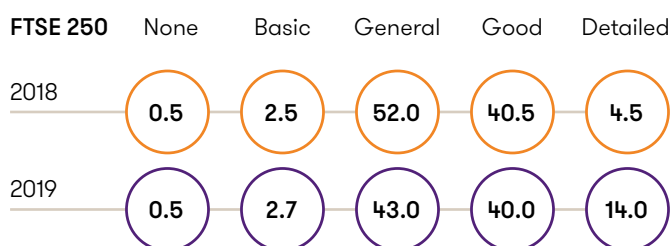
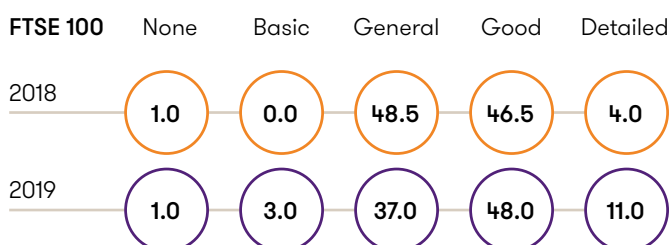
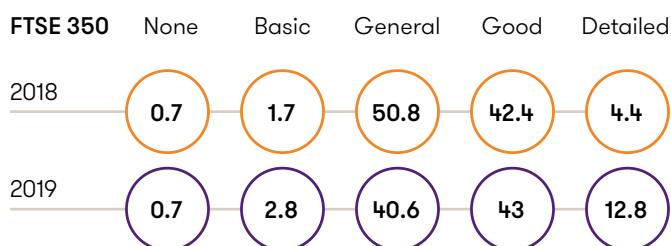
Viability statements were introduced to help companies better assess their risk appetite by incorporating stress and sensitivity analyses into risk management processes. They use a two-stage approach: assessing a company’s prospects over a specified period; and exploring whether there is a reasonable expectation that it will be able to continue in operation and meet its liabilities as they fall due.

All but two of the FTSE 350 offer a viability statement, with 56% (2018: 47%) giving good or detailed disclosures with specific insights into how they assess viability, including scenarios considered and how these link to principal risks.

Reporting has improved since last year. However, just 37 companies (2018: 13) – mostly in financial services, consumer goods and basic materials – fully address the detail envisaged by the FRC; for example, by including quantitative outcomes of scenario analysis, and disclosing the probability and extent of mitigating activities modelled in response to them.

The statements of the other 43% remain largely disconnected from principal risks. They do not report explicitly on their methodology, and give only basic or general disclosure as to why the chosen assessment period is appropriate.

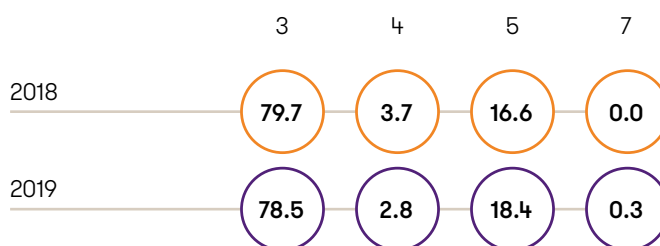
Do companies provide a satisfactory viability statement? (%)



The viability assessment period is meant to look beyond the 12 months considered for going concern. Seventy-nine percent of companies (2018: 80%) opt for three years, with most choosing this period to align with their medium-term strategic plan, budgeting and forecasting processes. Sixty-two businesses, including half of the basic materials and utilities sector, consider longer periods. No technology or telecommunications companies look at spans beyond three years.

The future of viability statements is unclear. The Kingman review of the FRC¹⁸ has suggested that the statements' effectiveness should be reviewed, and serious consideration given to abolishing them if they do not improve substantively. The main criticism is that companies do not provide enough insight for the investors for whom these statements were intended – again throwing into doubt the likely success of any significant shift to a more forward-looking form of reporting.

How many years are assessed in the company viability statement? (%)



Strategic report disclosure

“The strategic report should provide essential context to the financial statements to support an understanding of developments in the year and the future financial performance and position of the entity.”

[Guidance on the Strategic Report 2018, 4.4]

As content expands and page count grows, companies are trying to make their annual reports easier to read and navigate. Sometimes, though, they lose sight of the need to make sure that strategy is the underlying thread tying together all aspects of the report.

The strategic report was introduced to encourage companies to provide a holistic picture of their business – integrating their strategy and business model with their principal risks and challenges¹⁹ – in response to the call for clearer, more coherent reporting as highlighted by the financial crisis.

All but three FTSE 350 companies now include a strategic report in their annual report. Fifty-eight percent comply with all strategic report requirements for quoted companies (2018: 60%), with others often missing only small details in legislation or guidance, such as the way they present gender split across all levels.

Yet companies' approach to strategic report disclosure varies considerably: just 18% (2018: 17%) achieve the regulator's goal of providing high-quality, business model-led components, interlinked reporting and informative insight. This is a concern, as good annual reporting discipline is one of the indicators of long-term value creation.

¹⁸ The Independent Review of the Financial Reporting Council, John Kingman, December 2018 www.gov.uk/government/publications/financial-reporting-council-review-2018

¹⁹ Better and simpler company reporting, Department for Business, Innovation & Skills press release, June 2013 www.gov.uk/government/news/better-and-simpler-company-reporting

Culture



19

Just 19 companies use a 'dashboard' to measure culture effectively



78%

Of companies articulate their values



45%

Give good or detailed accounts of company culture, up from 33%



50%

Only 50% of the FTSE 350 clearly state their purpose beyond generating profit



34%

Discuss how they measure culture – but seem to use mainly repurposed data

Articulating values and purpose

“An entity’s culture can help to drive its success. The purpose, strategy and values should be aligned with the entity’s culture”

(FRC Guidance on the Strategic Report 2018, 3.2)

Ethics, culture and purpose in the boardroom have come under increased scrutiny in recent years. Corporate culture – including the board’s responsibility for defining, embedding and monitoring it – has been a significant focus for the FRC; first in its report of observations in 2016²⁰, and now in the new Code, where culture, values and purpose are far more prominent.

Companies’ tendency to articulate their values increased this year. Seventy-eight percent (2018: 67%) now set out their values; that said, these often have much in common with those of many other companies. When it comes to the challenge of explaining purpose, the number drops to half (2018: 40%) with technology and oil and gas being the outliers page 12.

Anecdotal feedback suggests that articulation of purpose, if taken seriously, requires much reflection – not just at board level, but across the company. Some companies have used it as a catalyst to engage more employees and stakeholders in a wide-ranging debate; this can also cover ESG responsibilities, an area of growing investor challenge. Those who take it less seriously may turn to external annual report writers for inspiration – thereby perhaps missing the point of the valuable role it can play in the ethos of decision-making.

Financial services companies are much better than other companies at articulating their purpose and culture. This is no surprise, as they have extra pressure from another regulator: the FCA has said much recently on purpose, and on how organisations create purposeful cultures.²¹ Forty-nine percent of financial services companies provide good and detailed disclosures on culture, slightly higher than the FTSE average.

Overall, 45% of companies provide good or detailed accounts of their culture (2018: 33%). This increase in detailed disclosure is most evident across the FTSE 100, though there are also improvements in the FTSE 250.

In the past, culture reporting often centred on actions to avoid value destruction, such as referencing processes and procedures, eg their code of conduct, preventative training programmes and other risk management related processes. This year the focus has started to evolve, with consideration given to how corporate culture contributes to value creation and how it could drive strategic progress. This is borne out by our recent research²² which found that successful companies (top quartile) typically have more strongly defined and integrated culture practices (89%) compared to bottom quartile performers (33%).

20 Corporate Culture and The Role of Boards: Report of Observations, FRC, July 2016 [frc.org.uk/getattachment/3851b9c5-92d3-4695-aeb2-87c9052dc8c1/Corporate-Culture-and-the-Role-of-Boards-Report-of-Observations.pdf](https://www.frc.org.uk/getattachment/3851b9c5-92d3-4695-aeb2-87c9052dc8c1/Corporate-Culture-and-the-Role-of-Boards-Report-of-Observations.pdf)

21 Business Plan 2019/20, FCA, 2019, [fca.org.uk/publication/business-plans/business-plan-2019-20.pdf](https://www.fca.org.uk/publication/business-plans/business-plan-2019-20.pdf)

22 Getting Smart About Governance, Grant Thornton, July 2019 [www.grantthornton.co.uk/gettingsmartaboutgovernance]



To what extent does the annual report address culture and values? (%)

FTSE 350	None	Basic	General	Good	Detailed
2015	26.3	28.2	26.3	16.3	2.9
2016	13.6	34.7	31.8	16.9	2.9
2017	5.6	26.9	28.9	34.4	4.3
2018	5.7	28.4	32.9	29.3	3.7
2019	3.5	17	34	38.5	6.9

FTSE 100	None	Basic	General	Good	Detailed
2015	15	28	32	23	2
2016	4	30	37	27	2
2017	4	21.2	25.3	45.5	4
2018	2	23.2	32.4	39.4	3
2019	1	14	30	41	14

FTSE 250	None	Basic	General	Good	Detailed
2015	31.6	28.3	23.6	13.2	3.3
2016	18.3	37	29.3	12	3.4
2017	6.3	29.6	30.6	29.1	4.4
2018	7.6	31.3	33	24.1	4
2019	4.8	18.6	36.2	37.2	3.2

The new Code says that culture needs to be aligned with strategy as well as other policies and practices. Reflecting this evolution, we reviewed whether boards explain how policies, practices and behaviours are aligned with purpose and values, and found that 66% attempt this.

Overall, 76% refer to purpose, values or culture in the context of their approach to investing in and rewarding their workforce, but only 17% give any meaningful explanation.

Twenty-four percent include some detail on how their culture enables, or is connected to, their strategy. An additional 45% refer to this but do not provide any detail. Remuneration is less well linked to culture, see page 67.



DID YOU KNOW?

24% explain how their culture is connected to their strategy

Role of the chair and CEO

“All directors must act with integrity, lead by example and promote the desired culture.”

(UK Corporate Governance Code 2018, Principle B)

The number of chairs that discuss culture within their annual report has risen significantly over the past four years: 72% now mention the topic, up from 22% in 2015. Rather than consigning culture to the governance statement, chairs use their primary statement alone (16%) or, increasingly, both statements (25%) to discuss the topic. This is perhaps an acknowledgement that putting governance at the heart of a company's strategy requires consistent messaging from the top.

Yet this recognition seems to have passed most CEOs by, with little change in the number discussing company culture in their annual statements (2019: 32%; 2018: 29%). This is surprising given the FRC's view that the CEO is the main promoter of an organisation's culture, and the increased focus on culture in the new Code. This area clearly requires more discussion at board level.

Does the chair discuss the culture and values of the company, and where? (%)

	No	Yes, in their primary statement	Yes, in their introduction to the corporate governance report	Yes, in both
2015	77.9	11.9	9.6	0.6
2016	61.4	12.7	16.9	9.1
2017	43.6	14.1	27.9	14.4
2018	42.8	18.9	21.9	16.5
2019	28.1	16	30.9	25

Measuring culture

“The board should assess and monitor culture. Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company's purpose, values and strategy, it should seek assurance that management has taken corrective action.”

(UK Corporate Governance Code 2018, Provision 2)

More companies now discuss how their culture supports strategy and a sustainable business model, but far fewer explain culture in the context of how their progress is measured.

The new Code requires boards to define and then assess and monitor culture. This year, 34% of the FTSE 350 discuss how they monitor and measure culture. Methods for gathering data on culture vary, ranging from employee surveys (30%) to health and safety statistics. Most give the impression that monitoring is based on existing data that has been repurposed for the annual report; 27% only use one or two indicators. This begs the question as to how effective board assessment of company culture can be.

To measure culture effectively, experts recommend that boards compile a bespoke basket of measures, which are not only balanced against the key culture drivers but also aligned to the organisation's specific business goals²³. A 'dashboard' of reliable indicators can enable companies to monitor the embedded culture at all levels, on a consistent basis over time. Only 19 companies (7%) have designed, and use, a specific dashboard of metrics or a scorecard of more than three metrics to measure culture. For example, Rio Tinto's board monitors cultural behaviours through a series of formal and informal interactions, such as site visits, town halls and the employee AGM. It uses a range of sources including safety performance, absenteeism, staff retention/turnover rates, employee surveys, exit interviews, major breaches of its ethics code, and calls to its whistleblowing programme.

However, the question remains: how sure can leaders be that what they are hearing and measuring is a true reflection of what is happening across the organisation? Judging by the fact that only three companies refer to having had a culture audit last year, there is a need for immediate debate.

What sources of information do companies use to assess culture? (%)

2019



Investor viewpoint

Andrew Ninian

Director, Stewardship and Corporate Governance, The Investment Association

Culture

A company's culture sets the template for future growth, providing the direction, common understanding and general attitude needed to create long-term results. Investors want to understand how the Board sets, assesses and measures the culture of the company. Investors take a holistic view, deriving information on a company's culture from a range of sources and indicators relevant to the specific company. This will range from approach to capital management and executive pay, the outcomes of employee and customer surveys, as well as their own experiences of interacting with the company, employees, management, and board.

Stakeholder engagement



26%

Over quarter mention the engagement of the SID, 22% of the remuneration chair



64%

now mention face-to-face engagement with shareholders, up from 46% in 2018



18%

Only 18% explain key issues raised by major stakeholders



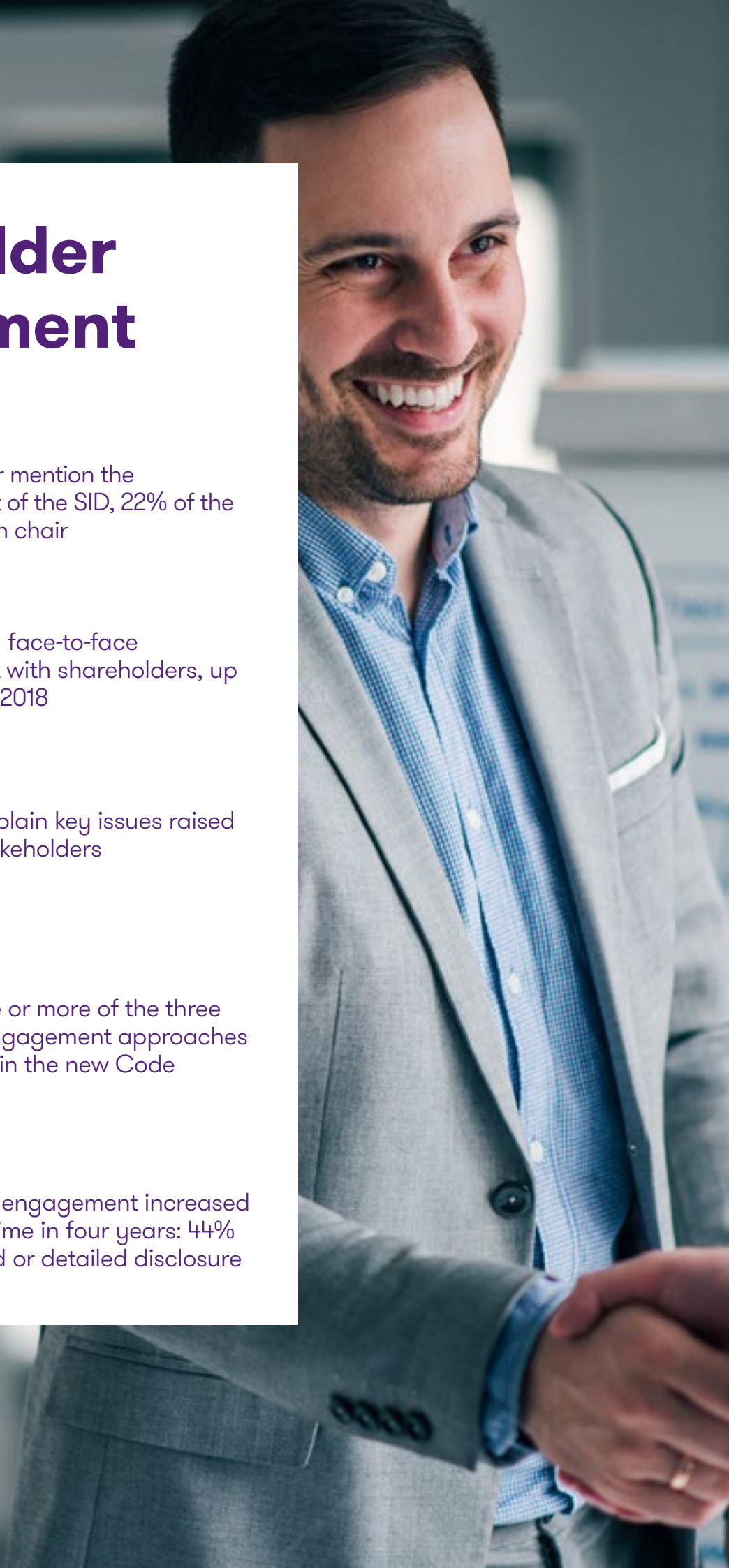
37%

adopted one or more of the three employee engagement approaches as specified in the new Code



44%

Shareholder engagement increased for the first time in four years: 44% provide good or detailed disclosure



More than just engagement

“In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties.”

[UK Corporate Governance Code 2018, Principle D]

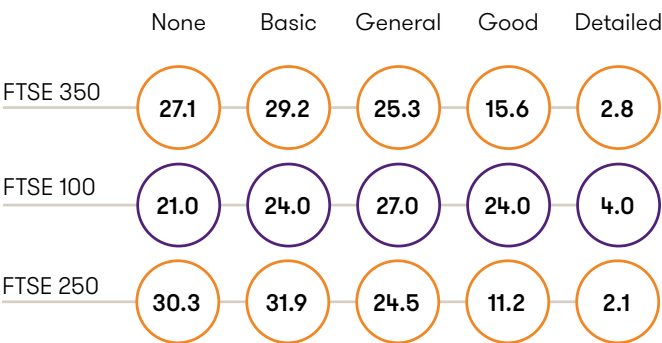
Under pressure from government, investors, commentators, regulators and wider society, there has been a greater focus on section 172 - the “duty to promote the success of a company” - over the past three years. In particular, there has been increased emphasis on the need to acknowledge impacts on a wider array of stakeholders who may have vested, if not legal, interests in a company.

Organisations’ first response has been to include new sub-sections in their annual reports, contributing to the higher page count. It is unclear to what extent this has led to changes in practice. Investors will have to challenge companies about their practices before we can find out. For that to happen, they will need to use investment strategies to show that their demands have teeth, particularly in the field of ESG. It may be some time before this virtuous circle has a lasting impact.

Overall, 73% give information on their key stakeholders; mostly identifying who they are and how each key stakeholder group is engaged. Stakeholder engagement mechanisms vary significantly, with interaction with local communities the most common. Most companies which discuss stakeholder engagement also mention other initiatives, including formal events, special committees, external assessments and customer satisfaction surveys.

Still, only 18% explain what key issues stakeholders raised and how they responded. Just 3% show well integrated thinking, providing extra detail with tangible examples of how stakeholders’ expectations were considered in board decisions. Although there is a significant amount of new content on stakeholders in this year’s reports, it rarely feels integrated into the strategic story.

Does the board explain in the annual report how their stakeholders’ interests and the matters set out in s172 influenced decision making? (%)



Employee engagement

“...For engagement with the workforce, one or a combination of the following methods should be used: a director appointed from the workforce; a formal workforce advisory panel; a designated non-executive director.”

[UK Corporate Governance Code 2018, Principle D]

This year we take a closer look at employee engagement practices, in line with the extra focus in the new Code. Most companies have embraced this new requirement in some way, with only 38, or 13% (2018: 34%) mentioning no type of employee engagement. At first glance this appears much better than last year. Yet only 37% adopted one or more of the three approaches as specified in the new Code. Three companies appointed an employee director to the board, 37 set up a workforce advisory panel, and 71 have a NED with responsibility for engaging with employees. Of these companies, five have opted for a combination of two methods, appointing a NED who will be working with the advisory panel. A further four, as an alternative to the approaches suggested by the Code, have employee representatives who attend some or all board meetings.

All other companies either repurpose employee surveys/questionnaires or refer to less structured means of engaging with employees. Overall, 63% (2018: 47%; 2017: 25%) of companies mention employee surveys and questionnaires. That said, surveys will only make true engagement possible if there is clear and regular follow-up, along with accountability to employees about actions. Yet companies rarely discuss how they use employee feedback from surveys. Thirty-six (2018: six) say they engage with employees through formal ‘meet the board’ or NED events, while 126 also say they get feedback in other ways.



Investor viewpoint

Andrew Ninian

Director, Stewardship and Corporate Governance, The Investment Association

Stakeholder engagement and employee voice – the need for engagement mechanisms

Investors have welcomed the renewed emphasis on the implementation of director’s duties and wider stakeholder engagement. Considered engagement with key stakeholders informing board decision-making will strengthen businesses and promote long-term value to the benefit of shareholders and stakeholders alike. The Corporate Governance Code requires one of three workforce engagement methods. But adoption of only one of the proposed measures will not be enough. There is no point in having a designated Non-Executive Director, if the Director does not have the appropriate mechanism to hear from employees. Whilst we have seen a significant number of companies outline how they will be responding to this aspect of the UK Corporate Governance Code this year, less companies have focussed on how they engage and incorporate the wider views of stakeholders in their Board decision making. Investors will expect to see a broad approach to stakeholder engagement, with clear transmission mechanisms between stakeholders and the board.



Regulator viewpoint

David Styles

Director of Corporate Governance, FRC

Employee engagement

The FRC is pleased to see that in many reports companies are considering and taking action on the most appropriate methods of engagement with employees. For next year's reports it will be equally important to explain how such methods have been effective in influencing board decision making, feeding back information to employees and articulating outcomes.



Governance viewpoint

Pamela Coles

Chief Governance Officer, Rolls-Royce plc

Employee representation to the board

Here at Rolls Royce we've been on a much-publicised journey to change our culture. Some years ago, we had a series of profits warning and an SFO enquiry and employees were feeling distant from board and worried about the future of the company. So, we had a burning platform to address that required real change and at the heart of this was a need for the leadership of the company to re-connect with its employees as a result of which we came up with a programme of measures and found ourselves ahead of the game.

As part of this programme we introduced the role of a designated board member responsible for employee engagement and its impact has been far greater than we could have anticipated. Boardroom discussions have changed, there's a much greater feeling of connectivity with the mood across the organisation, decision taking is made with a much more tangible consideration of the impact on our employees and their families and this is not just limited to the Group board but is evident among the executive and wider leadership teams. Further, what we have seen is that more members of the board are meeting people at all our sites around the world whenever they are on a visit and bringing those insights back to the board creating a much greater feeling of connectivity.

I attribute the success of the role to a combination of the enthusiasm of our NED and the express support of the board; no constraints or bureaucratic processes were put in her way; there was no filtering of where she could go nor who she could speak to. Getting the right person to do it, getting them comfortable in the role and feedback in to the board is important. The feedback was not always comfortable to hear so building trust that what was said would be listened to was important.

But success breeds success and with 55,000 employees there simply isn't enough of Irene to go around. So, in 2020, we will be rethinking the role to see how we can build on the success already achieved. We haven't ruled out anything but recognise that we need to add an element of formality into the process so that not just the most engaged are heard. We are keeping an open mind; we have already brought another NED to work alongside her who is based in the US and we have not ruled out other options mentioned in the UK Corporate Governance Code.

Grant Thornton's statistics suggest that many companies are wrestling with how to address this new requirement. My advice would be to embrace it fully but don't overthink it. The result may well surprise them.

Shareholder engagement

“In addition to formal general meetings, the chair should seek regular engagement with major shareholders in order to understand their views on governance and performance against the strategy.”

[UK Corporate Governance Code 2018, Provision 3]

One of the most significant changes in the new Code has been the incorporation of the old ‘Relations with shareholders’ section within ‘Board leadership and company purpose’. This year’s reporting seems to positively reflect this move towards treating shareholder engagement as part of the board’s leadership role.

For a number of years, we have highlighted a falling level of reported engagement between companies and shareholders. This year is the first since 2016 to see an increase in the number of companies that give good or detailed disclosures on shareholder engagement, at 44% (2018: 31%). This is most notable in the FTSE 100, where 62% provide extra detail on how they engage with shareholders (2018: 44%). Given the changed focus of the FRC in the new Code and the Stewardship Code it is still early days, but it is encouraging to see this improvement.

To what degree does the board demonstrate the steps taken to understand the views of major shareholders? (%)

FTSE 350	None	Some	More
2016	2.3	61.7	36.0
2017	0.3	67.2	32.5
2018	0.7	68.0	31.3
2019	0.7	55.5	43.8

FTSE 100	None	Some	More
2016	1.0	47.0	52.0
2017	1.0	44.4	54.5
2018	1.0	54.5	44.4
2019	0.0	37.0	62.0

FTSE 250	None	Some	More
2016	2.8	68.8	28.4
2017	0.0	78.2	21.8
2018	0.5	74.7	24.7
2019	0.5	65.4	34.1

When meetings between investors and the board are disclosed, the chair is typically the main point of contact. Across the FTSE 350, 59% state that their chair met with shareholders, up from 50% in 2018. Another 30% say their chair is available for meetings with investors but that none took place.

Does the chair meet with shareholders, and do they discuss governance and performance against the strategy? (%)

FTSE 350	2018	2019
Not disclosed	23.2	11.5
Available	26.6	29.9
Meets but not clear what was discussed	34.0	37.1
Yes - discussed	16.2	21.5

Overall, the way companies engage with investors seem to be improving. There is a rise in face-to-face meetings between companies and major investors, and less reliance on one-way forms of communication, such as the annual report, statements or other announcements. Sixty-four percent now mention face-to-face engagement (2018: 46%). This represents a 16% increase in the FTSE 100 and a 18% increase in the FTSE 250.

The Stewardship Code²⁴ 2020 has explicit principles and provisions that relate to “collaborative engagement”. These rely on two-way, active communication. While this is a new trend, it is encouraging to see that companies are finally taking engagement seriously and reporting on it in more detail.

²⁴ Stewardship Code 2020, FRC, October 2019, https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf



Shareholders and other non-executives

“Committee chairs should seek engagement with shareholders on significant matters related to their areas of responsibility. The chair should ensure that the board as a whole has a clear understanding of the views of shareholders.”

[UK Corporate Governance Code 2018, Provision 3]

While the chair and executive directors are most likely to have meetings with investors, the new Code also recommends that committee chairs seek engagement with shareholders on significant matters related to their areas of responsibility. We would expect to see these meetings reflected in company disclosures.

Thirty-three percent (2018: 22%) state that a NED, apart from the chair, attends meetings with major shareholders.

The difference between the FTSE 100 and FTSE 250 is much reduced this year. FTSE 250 companies are almost as likely to have a NED that meets investors as the FTSE 100. This is encouraging, as last year’s marked difference suggested investors were much more likely to engage with larger companies.

A crucial part of the SID’s role is to be there for shareholders when they have concerns that cannot be taken up with the chair, so it is unsurprising that there has been a significant increase in reported activity in this area with SID engagement now eclipsing that with the remuneration committee chair. Just over one quarter of the FTSE 350 state that the SID met with shareholders (2018: 12%).

Perhaps reflecting the ever increasing attention on remuneration, there is an increase in engagement with the remuneration chair, up to 22%. The nomination chair also sees greater engagement; that said, he or she is often also the chair of the board, so it is unclear whether this engagement is explicitly to discuss nomination committee matters. While these increases are notable, the audit committee chair still holds a low profile, with only 4% reporting direct engagement.

In addition to the NEDs who have met with shareholders, just over half of the FTSE 350 say that a NED is available for shareholder meetings.

Who attends meetings with major shareholders? (%)

	Met with shareholders		Available to meet with shareholders	
	2018	2019	2018	2019
SID	12.1	25.7	37.4	44.4
Remuneration chair	13.1	22.2	11.8	24.0
Nomination committee chair	2.0	8.7	9.4	15.6
Audit committee chair	2.0	4.2	10.1	9.4
Another	5.1	5.6	20.9	16.0

ESG reporting



76%

of companies give a good level of detail on environmental matters



30%

But only 30% have an environmental KPI, and just 20% say environmental risks are a principal threat



39%

Companies have on average 39% women and 61% men in their workforce



26%

only 26% of women and 74% men are at senior management level

E for environmental

“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...(d) the impact of the company’s operations on the ...environment.”
[Companies Act 2006, s172 (1)]

Non-financial reporting has expanded greatly over the past 10 years. Backed by European legislation, reporting frameworks, sustainability indices²⁵ and a growing clamour from investors and the public, greater information about ESG has become common practice. However, annual report disclosures vary in quality, as it is up to boards to align company strategy to the frameworks and to decide how much they report against them.

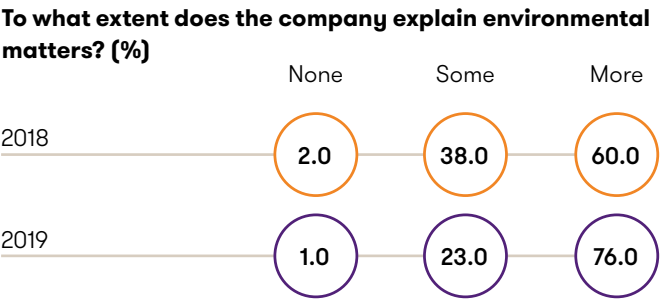
As well as being linked to the UN Sustainable Development Goals (SDGs),²⁶ demonstrable practices of strong governance, environmental stewardship and social responsibility are becoming key components of investor and stakeholder engagement. Further, companies now have to report against the EU’s non-financial reporting directive, which is helping to unify disclosures in this area.

The content and quality of environmental disclosures has improved significantly: 76% now give a good level of detail. Over the past three years, nearly all companies have correctly reported levels of greenhouse gas emissions.

Yet environmental issues are not being integrated into business strategy. Neither do they seem to be hitting the leadership agenda. Only 30% of companies have an environmental KPI, and only 20% consider environmental risks a principal threat to the achievement of their strategy.

Despite clear warnings, such as Bank of England Governor Mark Carney’s 2015 speech, ‘Breaking the Tragedy of the Horizon’²⁷, many organisations perceive the implications of climate change to be solely long-term and, therefore, not relevant to decisions made today. A growing cohort of investors disagree and are actively and publicly challenging companies to recognise that climate change poses significant risks as well as opportunities²⁸. They see environmental and other ESG matters as critical to understanding a company’s full risk profile, and how prepared it is for the future; and indicate they may engage and vote accordingly²⁹.

Investors are therefore looking for standardised, rigorous data to support their investment decisions. Reflecting such demands, the revised Guidance on the Strategic Report³⁰ challenges companies to go beyond discussion of the factors that affect their immediate sector or sub-sector, to cover mega-trends that influence their external environment. To what extent this more proactive engagement is leading to changing behaviours among the board and senior management, and the role they have to play overseeing climate-related issues, has yet to become clear.



25 Frameworks and indices include the CDP (formerly the Carbon Disclosure Project), Dow Jones Sustainability Indices (DJSI), the Global Reporting Initiative (GRI), GRESB, the Sustainability Accounting Standards Board (SASB) and Integrated Reporting (IR)
26 Sustainable Development Goals, UN website sustainabledevelopment.un.org
27 Speech: Breaking the Tragedy of the Horizon – climate change and financial stability, Bank of England, 29 September 2015 www.bankofengland.co.uk/-/media/boe/files/speech/2015/breaking-the-tragedy-of-the-horizon-climate-change-and-financial-stability.pdf?la=en&hash=7C67E785651862457D99511147C7424FF5EA0C1A
28 Recommendations of the Task Force on Climate-related Financial Disclosures, Financial Stability Board, June 2017 fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf
29 BlackRock Investment Stewardship’s approach to engagement on climate risk, BlackRock, January 2019 blackrock.com/corporate/literature/publication/blk-commentary-engaging-on-climate-risk.pdf
30 Guidance on the Strategic Report, FRC, July 2018 frc.org.uk/getattachment/fb05dd7b-c76c-424e-9daf-4293c9fa2d6a/Guidance-on-the-Strategic-Report-31-7-18.pdf

S for social

“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...(d) the impact of the company’s operations on the community...”

(Companies Act 2006, s172 (1))

Companies are paying more attention to the disclosure of social and governance issues. In 2019, there was a 4% improvement in the reporting of social, community and human rights activities – and a clear increase in companies providing a meaningful discussion of anti-bribery and anti-corruption, tax transparency and inclusion.

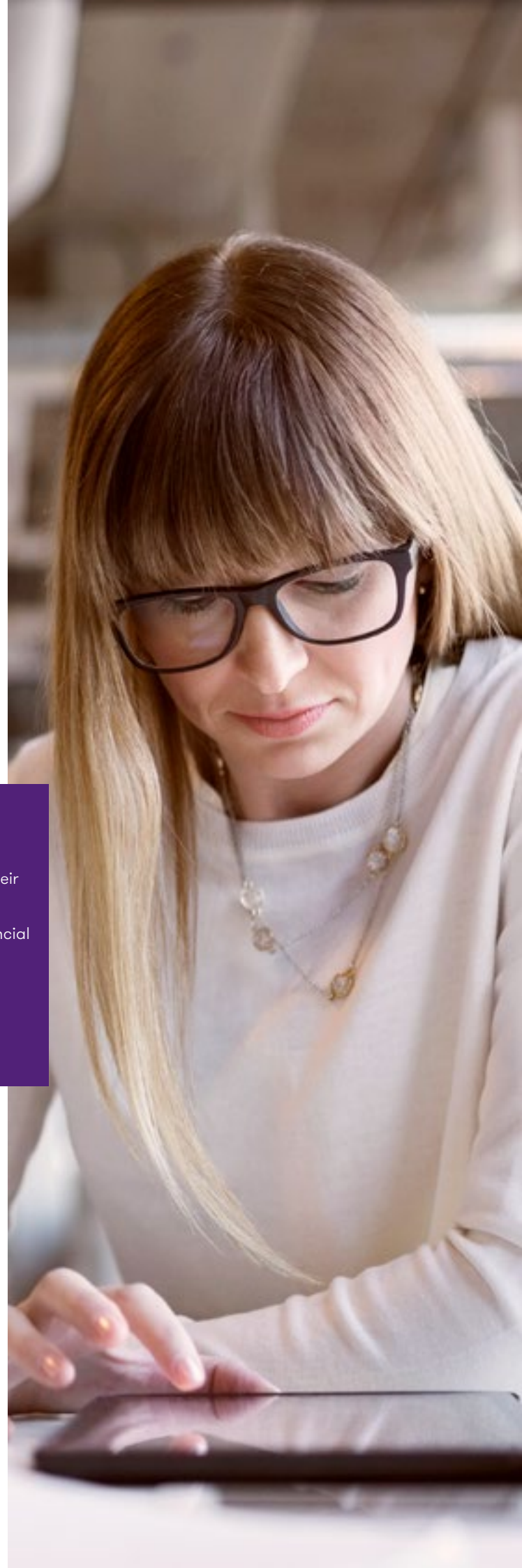
Getting smart about governance

Is there a link between better governance and performance? We investigated the financial performance of companies that improve their corporate governance to find out.

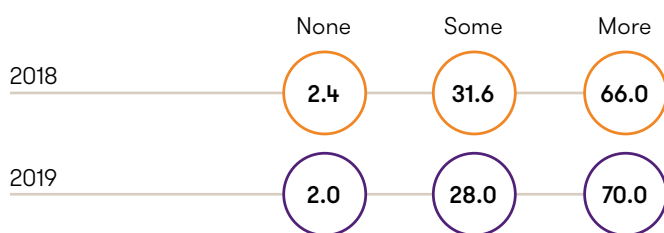
We identified a strong link between improved governance and financial performance. Each step up between quartiles saw an average 46% increase in free cash flow, and a 10% rise in EBIT margin³¹.

Our research provides important evidence for organisations looking to understand the value of investing in strong governance.

³¹ The case for transforming your approach to governance, Grant Thornton, 29 July 2019
grantthornton.co.uk/en/insights/the-case-for-transforming-your-approach-to-governance/



To what extent does the company explain social, community and human rights activities? (%)

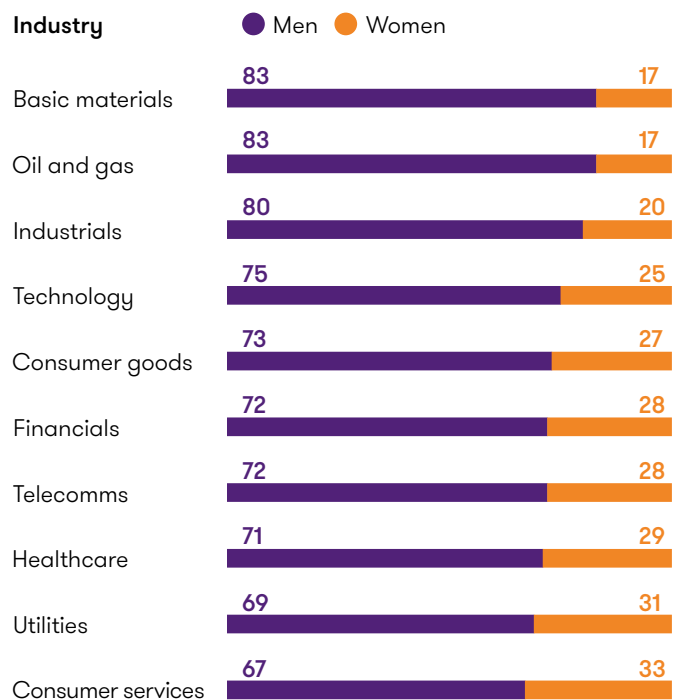


There has been a significant improvement in the quality of disclosures on employee matters. Seventy-seven percent of companies now offer a good or detailed level of information. Such disclosures are mainly combined with explanations of the culture and values of the organisation, which contributes to this improvement. However, despite this step forward, only 41% of companies have an employee-related KPI.

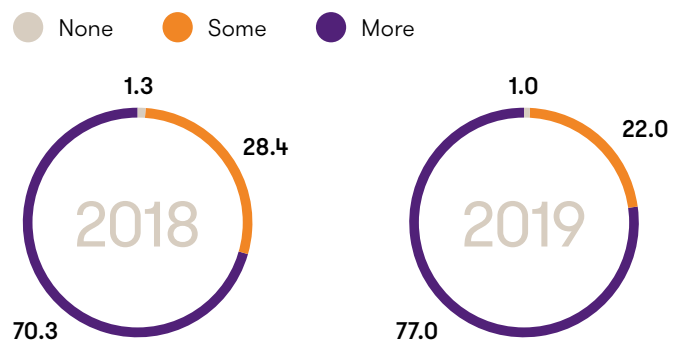
The number of companies failing to comply with the mandatory requirement to show their employee gender split at the end of the financial year fell to 36% (2014: 52%). While many companies state percentages for gender diversity, they omit to give the actual figures. This omission is surprising, as companies seem more focused on gender diversity this year – probably due to greater attention from the public, politicians and the regulator, driven by gender pay gap legislation and the Hampton-Alexander Review³².

Looking at the FTSE 350 overall, companies have on average 39% women and 61% men in their workforce, with 26% women and 74% men at senior management level. Fewer women hold senior management positions in basic materials and oil and gas, while utilities and consumer services businesses have almost one-third women at this level.

Senior management gender split by industry (%)



To what extent does the company explain employee matters? (%)



³² FTSE Women Leaders: Improving gender balance in FTSE Leadership, Hampton-Alexander Review, November 2018 [ftsewomenleaders.com/wp-content/uploads/2018/11/HA-Review-Report-2018.pdf](https://www.ftsewomenleaders.com/wp-content/uploads/2018/11/HA-Review-Report-2018.pdf)

Governance



32%

Only 32% of the FTSE 350 discuss the application of the Code principles in a meaningful way



73%

Claim they are fully compliant with the Code; 95% meet all but one or two provisions



48%

Provide good or detailed explanations of board evaluation, but only 43% give enough detail on outcomes



63%

Give little or no information on the skills and experience of their board



22%

companies have had their chair on the board for more than nine years and another 5% fast approaching this milestone

Applying the principles

“It is important to report meaningfully when discussing the application of the Principles and to avoid boilerplate reporting. The focus should be on how these have been applied, articulating what action has been taken and the resulting outcomes.”

(UK Corporate Governance Code 2018, Reporting on the Code)

In the new Code, the FRC places a greater focus on the application of the Code’s principles.

FCA Listing Rules require all listed companies incorporated in the UK, and overseas businesses with a premium listing, to outline in their annual report how they apply the main principles set out in the Code³³. This should be done in a way that enables shareholders to see how:

- the principles have been applied
- the board set purpose and strategy
- the board met objectives and achieved outcomes.

This listing rule is often overlooked by companies – unlike the requirement for a statement on compliance. Our findings suggest that companies are at best not treating the principles statement as a priority or, worse, are unaware of the increased focus on the listing requirement. Sixty-six percent offer some sort of statement on the application of the Code principles; typically, these include general explanations, signposting and cross-referencing to other parts of the annual report. This is marginally up on 12 months ago (2018: 63%).

Less than half of those who discuss the application of the principles (32%) do it in a meaningful way by, for example, explaining how they have been applied or specifying actions and outcomes; this is only slightly better than last year (2018: 27%). A small number of companies have used this focus to change the way they report: changing the structure of their reporting on governance, setting out the key activities of the board in promoting effective governance, and refocusing its messaging on the application of the principles, rather than compliance.

Compliance with the Code

“The effective application of the Principles should be supported by high-quality reporting on the Provisions. These operate on a ‘comply or explain’ basis and companies should avoid a ‘tick-box approach.’”

(UK Corporate Governance Code 2018, Reporting on the Code)

To help apply the principles effectively, companies should provide high-quality reporting on the Code’s provisions under the ‘comply or explain’ basis.



Regulator viewpoint

David Styles

Director of Corporate Governance, FRC

Application of the Code

The ‘comply or explain’ principle is designed to encourage companies to consider the UK Corporate Governance Code’s provisions within the context of their own activities. Our aim, therefore, is to promote an improvement in the quality in explanations which will encourage a move away from a “tick-box” approach to achieve better governance and transparency.

³³ Listing Rules, Financial Conduct Authority Handbook, September 2019. See LR 9.8.6R (5) handbook.fca.org.uk/handbook/LR.pdf

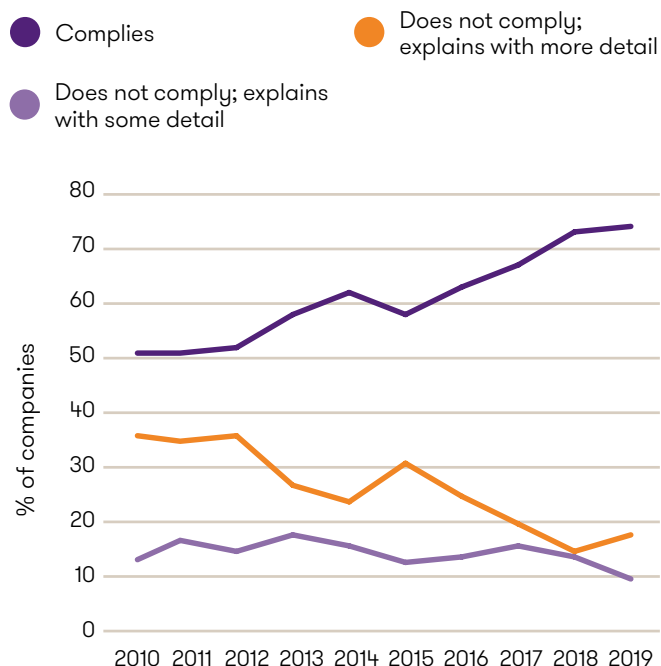
Full compliance grows

Full compliance has never been the aim, nor has it reflected the spirit, of the UK Corporate Governance Code, due to the 'comply or explain' principle. However, since we started this review, 18 years ago, there has been an increasing trend towards full compliance: this year it stands at 73%, with 95% complying with all but one or two Code provisions, consistent with 2018.

This year, for the first time, the FTSE 250 had a higher compliance rate than the FTSE 100: 74% claim full compliance, compared with 71% of the FTSE 100. This may be a response to the renewed focus on corporate governance from the media and policymakers. Full compliance among the FTSE 100 has slipped for two years in a row. This is not in itself a cause for concern, as the quality of explanations is improving: 63% of those who do not comply (2018: 50%) now give good or detailed reasons why.

Eleven companies have moved from compliance to non-compliance within the reported year while 22 have moved from non-compliance to compliance. This shows good evidence of the 'comply or explain' principle being used effectively; with non-compliance being for temporary reasons which are explained to investors through the annual report.

Do companies claim full compliance with the UK Corporate Governance Code? (%)



Do companies claim full compliance with the UK Corporate Governance Code? (%)

	2015	2016	2017	2018	2019
FTSE 350	57.1	62.0	66.2	72.0	72.9
FTSE 100	64.0	72.0	77.8	74.7	71.0
FTSE 250	53.8	57.2	60.7	70.7	73.9



Reasons for non-compliance

“Explanations should set out the background, provide a clear rationale for the action the company is taking and explain the impact that the action has had. Where a departure from a Provision is intended to be limited in time, the explanation should indicate when the company expects to conform to the Provision. Explanations are a positive opportunity to communicate, not an onerous obligation.”

(UK Corporate Governance Code 2018, Reporting on the Code)

The main area of declared non-compliance is board make-up and independence: 13 companies do not have at least half the board made up of independent NEDs, and 14 do not have a chair who was independent on appointment. These are both marginal reductions from last year.

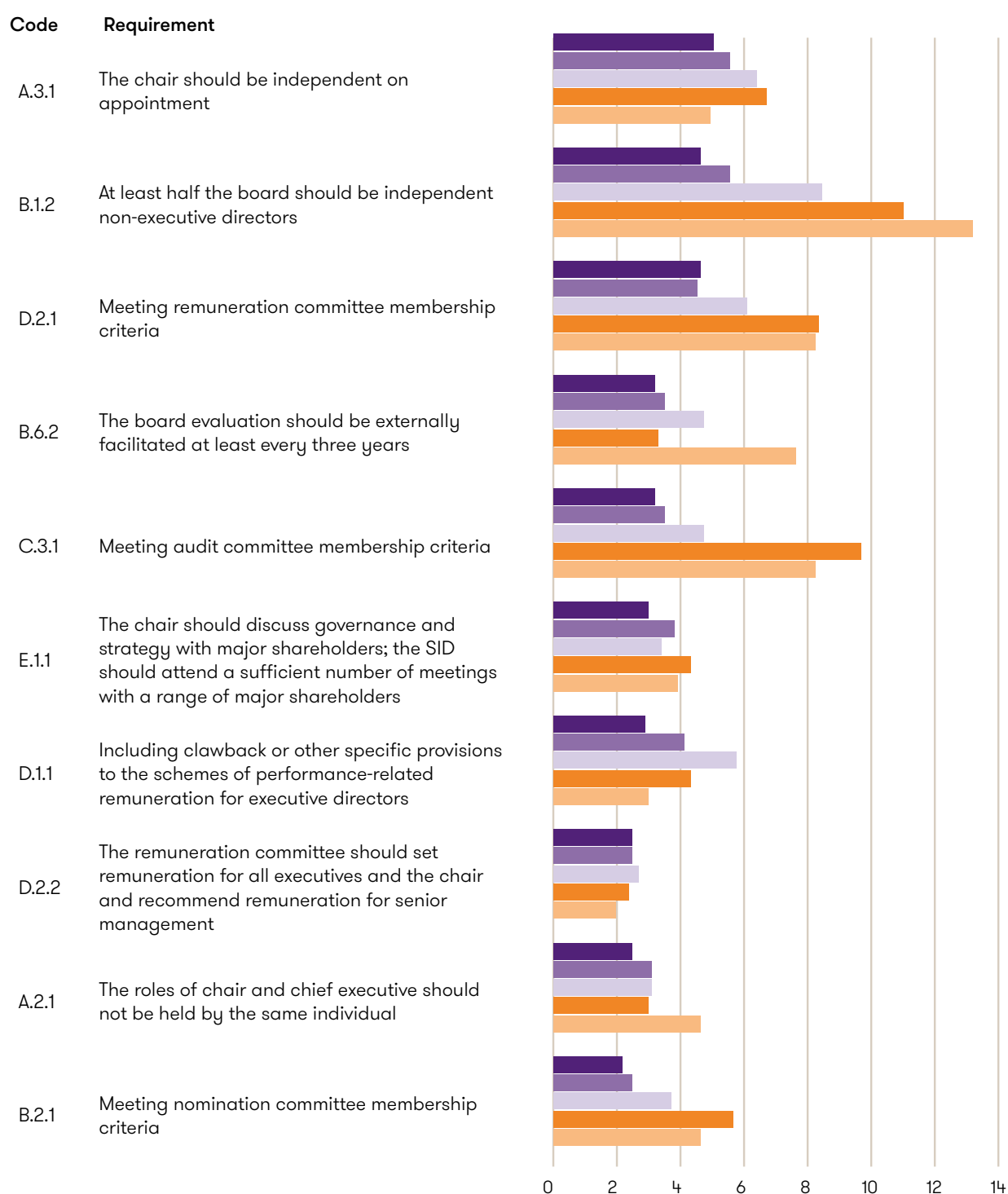
Compliance with the shareholder engagement requirement has risen. Eight companies declare non-compliance with E.1.1, down from 11 in 2018. This provision states that the chair should discuss governance and strategy with major shareholders, and/or that the SID should attend meetings with shareholders.

There is some discrepancy here; as we note on page 22, 32 companies (12%) do not report on meetings between shareholders and their chair. It may be that these companies have meetings that are not reported in the annual report, or that they are not declaring non-compliance. In 2018, 63 companies (23% of the FTSE 350) did not report on shareholder meetings and only 11 declared this as non-compliance. While these discrepancies may be a point of concern from a compliance perspective, the general quality of shareholder engagement reporting has improved for the first time in five years.

Non-compliance relating to remuneration has further reduced from 2018; however, it is troubling to see any non-compliance at all in this area, given the amount of attention from the public, investors and policymakers. Thirteen companies do not meet sufficient remuneration committee membership criteria (D.2.1); eight do not satisfy the provision covering clawbacks and holding periods of shares after vesting or exercise (D.1.1); and seven declare non-compliance with D.2.2, requiring the remuneration committee to set remuneration for all executives and the chair and to recommend that of senior management.

Areas companies list as non-compliant (%)

● 2019 ● 2018 ● 2017 ● 2016 ● 2015



Board composition

“The board and its committees should have the appropriate balance of skills, experience and knowledge.”

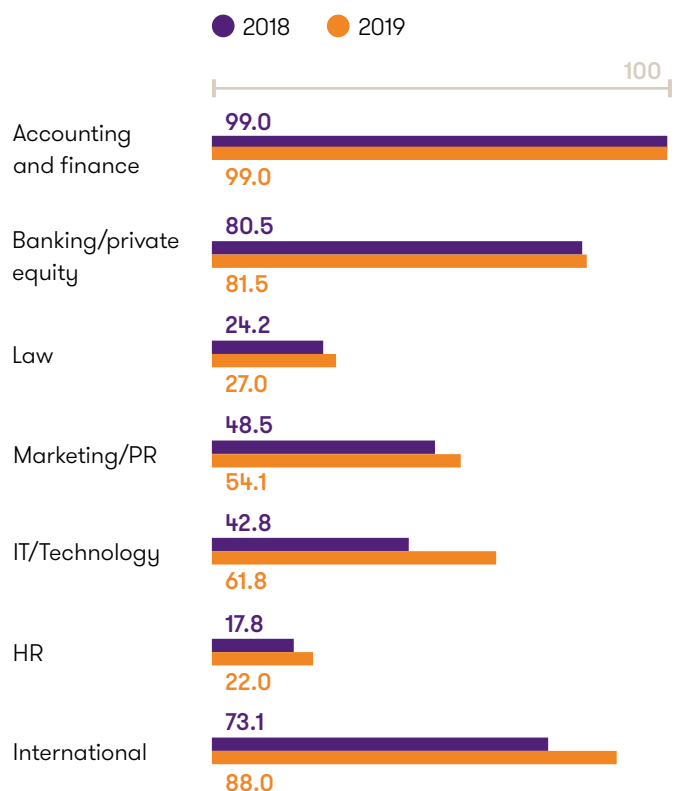
(UK Corporate Governance Code 2018, Principle K)

The boards of 224 companies appointed a new director this year. This is consistent with the past, but we are starting to see a widening diversity of director backgrounds, in line with NED changes. While most have directors with accounting, finance, banking and private equity credentials, this year there is a greater proportion with legal, human resources, marketing/PR and IT/technology experience.

A rising number of companies (62%) say they have directors with a technology background (2018: 43%). This is encouraging, as it suggests that companies are starting to bring to the board the skills needed to address technology risk. But experience is not evenly spread. Unsurprisingly, technology and telecommunications sectors have far more directors with these backgrounds.

The actual make-up of boards is shifting; the quality of disclosures around the skills and experience of directors has improved this year. Sixty-three percent give little or no information on the skills and experience of their board, and how it is suitable for their present business strategy (2018: 75%). Only 2% refer to how directors’ skills are relevant in the context of strategic risks, regulatory change and market shifts. Given the continued emphasis on the importance of diversity (of all types), it is surprising that there has not been greater innovation in identifying and communicating the skills available to the board.

How many companies disclose having board members with experience in the following areas? (%)



Director independence

“The board should identify in the annual report each non-executive director it considers to be independent.”
(UK Corporate Governance Code 2018, Provision 10)

Fifteen FTSE 350 companies have an executive chair, the same number as last year (although not all the same companies). Two state this is a temporary measure, with the rest choosing not to comply with the Code’s requirement for an independent chair. No company has the CEO and chair roles held by one person – something that historically was seen.³⁴ This compares to the US where although also in decline, 50% of the S&P 500 still have combined roles, down from 61% in 2008.³⁵

Twenty-three percent, as last year, have at least one NED deemed to be not independent. As previously, the most cited reason is that they represent a significant shareholder, with the next most common reason being that they have been board members for more than nine years. Explanations for non-independence have improved, with only one company giving no reason; eight (a fifth of those who do not comply) offer good explanations.

In addition, 12% of the FTSE 350 consider a director to be independent, despite not complying with one of the criteria in B.1.1, and over half of these give a vague explanation or no reason for this assessment.

“The chair should not remain in post beyond nine years from the date of their first appointment to the board. To facilitate effective succession planning and the development of a diverse board, this period can be extended for a limited time, particularly in those cases where the chair was an existing non-executive director on appointment. A clear explanation should be provided.”

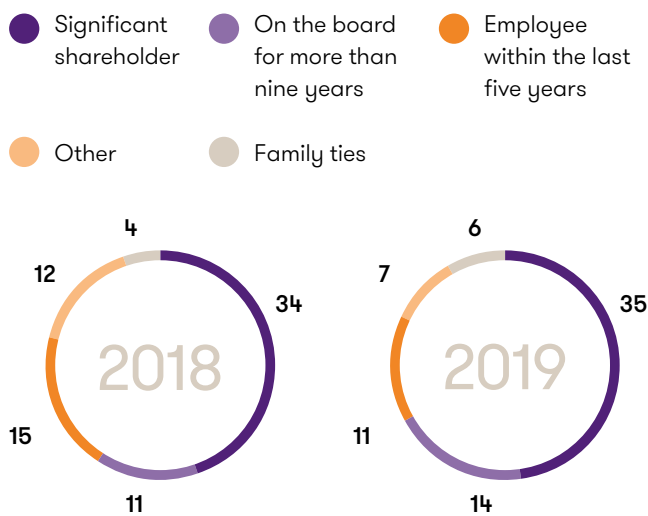
Corporate Governance Code 2018, Provision 19

Nineteen percent of the FTSE 350 have appointed a new chair this year (56 companies). Sixty-three companies (21%) have had their chair on the board for more than nine years with another 14 fast approaching this milestone. Whereas there was formerly no need to justify this, the new Code requires such companies to explain how they ensure the independence of their chairs, and/or how they are addressing longer-term succession. This adds to the load on the nomination committee which – as well as being under greater pressure to address succession planning and diversity – will now have to be addressing the need for an independent chair alongside greater diversity on the board.

Nomination committees – and head-hunters – could also soon face a new gender diversity challenge. The number of companies with long-standing chairs inevitably means that a lot of businesses will soon be looking for replacements. Traditionally, chairs have often been former CEOs or, at the very least, had executive board experience. Even with recent strides in the number of women on boards, to date there have been relatively few female CEOs or executive directors. Will companies look to appoint chairs based on different criteria, reflecting less traditional career routes or will they stick with candidates from tried and tested backgrounds thereby significantly restricting their choice. The present situation, with just 16 FTSE chairs currently being held by women, is not tenable. Headhunters will have their work cut out – the 59 female SIDs are likely to be on the receiving end of an ever increasing number of exploratory calls.

³⁴ For example, 10 UK companies had a joint chairman and chief executive, with another seven combining the roles at some point during the year in 2012, Grant Thornton Corporate Governance Review 2012 <https://www.grantthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/publication/corporate-governance-review-2012.pdf>
³⁵ 2018 US Spencer Stuart Board Index, https://www.spencerstuart.com/-/media/2018/october/ssbi_2018.pdf

Why are non-executive directors not considered independent?



Board evaluation

“There should be a formal and rigorous annual evaluation of the performance of the board, its committees, the chair and individual directors.”

(UK Corporate Governance Code 2018, Provision 21)

In this year’s annual reports, we see interesting developments in board evaluations. While companies are improving their explanations of process, they seem more reluctant to talk about outcomes, with the quality of explanations declining.

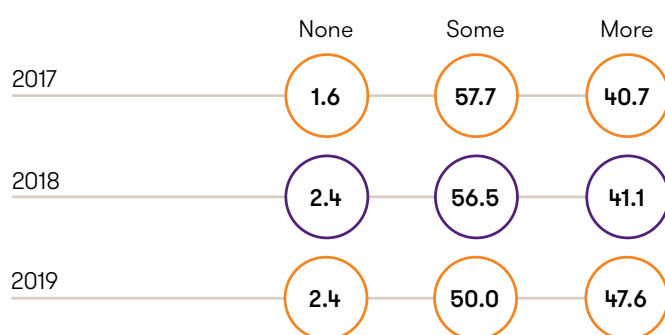
Forty-eight percent of companies provide good or detailed explanations of how their board, committees and directors are annually evaluated (2018: 41%). These companies give extra detail on how they conduct evaluations, including their methods, and on how information is collected by the board, chair, company secretary and/or external evaluator.

However, the annual report should also offer detail on outcomes. These include board strengths and areas for improvement or prioritisation, as well as planned actions, timescales for change and follow-up on the previous year’s outcomes. But just 43% provide enough detail on outcomes and previous year’s follow-up actions (2018: 47%).

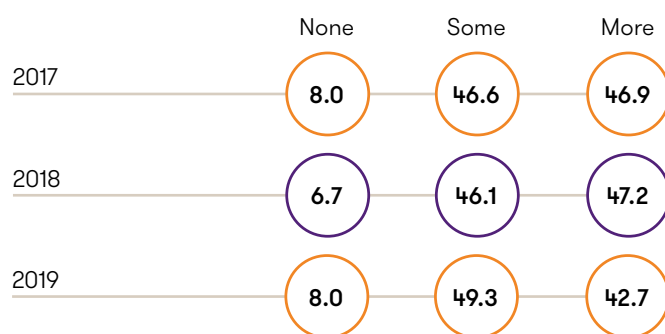
Board evaluation outcomes are often considered ‘too sensitive’ for the annual report, particularly as they may include areas where the board needs to increase its effectiveness. Yet many companies do provide helpful information, giving insight into how, for example, they are improving the way board members work together.

While a reluctance among companies to expose themselves to scrutiny is not surprising, it is likely to take greater investor and possibly regulator pressure before most businesses apply the intent of the new Code.

How much explanation is there of how the board, committees and individual directors are annually formally evaluated for their performance? (%)



To what extent are the outputs and actions arising from the board evaluation disclosed? (%)



Board evaluations also relate to the induction and training of directors, as many companies use them to identify development needs for NEDs. The quality of disclosures relating to training and induction has fallen: 69% of the FTSE 350 give no, limited or generic reporting on this area (2018: 60%).

External evaluation

“The chair should consider having a regular externally facilitated board evaluation. In FTSE 350 companies this should happen at least every three years. The external evaluator should be identified in the annual report and a statement made about any other connection it has with the company or individual directors.”

[UK Corporate Governance Code 2018, Provision 21]

This year just over one third of companies (2019: 38%; 2018: 39%) conduct externally evaluated reviews. Most do this every three years, as recommended. However, some consistently exceed this requirement, or shorten the length of time between reviews to when it is more useful for them, such as before or after a major strategic change, or following the appointment of a new chair.

Thirty-four board evaluation organisations are active across the FTSE 350. The range includes dedicated board evaluators, one-person firms, larger organisations, academics, and two search companies.

The shape of the evaluation market is changing, with less domination by the four providers mentioned in past reviews. Previous market leaders are conducting fewer evaluations and smaller players are getting more, including two newcomers that each picked up several evaluations this year. However, the top two are constant and are responsible for 38% of all evaluations. One organisation completed 24% (2018: 30%) of all reviews, alongside a ‘long tail’ of firms conducting just one or two.

The market for board evaluation is currently under review by The Chartered Governance Institute (previously ICSA: The Governance Institute): at the request of the Department for Business, Energy and Industrial Strategy. This review is due to be published in October 2019. One of its suggestions is for an assessment of the need for more guidance on disclosure of the conduct and outcomes of evaluations, to make sure they help make boards more effective and provide assurance to investors and the public. As, anecdotally, evaluations tend to be seen as assurance exercises for the chair rather than as a development exercises to improve performance or to inform the investors, This guidance could start to change that focus but, given the innate conservatism of chairs, it will take time.

Nomination committee



7

Companies still offer no nomination committee report



3

Businesses had no nomination committee meetings, despite two appointing new directors



81%

Refer to senior management succession, but just 13% go into detail



34%

Mention diversity of social background, a jump from 9% in 2018



29%

Give good and detailed reporting on their board gender diversity policy

Quality still lagging behind other committees

"The board should establish a nomination committee to lead the process for appointments, ensure plans are in place for orderly succession to both the board and senior management positions, and oversee the development of a diverse pipeline for succession."

(UK Corporate Governance Code 2018, Provision 17)

The quality of nomination committee reporting continues to lag behind the audit and remuneration committees, and has fallen slightly from last year. Less than 40% of the FTSE 350 provide strong descriptions of the nomination committee's work and the appointment process for new directors; 61% give no, basic or generic reporting. This includes seven companies that have no nomination committee report (2018: four).

The number and quality of report introductions from nomination committee chairs has increased marginally: 75% now include a preface. This is a significant change from 17% in 2012, but still far short of the remuneration committee (97%) and audit committee (84%) reports.

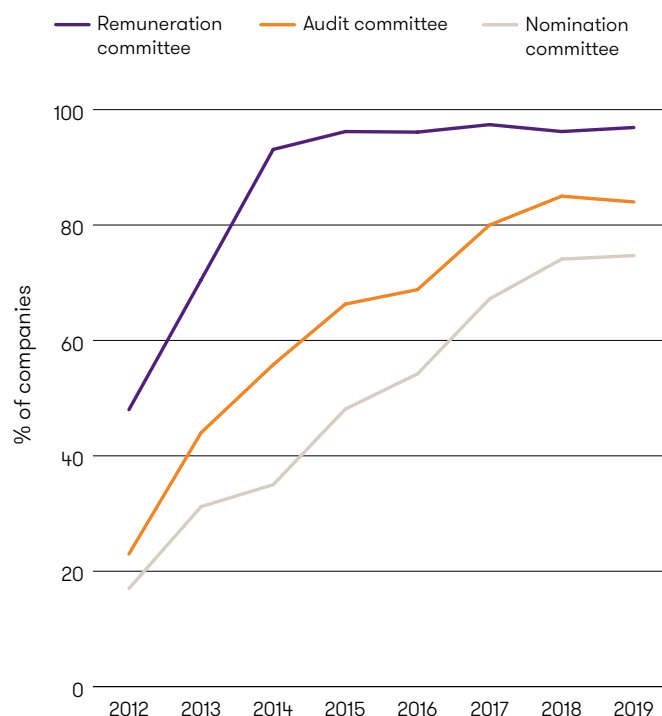
When it comes to quality, only 17% of the FTSE 350 give a detailed, personal introduction. The FTSE 250 seems to be leading the field: 27% of FTSE 100 companies do not include introductions from the chair, compared with 24% of the lower index. With the increasing responsibilities being placed on this committee, significant improvements are likely next year.



DID YOU KNOW?

Only 17% of the FTSE 350 give a detailed, personal introduction in their reports

Personal commentary from the chair (% Yes)



The nomination committee meets, on average, 3.6 times a year. This is less than the audit committee (4.8) and remuneration committee (4.9), though the difference is less pronounced than previously. The number of meetings has grown in recent years: in 2012, nomination committees met an average of 2.6 times. This reflects the increased responsibility of, and expectations on, the nomination committee.

Three companies had no nomination committee meetings this year (2018: 10), while 22 had only one. Most concerning were the two companies which had no nomination committee meetings this year, but appointed directors.

Of the 224 companies which appointed a new director, 27% do not follow the Code's requirement to give the name of the search firm used, while another 7% say they did not use a search firm. One firm conducted 23%³⁶ of these searches; the next most commonly-used company did 12%.

³⁶ This significant market share reflects the merging of the Zygos Partnership and Russell Reynolds.



Succession planning

“...an effective succession plan should be maintained for board and senior management.”

(UK Corporate Governance Code 2018, Principle J)

The increased focus on succession planning from the regulator and investors in recent years is starting to make an impact. This year slightly more companies provide extra detail on what they do, who is responsible, and how they make sure board succession addresses future needs. Seventeen percent give extra detail (2018: 14%). At the other end of the scale, 5% give no description of their succession planning at the board level, up from 2% last year.

The new Code emphasises the nomination committee’s enhanced responsibility for succession planning below board level, that is, in the executive team. This, in turn, has brought closer attention on senior management teams immediately below. This is emerging in annual reports: 81% mention or describe senior management succession planning, including how nomination committees are developing a pipeline of internal candidates, identifying future talent, and engaging them in leadership development. But there is still limited detail, with reports typically describing a generic process: only 13% of the FTSE 350 give good insight into how this works in practice.

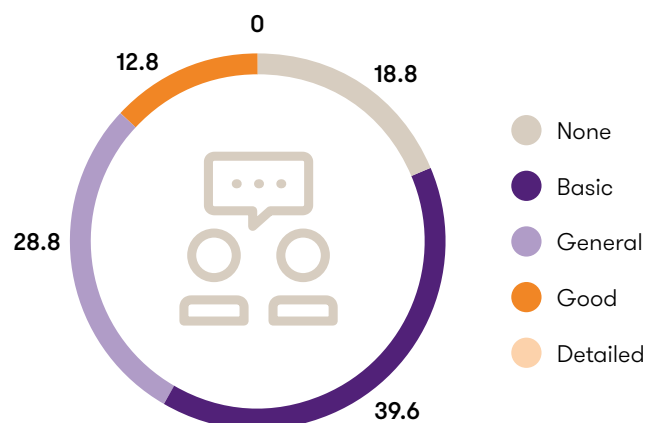
To what extent do companies describe board succession planning? (%)

FTSE 350	None	Basic	General	Good	Detailed
2018	2.0	34.0	50.3	13.0	0.7
2019	4.9	33.3	45.1	15.3	1.4

FTSE 100	None	Basic	General	Good	Detailed
2018	1.0	27.3	57.4	14.1	0.2
2019	2.0	27.0	50.0	18.0	3.0

FTSE 250	None	Basic	General	Good	Detailed
2018	2.5	37.4	47.5	12.6	0.0
2019	6.4	36.7	42.6	13.8	0.5

To what extent does the board describe the company’s succession planning for senior management and development of a diverse pipeline? (%)



Diversity policy

“The annual report should describe the work of the nomination committee, including: the policy on diversity and inclusion, its objectives and linkage to company strategy, how it has been implemented and progress on achieving its objectives”

[UK Corporate Governance Code 2018, Provision 23]

Board and senior management diversity remains a hot topic, being an integral part of the work of the nomination committee in making sure boards are effective. The pressure of public expectation and from government and business initiatives – such as the reviews by Hampton-Alexander,³⁷ Parker³⁸ and McGregor-Smith³⁹ – is starting to have a pronounced effect on boards and reporting. This is combined with a growing recognition of the importance of widening diversity considerations; embracing, for example, age, cognitive factors and social background.

The new Code says the nomination committee report should “outline the policy on diversity and inclusion, its objectives and linkage to company strategy, and how it has been implemented and progress on achieving the objectives”. Twenty-nine percent of nomination committee reports make no mention of the company’s diversity policy, while 40% describe the policy but do not give any detail on its execution, or of progress in the year. But as we discuss in the section on ESG reporting, overall reporting on employee-related matters, diversity and gender pay has increased in quality and detail.

Gender diversity

“Both appointments and succession plans should be based on merit and objective criteria and, within this context, should promote diversity of gender...”

[UK Corporate Governance Code 2018, Principle J]

Gender diversity reporting has reached a new high, with 29% of the FTSE 350 providing good or detailed reporting on boardroom gender diversity policy. This eclipses the high of 26% in 2015, when gender diversity was under the spotlight, following the publication of Lord Davies’ Women on Boards progress report.⁴⁰

As usual in this area, the FTSE 100 leads the way: 40% of the index provide good or detailed reporting, compared with 23% of the FTSE 250. This is partly due to the continuing wake of the Davies review, which focused on the FTSE 100 from 2011–15. The Hampton-Alexander review, which tracks the progress of women at board level, has set a target of 33% women on boards by 2020. In July 2019 women held 32% of FTSE 100 directorships, and 27% in the FTSE 250.⁴¹ The latter review widened the focus beyond board level, to look at the gender ratio of the executive committee and its direct reports. It set a target of 33% female representation at this level, noting this can only be achieved if half of all appointments go to women.⁴²

Further information on gender diversity at the senior management level can be found in the section on ESG reporting.

37 FTSE Women Leaders: Improving gender balance in FTSE Leadership, Hampton-Alexander Review, November 2018 [ftsewomenleaders.com/wp-content/uploads/2018/11/HA-Review-Report-2018.pdf](https://www.ftsewomenleaders.com/wp-content/uploads/2018/11/HA-Review-Report-2018.pdf)

38 A Report into the Ethnic Diversity of UK Boards, The Parker Review Committee, October 2017 [ey.com/Publication/vwLUAssets/The_Parker_Review/\\$FILE/EY-Parker-Review-2017-FINAL-REPORT.pdf](https://ey.com/Publication/vwLUAssets/The_Parker_Review/$FILE/EY-Parker-Review-2017-FINAL-REPORT.pdf)

39 Race in the workplace, The McGregor Smith Review, February, 2017 www.gov.uk/government/publications/race-in-the-workplace-the-mcgregor-smith-review

40 Women on Boards, Davies Review Annual Report, 2015 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/415454/bis-15-134-women-on-boards-2015-report.pdf

41 The Female FTSE Board Report 2019, Cranfield University, July 2019 www.cranfield.ac.uk/~media/files/the-female-ftse-board-report-2019.ashx

42 FTSE Women Leaders: Improving gender balance in FTSE Leadership, Hampton-Alexander Review, November 2018 [ftsewomenleaders.com/wp-content/uploads/2018/11/HA-Review-Report-2018.pdf](https://www.ftsewomenleaders.com/wp-content/uploads/2018/11/HA-Review-Report-2018.pdf)



Investor viewpoint

Andrew Ninian

Director, Stewardship & Corporate Governance, The Investment Association

Progress on gender diversity – but still more to be done on SID and chair roles

2020 represents the culmination of the Hampton-Alexander Review's targets. The 33% target for Board and for Executive Committees and their Direct Reports has been an important step in reducing the gender disparity at the very highest level of the corporate world. This year we have seen significant progress in improving women on Boards particularly in those companies that previously have only had one female director – the so called "one and dones". However, women continue to be underrepresented at Chair level and, with 63 companies having chairs serving for more than nine years, and another fourteen reaching this milestone shortly, 2020 is not an end but a beginning. Investors will continue to assess how women are being considered for the senior board positions such as Chair and Senior Independent Director, it will continue to be a key barometer of progress to UK companies really embedding progress on gender equality in senior leadership positions.



How much explanation is there of the company's policy on gender diversity in the boardroom? (%)

FTSE 350	None	Some	More
2015	8.0	66.0	26.0
2016	6.0	71.0	23.0
2017	2.6	81.0	16.4
2018	2.7	77.8	19.5
2019	4.5	66.3	29.3

FTSE 100	None	Some	More
2015	6.0	59.0	37.0
2016	4.0	59.0	37.0
2017	3.0	69.7	27.3
2018	3.0	67.7	29.3
2019	2.0	58.0	40.0

FTSE 250	None	Some	More
2015	8.0	70.0	22.0
2016	7.0	77.0	16.0
2017	2.4	86.4	11.2
2018	2.5	82.8	14.6
2019	5.9	70.7	23.4

How much explanation is there of the company's policy on other aspects of diversity in the boardroom? (%)

FTSE 350	None	Some	General	Good	Detailed
2017	12.8	59.3	24.6	3.3	0.0
2018	7.7	43.8	41.1	7.4	0.0
2019	6.3	35.1	44.8	12.2	1.7

Other aspects of diversity

“Both appointments and succession plans should be based on merit and objective criteria and, within this context, should promote diversity of ... social and ethnic backgrounds, cognitive and personal strengths.”

(UK Corporate Governance Code 2018, Principle J)

Building on the success of the gender diversity push, there is evidence of a broader definition of board diversity now emerging. While in 2017 72% of the FTSE 350 gave no, or very basic, mention of other kinds of diversity, this fell to 41% this year. Fourteen percent now give good or detailed reporting in this area.

It is encouraging to see companies widening their take on diversity. While in 2018, the spotlight was mainly on skills and experience, this year other areas attract greater attention. Forty-two percent of the FTSE 350 mention a board policy on ethnicity, 17% on race, and 19% on nationality, all up on last year. The most notable riser is social background, which has more than tripled to 34% (2018: 9%).

What other kinds of diversity are mentioned? (%)

	2017	2018	2019
Skills and experience	65.0	71.9	67.4
Ethnicity	24.1	29.6	41.7
Nationality	16.5	17.9	18.8
Age	12.0	21.5	24.0
Race	10.2	13.9	17.0
Social background	-	8.8	34.0
Other	22.6	25.9	33.0
Not clear	21.4	14.9	12.2

Future of the nomination committee

Nomination committees will have much to report on next year. They will not only have an increased focus on both succession planning, looking deeper into their organisations and the future, and the diversity agenda, but many companies will also be looking for a new chair.



Audit committee



4.8

The average times a year the audit committee meets (2018: 4.7), but with most still meeting quarterly



84%

Of audit committee reports include a personalised introduction from the audit committee chair (2018: 85%)



73%

Of the FTSE 350 provide only basic or general explanation of their review of internal control effectiveness



40%

Have not changed their auditor in more than a decade, including 9% which have retained the same auditor for more than 20 years



Reporting on issues in relation to the financial statements

"The annual report should describe the work of the audit committee including: the significant issues that the audit committee considered relating to the financial statements, and how these issues were addressed."

[UK Corporate Governance Code 2018, Provision 26]

Audit committee reporting on the process underpinning their assessment of the issues and key judgments in relation to the financial statements, has improved, and remains of a high quality. Twenty-five percent now include detailed accounts and 51% give good descriptions. The quality in the FTSE 100 is generally better than in the FTSE 250, with 29% providing detailed reports as opposed to 22%.

Risk management

"The board should monitor the company's risk management systems ... and, at least annually, carry out a review of their effectiveness and report on that review in the annual report."

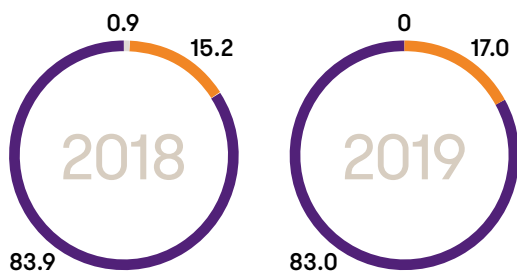
[UK Corporate Governance Code 2018, Provision 29]

The quality of risk management reporting has not changed – or improved – much for several years. This year, though, quality declined. Sixty-five percent produced good or detailed accounts of their assessment and response to principal risks (2018: 73%). The fall is most evident among the FTSE 250, where 55% provide good or detailed reporting (2018: 67%), notably lower than the FTSE 100 at 83%. Indeed, the FTSE 100 has shown a consistent quality of reporting since 2015 (84%).

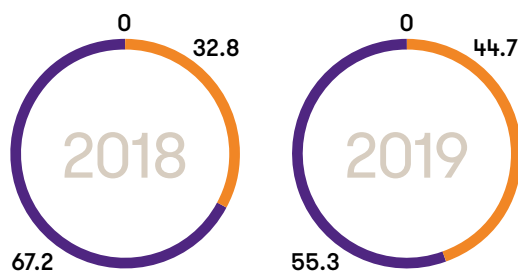
How much information is there about the company's risk management process? (%)

● None ● Some ● More

FTSE 100



FTSE 250



Internal controls

“The board should monitor the company’s... internal controls and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls.”

(UK Corporate Governance Code 2018, Provision 29)

The quality of reporting of internal controls fell again this year and, as with risk management reporting, this is mainly due to the FTSE 250. Just 57% of the FTSE 350 provide detailed accounts of their internal control policies, systems, structures and reporting (2018: 63%).

Comparison of the FTSE 100 and FTSE 250 since 2015 (the first year of reporting after the updated audit and risk reporting requirements⁴³) shows the FTSE 100 has changed very little, with 68–71% providing good or detailed reporting. By contrast, FTSE 250 output is less consistent and of lower quality, with only half providing extra detail in internal controls reporting.

How much information is there about the company's internal control systems? (%)

FTSE 100	None	Some	More
2015	0.0	32.0	68.0
2016	0.0	30.0	70.0
2017	0.0	29.0	71.0
2018	0.0	32.3	67.7
2019	0.0	30.3	69.7

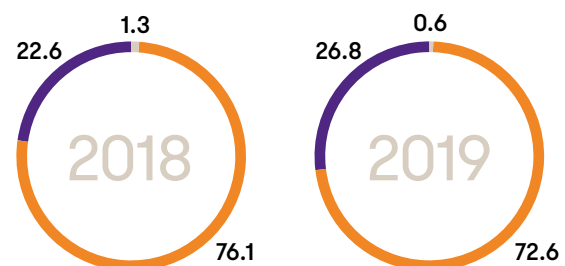
FTSE 250	None	Some	More
2015	0.5	41.3	58.2
2016	1.2	38.6	60.2
2017	0.0	36.9	63.1
2018	0.0	47.5	52.5
2019	0.0	49.7	50.3

We noted last year that the requirement for companies to explain how they had reviewed the effectiveness of internal controls – rather than simply stating that they had – had garnered little attention since its introduction in 2014. It remains a concern that, despite some improvement, the quality of disclosure remains poor: only 27% provide good or detailed information.

How much information is provided on the process the board have applied in reviewing the effectiveness of the internal control system? (%)

None Some More

FTSE 350



The December 2018 Kingman review⁴⁴ expressed reservations about the quality of internal controls. It stopped short of a full recommendation, but floated the possibility of introducing a Sarbanes-Oxley-style reporting requirement for internal and external controls assurance. As the review notes, this would be a major, and potentially expensive, step for businesses. Yet at its heart is a growing realisation that UK business needs to consider a stronger, more formal framework of internal controls. Notably, the review was “particularly struck by the support for this amongst senior audit committee chairs with experience of operating this regime in US-listed companies”. Given the falling quality of internal controls reporting across the FTSE 250, despite growing publicity about recent corporate failings, the review’s suggestion may start to gain support.

⁴³ Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, FRC, September 2014 [frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf](https://www.frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf)

⁴⁴ The Independent Review of the Financial Reporting Council, John Kingman, December 2018 www.gov.uk/government/publications/financial-reporting-council-review-2018

Audit tendering and independence

“The annual report should describe the work of the audit committee, including: an explanation of how it has assessed the independence and effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, information on the length of tenure of the current audit firm, when a tender was last conducted and advance notice of any retendering plans.”

(UK Corporate Governance Code 2018, Provision 26)

Nine companies say nothing about their audit tender process, either when they tendered for their audit or when a tender is planned. Twenty-seven companies have not had a tender in the last decade, although all say they plan one in the next four years.

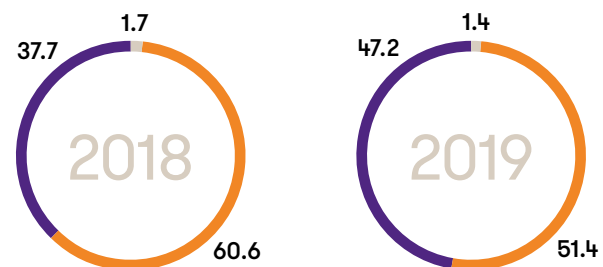
Twenty-eight companies tendered their audit this year. Fifteen chose to change their auditor as a result, while the other 13 retained their existing firm. This includes three companies which have not changed their auditor since 1999, 1988 and 1973; and two that have not switched since incorporation. While not yet being in breach of the 10-year requirement to tender, 40% of the FTSE 350 have not changed their auditor in more than a decade, including 9% which have stayed with the same auditor for more than 20 years.

The shape of the external audit market has altered very little, with more than 80% of our sample being audited by three firms, 17% by a fourth, and five companies using Grant Thornton UK or BDO.

Reporting on how audit committees reach their recommendation on the appointment, reappointment or removal of external auditors is much improved on 2018. Forty-seven percent provide good or detailed disclosures; giving more information on tenders, on how the audit committee evaluates the auditor or tendering firm, and on actions identified to ensure good-quality service in future. Given public and regulatory focus on audit tenders, it is encouraging to see better reporting this year, although there is still some way to go.

How much information does the audit committee report provide on how it reached its recommendation to the board on the appointment, reappointment or removal of the external auditors? (%)

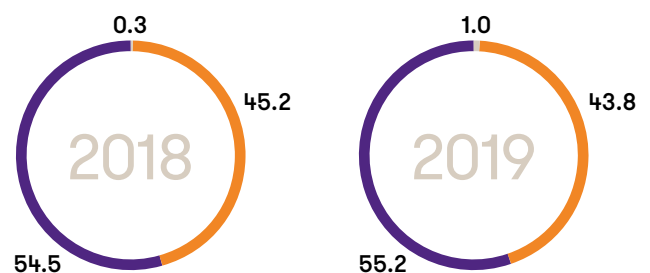
None Some More



The quality of audit committee disclosures on their means of safeguarding auditor objectivity and independence remains static, with 55% providing good or detailed disclosures.

If the auditor provides non-audit services, is there a statement as to how the auditor’s objectivity and independence is safeguarded? (%)

None Some More



Remuneration committee



42%

Say the committee sets remuneration for senior management



19%

Review both workforce remuneration and alignment to culture



15%

Clearly explain how executive remuneration is linked to strategy and KPIs



10%

Link non-financial metrics to long-term incentives



5%

Address the six factors of clarity, simplicity, risk, predictability, proportionality and alignment to culture



Role of the remuneration committee

"The remuneration committee should have delegated responsibility for determining the policy for executive director remuneration and setting remuneration for the chair, executive directors and senior management. It should review workforce remuneration and related policies and the alignment of incentives and rewards with culture, taking these into account when setting the policy for executive director remuneration."

(UK Corporate Governance Code 2018, Provision 33)

For several years, the regulator and government have focused increasingly on the need for executive remuneration to be more closely aligned with the interests of both shareholders and wider stakeholders.

Central to this debate has been the alignment of executive pay with that of employees. There is also a groundswell of opinion that other matters, such as a company's impact on society and the environment, must be explicitly linked to executive and senior management remuneration.

The Investment Association has focused on executive pensions, saying they should be aligned to those of the workforce. Both the new Code and other recent regulation have introduced various provisions, including pension alignment; the use of relevant indicators, such as pay ratios and pay gaps to highlight disparities, and post-employment shareholding policies for further linkage to shareholders' interests.⁴⁵

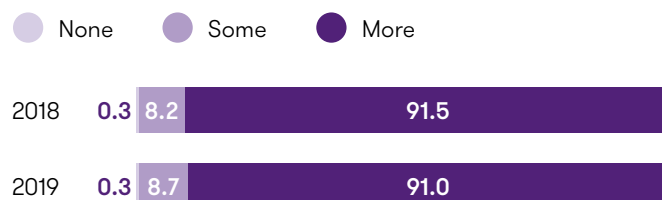
The new Code sets the remuneration committee the new challenge of a wider remit. Its new responsibilities include not only setting pay for senior management, but also when determining remuneration policy, addressing six factors: clarity, simplicity, risk, predictability, proportionality and, most importantly, alignment to culture. While some reports already start to reflect this, effort and time is required for an intelligent redesign of remuneration and related reporting, to address the changes. With companies only having to seek shareholder support for remuneration policies every three years, any substantive change is likely to take some time before most have to openly demonstrate these considerations.

Overall, 91% of companies provide strong remuneration policy disclosures, including 41% who give detailed explanations. Industries where more companies offer detailed disclosures, as opposed to merely good, are utilities and healthcare.

Very detailed disclosures include specific commentary on key features of remuneration policies clearly showing how remuneration arrangements promote the longer-term interests of the company, shareholders and workforce.

How clearly are companies describing their remuneration policies? (%)

FTSE 350



Report length

The remuneration committee report length remains unchanged, at an average of 20 pages. Nearly all have personal introductions from the chair; the quality of which continue to improve, with 83% providing good or detailed insights (2018: 77%). This may be a foretaste of a freshly invigorated remuneration committee, given its new responsibilities under the new Code.

Remuneration committee chairs

"Before appointment as chair of the remuneration committee, the appointee should have served on a remuneration committee for at least 12 months."

(UK Corporate Governance Code 2018, Provision 32)

The new Code requires an appointee chair to have at least 12 months' prior remuneration committee experience. This could be either as a chair or member, given that the Code does not specify either. This year, 12% of companies say they satisfy this requirement. While the effect of this requirement on recruiting new chairs cannot be predicted, it is already having some influence with a number of companies referring to incoming chairs having at least 12 months' experience, and that the terms of reference having been updated to fulfil this requirement.

⁴⁵ Corporate Governance: The Companies (Miscellaneous Reporting) Regulations 2018 Q&A, Department for Business, Energy & Industrial Strategy, November 2018 assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/715740/corporate-governance-company-reporting-faq.pdf

Forms and elements of remuneration

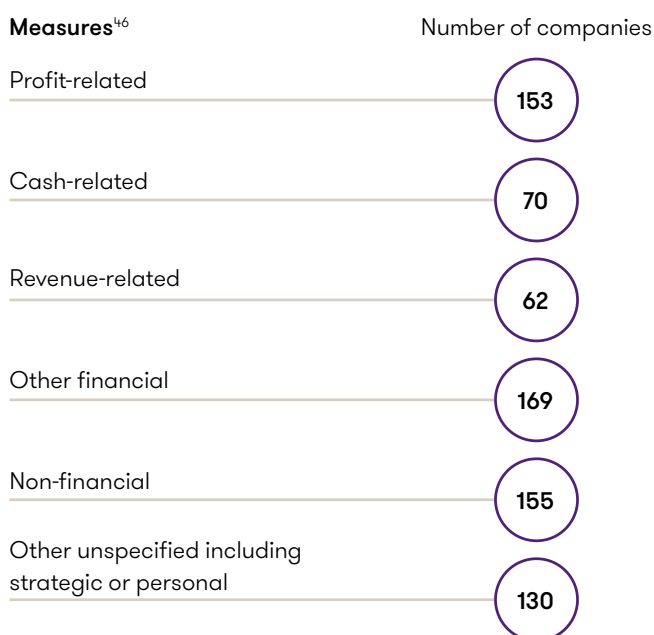
Annual bonuses

Annual bonuses remain a popular vehicle for executive remuneration, with 97% of companies (unchanged from last year) using them. Of these, 98% state the maximum bonus that is available to executive directors, with the highest observed being 428% of salary (2018: 435%).

There is no change in the median annual bonus from last year, which remains at 180% of salary for FTSE 100 CEOs and 150% of salary in the FTSE 250.

Financial measures remain the most common in the FTSE 350. Of specific financial targets, profit-related measures are the most popular. The use of non-financial measures is on the increase, with 155 (55%) of companies linking their annual bonus to at least one such metric.

What metrics are used in executive annual bonuses?



⁴⁶ The totals are greater than 100%, given the frequent use of multiple performance measures.

Long-term incentives

“Executive remuneration... should be clearly linked to the successful delivery of the company’s long-term strategy.”

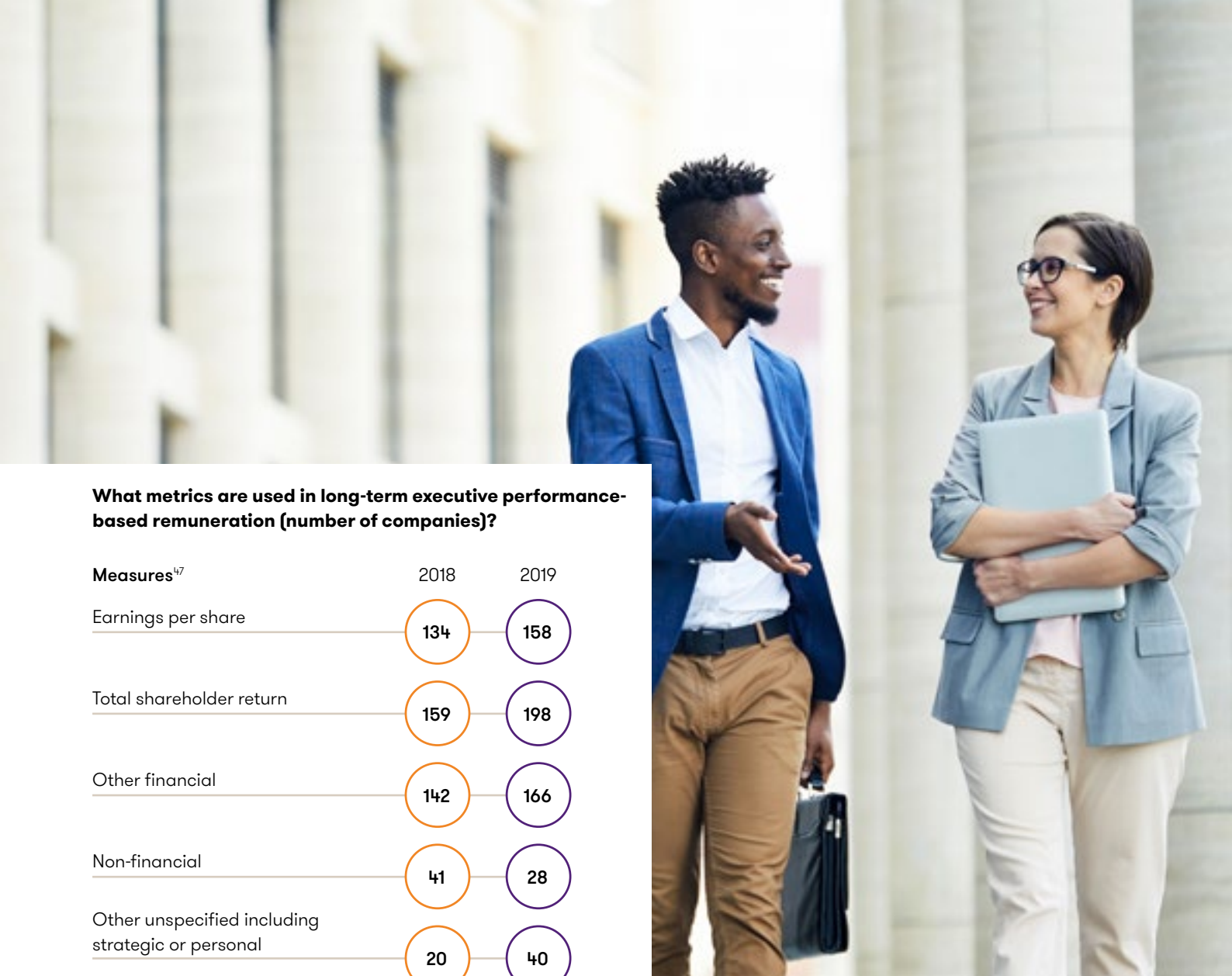
(UK Corporate Governance Code 2018, Principle P)

Long-term incentives are still common, with 96% of companies saying they use them. By far the most popular is the performance share plan, used by 94% of these; other schemes include restricted and deferred shares, but these have not become mainstream. Forty-six companies mention the use of alternative share plans (2018: 36), but 32 of them have this in addition to a typical performance share plan.

Total shareholder return (TSR) is still the most popular performance condition – and most companies still tend toward financial metrics, with only 10% referring to non-financial measures in their long-term incentive schemes. More businesses do include strategic, personal and non-financial measures, such as customer service and employee engagement. The use of multiple performance conditions continues to increase, with 84% (2018: 71%) of companies now using more than one condition. Where one performance condition is used, it tends to be TSR.

It will be interesting to see if the emphasis on other stakeholders beyond shareholders manifests itself in the choice of metrics in future.

What can be certain is that the setting and reporting of non-financial performance metrics needs further development, greater communication and clear linkage back to the delivery of long-term strategy.



What metrics are used in long-term executive performance-based remuneration (number of companies)?

Measures ⁴⁷	2018	2019
Earnings per share	134	158
Total shareholder return	159	198
Other financial	142	166
Non-financial	41	28
Other unspecified including strategic or personal	20	40

Incentive plans – non-financial metrics

“Where performance-based incentive plans are used, the choice of performance measures is important. Using a range of financial, non-financial and strategic measures can help ensure that targets are aligned with how the company will deliver value over the long-term in line with company purpose. Metrics need to be reliable and credible to satisfy shareholders, and their purpose should be explained.”

(FRC Guidance on Board Effectiveness 2018, 137)

Metrics are a critical symbol of intent, remaining an important way to link remuneration to long-term sustainable success. This year most (51%) companies only use financial incentives when setting remuneration packages. This shows that while there is growing acknowledgement of the importance of non-financial factors, they have not fully made their way into executive remuneration schemes. Where this has happened, it is often in the annual bonus, in the form of personal goals

for the executive. This may reflect investor, company or market focus on the short term, as well as the challenges of formally setting non-financial metrics. Yet individual objectives can be criticised, as they often reward executives for work that is reasonably expected of a position.

The metrics we have seen that target stakeholders are somewhat reassuring; they mostly relate to key stakeholders such as customers (16%), or employees (13%; for example, with health and safety). But only 6% of the FTSE 350 include environment and wider sustainability-related measures or objectives, including those who use them in long-term incentives plans. And just one company mentions suppliers.

Only 17% mention culture-related metrics; 78% of which cover them in the annual bonus. Given the length of time it takes to build and embed a culture and how quickly it can be destroyed, culture should perhaps be linked to long-term incentives rather than the more short-term bonus. Only 2% have measures or objectives linked to reputation.

⁴⁷ See above

Performance and holding periods

“Share awards granted for this purpose should be released for sale on a phased basis and be subject to a total vesting and holding period of five years or more.”

(UK Corporate Governance Code 2018, Provision 36)

The new Code and regulations require a total vesting and holding period of five years or more for share awards given to executives. The most popular format is a three-year performance period followed by a two-year holding phase. This year, 52 companies adopt shorter than five year combined periods, including those who do not disclose holding periods at all.

Retention (additional holding) period of awards after vesting (number of companies)

Number of years	2018	2019
0.5	2	0
1	13	15
2	176	213
3	8	8
4	2	0
5	2	2

Shareholding requirements

“Remuneration schemes should promote long-term shareholdings by executive directors that support alignment with long-term shareholder interests.... The remuneration committee should develop a formal policy for post-employment shareholding requirements encompassing both unvested and vested shares.”

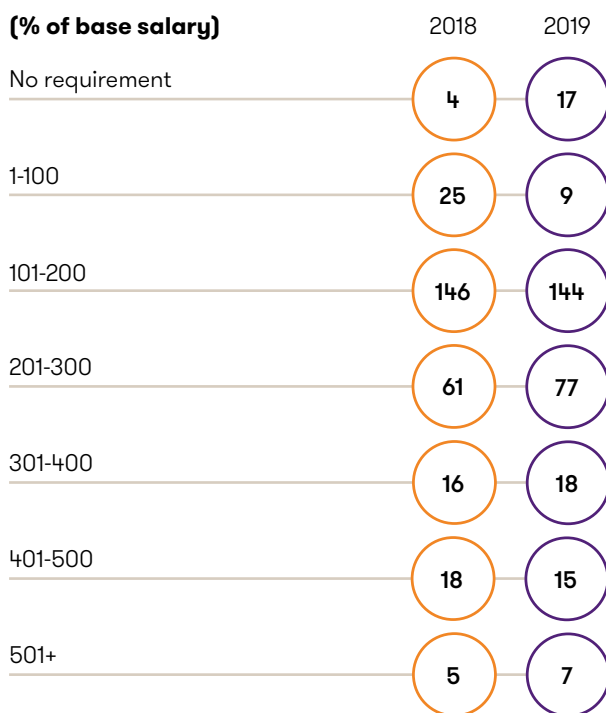
(UK Corporate Governance Code 2018, Provision 36)

To align the interests of management to shareholders, the new Code introduced requirements for shareholder employees to hold their shares for set periods once they leave the company. Current practice is mostly for half or all of the shareholding requirement to apply post-employment, for two years in most cases. Companies will need to make sure that any new policy applies to both vested and unvested shares, as only 13% currently mention this.

This new requirement is in addition to the existing practice for executive directors to hold a multiple of their remuneration in company shares. Ninety-three percent of companies state this practice, with the most popular being a holding of 200% (56% of companies). There has been a marginal increase in the average expected holding.



What is the minimum shareholding requirement for the CEO? (number of companies)



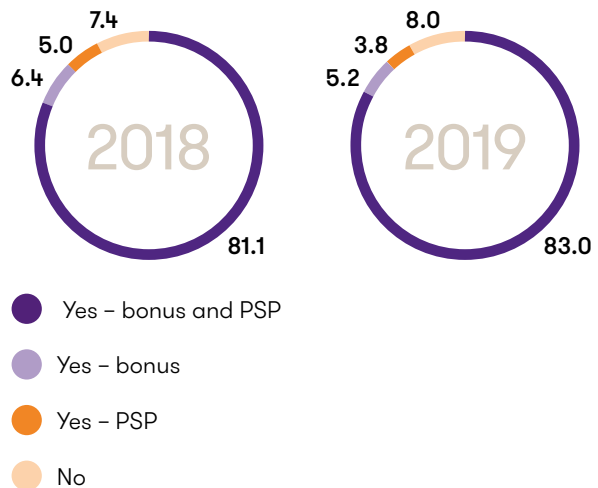
Malus and clawback

“Remuneration schemes and policies should also include provisions that would enable the company to recover and/or withhold sums or share awards and specify the circumstances in which it would be appropriate to do so.”

[UK Corporate Governance Code 2018, Provision 37]

The Code requires the strengthening of malus and clawback provisions. This year, more companies adopted both provisions, with most businesses without them being from the consumer services or basic materials industries. As before, no company reports having to invoke its clawback provision.

Is there a clawback provision? (%)



The Guidance on Board Effectiveness⁴⁸ extends the circumstances in which malus and clawback may be applied to include, for example, reputational damage and corporate failure. Only 13% report strengthening their malus and clawback provisions to include additional triggers. Six companies report that their existing malus and clawback provisions met these requirements already.

⁴⁸ Guidance on Board Effectiveness, FRC, July 2018, point 142 [frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF](https://www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF)

Wider alignment and engagement

The six factors

“When determining executive director remuneration policy and practices, the remuneration committee should address the following: clarity... simplicity... risk... predictability... proportionality... and alignment to culture.”

[UK Corporate Governance Code 2018, Provision 40]

The new Code asks remuneration committees to address six factors – clarity, simplicity, risk, predictability, proportionality and alignment to culture – when determining policy and practices. These should be covered when describing the work of the committee in annual reports.

This is not an area that many have started to explore. Only 14 companies (5%) refer to the six factors; these are evenly split across the FTSE 100 and FTSE 250. Better disclosures will reflect on these factors, referring to where related information can be found within the report.

Interestingly, of those that say they consider these factors, two faced significant dissent over their remuneration reports, highlighting the need for reality to match rhetoric.

Alignment to culture

“When determining executive director remuneration policy and practices, the remuneration committee should address... alignment to culture - incentive schemes should drive behaviours consistent with company, purpose, values and strategy.”

[UK Corporate Governance Code 2018, Provision 40]

It is generally accepted that well-constructed incentive schemes drive positive behaviour, and poorly-constructed ones do the opposite. Prominent among good schemes will be a link between pay and the creation of a desired culture (one of the six factors). With the adoption of the six factors, we may see a shift in the use of non-financial incentives, with a link to more lasting performance-based targets.

Our research shows that while 72% review workforce and related policies, only 22% consider the alignment of executive incentives and rewards to culture. The financial industry has the most companies that review both workforce remuneration and alignment to culture, reflecting the FCA's push on culture. Industrials and consumer services come next.

Alignment to strategy

“Remuneration policies and practices should be designed to support strategy. Executive remuneration should be... clearly linked to the successful delivery of the company's long-term strategy.”

[UK Corporate Governance Code 2018, Principle P]

Ninety-five percent of companies (2018: 94%) discuss the link between remuneration and strategy, either by way of explanation or signposting. But of those that do, only 15% provide detail and clear explanation that reinforces the link between execution of strategy, KPIs and the creation of long-term sustainable value and rewards.



DID YOU KNOW?

Only 7% of companies provide any details into their engagement with employees to explain the link between their pay and that of executives

Engagement with employees

“There should be a description of the work of the remuneration committee in the annual report, including: ... what engagement with the workforce has taken place to explain how executive remuneration aligns with the wider company pay policy...”

[UK Corporate Governance Code 2018, Provision 41]

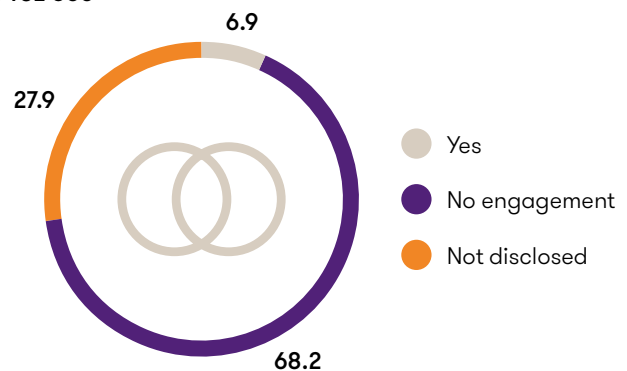
Given the new Code requirement to engage with the workforce to explain how executive remuneration aligns with wider company pay, the committee should ensure the employee voice is considered. That said, looking at remuneration committee reports, some companies mention ways they consider the employee voice – for example, by using surveys, designating a NED, employee forums or workforce panels.

Eight companies say the NED responsible for employee engagement is a committee member or that the remuneration committee chair is the designated NED.

Many companies, unsurprisingly, fail to provide real insight into their engagement with employees to explain the link between their pay and that of executives. Only 7% provide any details. These companies use existing employee engagement channels, mainly staff forums. In future, meaningful insights would offer evidence of two-way dialogue, including how it works – which could mean existing engagement channels – as well as the outcomes of such exchanges. Interestingly, 68% state that no engagement took place.

Does the description of the work of the remuneration committee include the details of what engagement has taken place to explain how executive remuneration aligns with the wider workforce? (%)

FTSE 350



Engagement with shareholders

“There should be a description of the work of the remuneration committee in the annual report, including: ... what engagement has taken place with shareholders and the impact this has had on remuneration policy and outcomes...”

[UK Corporate Governance Code 2018, Provision 41]

Seventy-four percent of companies mention that engagement with shareholders took place, but only 38% clearly say what impact it had on remuneration policy. And only 22% disclose that their remuneration committee chair met with shareholders (2018: 13%). Increasing transparency has an important role to play in the pursuit of trust. Companies still have work to do in this area.



Other findings

Senior management – the extended remit

“A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management remuneration should be established.”

[UK Corporate Governance Code 2018, Principle Q]

The remit of the remuneration committee has been extended, so that it now determines remuneration for senior management. Forty-two percent of companies claim they now do this.

There has previously been evidence of some committee involvement with remuneration and incentive-setting below the executive team, but it has been inconsistent. As this is now encouraged, we hope to see more information next year – especially given the nomination committee’s new responsibility for overseeing succession to the executive team.

Some companies say the remuneration committee’s terms of reference have been extended to address the new requirement, defining senior management as one level below the board. Others refer to selected senior management being covered. Companies may go beyond this, stating who is covered, and providing added context for senior management remuneration, such as appropriateness, and an explanation of differences between this and board-level pay, along with any alignments.

Use of discretion

“Directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking account of company and individual performance, and wider circumstances.”

[UK Corporate Governance Code 2018, Principle R]

Remuneration committees are asked to use discretion to avoid formulaic outcomes where the recommendation would not otherwise reflect individual performance, actual results achieved, or meet the original intention of the remuneration policy, and/or where unforeseen or unexpected circumstances would result in unreasonable consequences which do not reflect a director’s individual contribution.

This year many committees (84%) mention discretionary considerations, even if they just say that no discretion was used. But best practice companies will dedicate a few sentences to providing insight into the consideration process, and to why they did or did not exercise discretion.

Remuneration consultants

“Where a remuneration consultant is appointed, this should be the responsibility of the remuneration committee. The consultant should be identified in the annual report alongside a statement about any other connection it has with the company or individual directors. Independent judgement should be exercised when evaluating the advice of external third parties”

(UK Corporate Governance Code 2018, Provision 35)

Twenty-nine remuneration consultants are named (2018: 25), with over 93% (2018: 95%) of companies using one or more of just six firms. Of these six, two audit firms acted as consultants to 55% (2018: 42%) of FTSE 350 companies, while one of those two consults more than a quarter of the FTSE 350. In accordance with the Code, most companies disclose if their remuneration consultant has any ties to them, but a six-month separation period is all that is required to meet audit independence requirements. Once the resolution of the various inquiries into the audit market have been concluded, a different perspective may be presented in respect of audit firm independence.

Four companies refer to their use of more than three advisers at a time. That said, one of these companies received significant dissent against its remuneration report.



Governance viewpoint

Pamela Coles

Chief Governance Officer, Rolls-Royce plc

Remuneration

Several major investors have emphasised the importance of broader, non-financial, ESG focussed objectives. We support these ambitions. But for them to have teeth, they have to be seen by all - the board, the employees and the investors - as critical to future success. Such key performance metrics have to be adopted and built into all reward mechanisms for the executive directors and then be filtered down to senior managers and beyond, so that everyone in the organisation recognises them as a common objective from which reward may flow.

For us, customer delivery, particularly the large civil aero engines but also across all our businesses, are critical to success. It is now embedded across our reward mechanism, as is employee engagement. But linking performance explicitly to environmental impact is, as yet, in the work in progress box.

This year's research suggests many companies are struggling with introduction of the non-financial metrics. The institutions are encouraging a greater focus on such targets, but companies should be cautious of making them up on a whim. They should reflect what the organisation is really driving for. Of course, financial metrics will and should remain dominant. But one or two purpose related KPIs, which can be applied to the whole workforce and are measurable on a consistent basis, open to some form of independent assurance and linked to the interests of the investors, can be very powerful in pulling an organisation together.

The more explicit the company is about what is critical to its success, and the more transparent it is as to how effort and reward are linked to that goal, the more integrated the efforts of all employees will be. But it is not easy and will take time.



Investor viewpoint

Andrew Ninian

Director, Stewardship & Corporate Governance, The Investment Association

Non-financial measures and remuneration

Long term investors want the companies in which they invest to deliver long term returns. This requires investors to view companies from a more holistic vantage point. Expectations have evolved to consider a company's culture, the diversity of its workforce, its environmental impact and consideration of stakeholders. These concerns, traditionally labelled 'non-financial KPIs', were once considered 'soft'; dismissed as intangible and unquantifiable. This should no longer be the case. These 'strategic KPIs' represent a part of the investment decision-making process and are seen as integral to driving long-term value creation. We are increasingly seeing these metrics incorporated into remuneration structures.



Responding to the challenges of the new Code and wider public considerations

This year's research reveals some encouraging trends, as companies start developing their responses to the new Code. However, most companies are holding back and waiting to see how others will respond. Further consideration, planning and innovation needs to go into preparing for 2019 and 2020 year-end reporting periods if the new Code is to lead to more transparency for stakeholders.





Applying the principles

With the new Code focusing on the application of the core principles, companies will need to provide better insights, specifying actions and outcomes, after only 32% gave meaningful descriptions this year.

There is now a chance for a fundamental shift in how companies report and communicate with stakeholders, but this will require leadership and commitment from the board.



Business purpose

Clarity of purpose will be key in future, along with ethical leadership, transparency and accountability. The board should set the company's purpose and the strategy to deliver it, outlining what success looks like and how it will be measured.

This may be by setting formal objectives to help achieve purpose, or through articulating how strategic outcomes flow from purpose. Aligning purpose with company culture and connecting it with the business model will be crucial in this process.

The most enlightened companies may look on this as the ideal opportunity to seek greater workforce (and investor) engagement in determining what their true business purpose is.



Stakeholder engagement

Companies are more mindful of the impact of their decisions on key stakeholders, as indicated by the fact that 73% of the FTSE 350 identify who their major stakeholders are and how they engage with key stakeholder groups. But to meet the new statutory requirements will require much greater effort. Companies need to explain what significant issues their stakeholders raised and how they responded. They should also show well-integrated thinking, giving extra detail and tangible examples of how stakeholders' expectations were considered in board decisions.

Businesses also need to avoid duplication. To meet the Companies Act requirement for stakeholder reporting in the directors' report, cross-referencing should be used where content is integrated elsewhere in the annual report.



Employee engagement

With only 37% of the FTSE 350 choosing one of the three engagement methods outlined in the Code, companies must devise and execute plans to engage more effectively with their workforce, as recommended by the new Code. Or they should develop alternative mechanisms and explain them in detail.



Environment

Although companies are making better environmental disclosures, there is little evidence that they are integrating these issues into the heart of business strategy. Businesses should focus on environmental matters, including climate change, in the context of long-term risks and strategic priorities, add them to the leadership agenda and reflect such targets in executive remuneration.



Integrated forward-looking reporting

Annual reports are far too long, with 181 pages now the average length. In addressing the challenges of the new Code, companies should ensure that information is not just added, but integrated with other information to give a holistic picture of the business.

A new narrative approach would be an ideal solution, but a more realistic challenge might be to reduce 10% of the content and limit the use of images that are cosmetic, rather than explanatory.



Culture

The FRC has focused consistently on the need to report on organisational culture and how it is embedded and measured, yet most companies still fail to deliver. Twenty-two percent of the FTSE 350 do not articulate their values, while 55% provide no, little or general explanation about culture.

To rectify this, boards need to clarify what values, behaviours and attitudes they are trying to promote, the role of the CEO and senior management in this process, and the quality and reliability of the information they use to monitor it.

A challenge facing the board is how it can be sure that what it is hearing and measuring is a true reflection of what is happening outside the leadership suite. A single data source is unlikely to enable the board to monitor culture at all levels of company, in a reliable and consistent way.

Companies must decide what works best for them: be it a bespoke dashboard or scorecard with different indicators; a culture audit; or, ideally, a combination of metrics and methods and then monitor it consistently over time.



Long-term incentives

In line with the new Code's focus on simplicity, clarity, risk, predictability, alignment to culture and proportionality, companies need to link rewards to what they say they value – and to their performance measures, including the remuneration committee's use of discretion.

As it is, there is a disconnect between the high number of non-financial KPIs disclosed (45% of all KPIs) and the low level of companies (10%) that cite non-financial performance metrics in long-term incentives.

There should also be a stronger focus on engagement with shareholders and employees. Only 38% of the FTSE 350 clearly state what impact shareholder feedback had on their remuneration policy, and just 7% say how they engage with employees to explain the link between executive pay and that of the wider workforce. The remuneration committee chair has a significant role to play in ensuring that shareholder and employee voices are heard.



Boards fit for the future

The new Code gives the nomination committee a greater role to play in addressing emerging skills needs, meeting the challenges of diversity, and planning for succession below board level. As 87% give little or no insight into the development of executive pipeline and senior management succession, there is a steep slope to climb.

Fewer companies outline how they are future-proofing themselves, or have already done so, by recruiting or developing the knowledge and experience needed. Technology is a particular challenge: it can be hard to find digital-savvy people with the wide experience that board membership requires. Companies need to address their need for skills and experience to navigate the fourth industrial revolution.

Effectiveness evaluations may help make boards fit for the future, but this year's disclosures indicate a need for more innovative approaches and explicit company reporting on follow-up actions.

Addressing the succession of chairs and considering wider issues of diversity are further hurdles: 77 chairs have either been on the board for more than nine years or are approaching this deadline; only 16 chairs are women.

For information on how we can help assess the quality of your annual report, please contact us.



Recent and forthcoming developments

	Comments	Timing	Mandatory reporting in the annual report?
Corporate governance reforms			
	The Companies (Miscellaneous Reporting) Regulations 2018 have been approved by Parliament in July 2018. The Regulations make the legal changes necessary for the Government's package of corporate governance reforms announced by the Department for Business, Energy and Industrial Strategy (BEIS) in August 2017.	To take effect for financial years beginning on or after 1 January 2019	
Section 172(1) Statement	<p>The strategic report will have to include a statement describing how directors have had regard to the matters set out in section 172 (1) (a)-(f) of the Companies Act 2006 when performing their duty under section 172. For companies that are unquoted, the section 172(1) statement must also be made available on the website and updated each year.</p> <p>The same category of companies will also have to state in the directors' report how the board have engaged with suppliers, customers and others in a business relationship with the company and the effect that has had, including the effect of principal decisions taken during the year.</p>		Companies already required to produce a strategic report except those qualifying as medium-sized in relation to a financial year
Employee Engagement	Companies will need to include a statement in the directors' report summarising how directors have engaged with employees during the year, what concerns have been raised and how their views have been taken into account and influenced board decisions		Companies with more than 250 UK employees
CEO Pay Ratio	A 'pay ratios table' of CEO pay to the first quartile, median and third quartile of UK employees pay. Where a company is a parent, the ratio information must relate to the group. There are three options for how to calculate the pay and benefits. Going forward, historical data will have to be disclosed for each preceding year in which the requirement applied, up to a maximum of nine years. The report must also include the methodology used, an explanation of changes to the ratios from year to year and why the company believes the median pay ratio is consistent with its wider UK pay policy		<p>Quoted companies with more than 250 UK employees.</p> <p>"Quoted" means UK incorporated companies who are quoted on the UK Official List (not AIM), the New York Stock Exchange, NASDAQ or a recognised stock exchange in the European Economic Area</p>
Corporate Governance Statement	Companies will have to include a statement in the directors' report about the corporate governance arrangements in place and/or which corporate governance code, if any, they followed during the year, how it applied the code, and any part of the code it did not follow, with reasons why		<p>Companies with either:</p> <ul style="list-style-type: none"> • 2,000 or more global employees; or • a turnover over £200 million globally and a balance sheet over £2 billion globally. <p>Companies already required to report on their corporate governance, community interest companies and charitable companies are also exempted</p>

	Comments	Timing	Mandatory reporting in the annual report?
Other regulations			
Companies (Directors Remuneration Policy and Directors Remuneration Report) Regulations 2019	<p>The Regulations implements the amendments to the EU Shareholder Rights Directive in Articles 9a and 9b. Remuneration regulations now apply to unquoted traded companies (previously only applied to quoted companies).</p> <p>Among the key changes, now companies have to report on the remuneration of anyone in the role of the CEO or deputy CEO even if they are not a board director. Also to make a payment to a director that is inconsistent with the approved remuneration policy in place requires shareholder approval for an amendment to the policy (rather than, as previously, shareholder approval simply for the payment itself).</p> <p>In terms of reporting, companies have to provide additionally:</p> <ul style="list-style-type: none"> the split between fixed and variable remuneration awarded annually to each director information on deferral periods as well as vesting and holding periods for share-based remuneration include a five-year rolling comparison between the annual change in each director's remuneration and that of average employees. 	Changes for the remuneration report take effect from 10 June and apply to policies approved on or after that date	Unquoted traded companies
The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018	<p>The Regulations implements the policy on Streamlined Energy and Carbon Reporting (SECR).</p> <p>The new rules are designed to increase awareness of energy costs, better align with other reporting frameworks, provide transparency for investors and ensure that organisations have data to enable them to implement energy efficiency measures and ultimately reduce their impact on climate change.</p> <p>Quoted companies in their directors' reports must additionally report:</p> <ul style="list-style-type: none"> underlying global energy use that is used to calculate GHG emissions, including previous year's figure (in the first year, previous figures are not required) information about energy efficient action taken in the organisation's financial year proportion of energy consumption and emissions related to emissions and energy consumption in the UK (including offshore area). <p>There are separate requirements for unquoted companies and LLPs. Low energy users i.e companies that have consumed 40MWh or less are exempt for disclosing.</p>	Applies to accounting periods beginning on or after 1 April 2019	Quoted companies, large unquoted companies and large LLPs

	Comments	Timing	Mandatory reporting in the annual report?
Governance of listed companies			
The UK Corporate Governance Code	<p>The FRC published its new 2018 UK Corporate Governance Code (the new Code) on July 16, 2018. It has been designed to set higher standards of corporate governance in the UK so as to promote transparency and integrity in businesses.</p> <p>The new Code is “shorter and sharper” than the last edition, consisting now of 18 principles and 41 provisions. The new Code retains the “comply or explain” approach but provides more emphasis on companies explaining how the principles have been applied. Many of the changes made in the December draft remain, although the FRC has reworked back some of its proposals regarding independence and smaller companies exemptions.</p> <p>The new Code’s main changes and points of interests include: company purpose and culture, employee and stakeholder engagement, chair’s tenure, NED independence and board balance, nomination committee responsibilities including succession planning and diversity and remuneration</p>	Applies to accounting periods beginning on or after 1 January 2019	Yes, in line with the Listing Rules
The Guidance on Board Effectiveness	<p>The revised guidance was published (and consulted on) at the same time as the new Code. It contains suggestions of good practice to support directors in applying the new Code, and should be viewed alongside it. The structure of the Guidance follows the structure of the new Code.</p> <p>The revised guidance now includes some of the procedural aspects of governance which, historically, were covered by the new Code. Such former features of the Code are now well-established as good practice and compliance levels are high. The Guidance is intended to act as a reminder to boards and their support teams that good practice and procedure should continue to be followed</p>	Published in July 2018	The Guidance serves as a best practice statement and, as such, has persuasive rather than mandatory force

	Comments	Timing	Mandatory reporting in the annual report?
Other FRC guidance and related projects			
The Guidance on the Strategic Report	<p>The revised guidance has been updated to reflect the new Code, and regulatory updates resulting from The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016 and The Companies (Miscellaneous Reporting) Regulations 2018.</p> <p>While the general structure of the guidance and key messages remain largely unchanged, there have been important changes in two key areas:</p> <ul style="list-style-type: none"> the revised guidance places a greater focus on the directors' duty to promote the success of the company under section 172 of the Companies Act 2006; updates have been made to reflect the new requirements for 'traded', banking or insurance companies, with more than 500 employees (referred to as PIEs in the guidance) to prepare a 'non-financial information statement' within their strategic report 	<p>Published in July 2018.</p> <p>The non-financial reporting Regulations apply from financial years beginning on or after 1 January 2017; and the legislative requirements relating to the director's section 172 duty apply for financial years beginning on or after 1 January 2019</p>	The Guidance on the Strategic Report serves as a best practice statement and, as such, has persuasive rather than mandatory force
FRC Financial Reporting Lab Performance Metrics — Principles and Practice	This report considers the regulatory changes in the reporting on performance to understand if these changes met the needs of investors. Practical examples are provided	Published in November 2018	Lab reports do not form new reporting requirements
FRC Financial Reporting Lab – Climate and Workforce Reporting project	This project aims to look at how companies might meet the needs of investors on the reporting of climate and workforce	Report is expected to be published in the autumn. The FRC published a joint regulatory statement on climate change alongside the PRA, FCA and TPR on 2 July 2019	Lab reports do not form new reporting requirements
FRC Financial Reporting Lab – AI (Artificial Intelligence) and Corporate Reporting	This report was published as part of the Digital Futures project which aims to understand how new and developing technologies can be used to disseminate company communications in the most efficient manner	Published in January 2019	Lab reports do not form new reporting requirements
FRC Financial Reporting Lab Risk and Viability Reporting – Where are we now?	<p>The report surmises investors' thoughts on business model, risk and viability reporting. Practical examples are provided.</p> <p>In relation to the business model, investors look for better linkage to other elements in the report including risks. Also they would like to have more clarity of how the risks are managed. The FRC had previously highlighted the need for companies to consider a broad range of factors when determining their principal risks, for example, cyber security, climate change and Brexit.</p> <p>On viability, investors look for better insight into the long-term prospects of the company with disclosure of risks even if the viability statement is limited to a shorter period</p>	Published in October 2018	Lab reports do not form new reporting requirements

	Comments	Timing	Mandatory reporting in the annual report?
Governance principles for large private companies			
Wates Corporate Governance Principles for Large Private Companies	Following on from the Companies Miscellaneous Reporting Regulations 2018, which requires companies of a certain size to disclose their corporate governance arrangements, this code was introduced to assist private companies to comply with the requirement. It contains principles which operate on an apply and explain basis coupled with supporting guidance in the areas of purpose and leadership, board composition, director responsibilities, opportunity and risk, remuneration and stakeholder engagement.	Published in December 2018	No. The company, however, may adopt and report against this code in line Companies (Miscellaneous Reporting) Regulations 2018
Diversity			
Board diversity	<p>Since the FTSE 100 reached the Davies' target of 25% women on boards in 2015, Sir Philip Hampton and Dame Helen Alexander are leading since 2016 a new review on improving female representation in leadership positions of British business. This broadens the ambition to the entire FTSE 350, and raises the target to 33% of women on boards by 2020. The focus for the work on the gender pipeline will be on representation on executive committees and direct reports to the executive committee.</p> <p>The third report was published in November 2018 with an update provided in July 2019. The update shows that the FTSE 100 is on track to reach target of 33% board positions by 2020 with 32.1% held while 27.5% of FTSE 250 board positions are now held by women, up from 24.9%. The update also states that for the first time, the FTSE 250 could meet the 33% target for women in senior leadership positions if current progress is maintained.</p> <p>The Parker Review committee, led by Sir John Parker, released in October 2017 their consultation report: Beyond One by '21: examining the ethnic diversity of FTSE 350 boards. This recommends that FTSE 350 boards should have at least one director of colour. Nomination committees will be expected to acknowledge this target and discuss in their annual reporting.</p> <p>An update in October 2018 showed 54 of the FTSE 100 do not have a single board director from an ethnic minority background, compared to 51 in 2017.</p>	<p>The target is aiming for 33% women on boards, executive committee and their direct reports by 2020 for all FTSE 350 companies.</p> <p>The report recommends that FTSE 100 boards should have at least one director of colour by 2021, and FTSE 250 by 2024</p>	Yes. Reporting on board diversity should include any measurable objectives that a company has set for implementing its diversity policy

	Comments	Timing	Mandatory reporting in the annual report?
Governance of investors			
The Stewardship Code	<p>The FRC has published the revised version of the UK Stewardship Code (Code) following the consultation it launched in January 2019.</p> <p>The Code focuses on the responsible investment of money with a new emphasis on creating long-term value and on considering beneficiary and client needs. It comprises a set of 12 “apply and explain” principles for asset managers and asset owners, and a separate set of six “apply and explain” principles for service providers. Each principle is supported by reporting expectations which signpost the information that organisations should include in their report.</p> <p>Key changes include:</p> <ul style="list-style-type: none"> • a requirement to report annually on stewardship activity and its outcomes, submitting this to the FRC for approval • an expectation that signatories will take ESG factors into account in their investment decisions • an expectation that signatories will explain how they have exercised stewardship across asset classes beyond listed equity • a requirement for signatories to explain their organisation’s purpose, investment beliefs, strategy and culture and how these enable them to practice stewardship. 	Published in October 2019. Takes effect on 1 January 2020. Transitional arrangements from the 2012 to the 2020 Stewardship Code can be found in Part 3 of the FRC’s Feedback statement	No
Format of corporate reporting			
European Single Electronic Format for Reporting (ESEF)	<p>ESEF introduced a number of changes to the electronic format for reporting:</p> <ul style="list-style-type: none"> • all Annual Financial Reports (AFRs) should be prepared in XHTML which is human readable and can be opened with any standard browsers • where AFRs contain IFRS consolidated financial statements, these shall be labelled XBRL ‘tags’ which make the labelled disclosures structured and machine readable • the XBRL tags shall be embedded in the XHTML document using the inline XBRL technology, which allows the benefit of XBRL tagged data to be combined with the human readable presentation of AFRs 	From 1 January 2020	Yes, for issuers in EU regulated markets

Governance and board advisory services

Benchmarking and best practice guidance

What are the best practice insights you'd like to glean from your competitors' boardrooms? Do you know how your current practices align to new or upcoming governance codes?

We have 17 years of experience in assessing annual reports and applied governance practices. We have a unique best practice database that holds more data than any other UK governance researcher.

We'll use this insight to tell you how your decision-making structures, communications and reporting compare to your peers and any relevant codes, and help you ensure they are fit for purpose.

When is it relevant – Organisations seeking to understand if their existing governance approaches are fit to deliver their strategic objectives for the benefit of stakeholders, and if there are learning points based on peer and code comparison.

Value add to client – Identifying any gaps in the structures to highlight areas that may lead to inefficiency and impact value.

Types of solutions

- Gap analysis against new guidance
- Benchmark reporting to market good practices or compliance with governance codes
- Identification of areas for improvement in market communications and/or issues with internal framework and approach
- Detailed insights on governance practices for stakeholders such as lenders and investors
- Regular training and updates

Governance restructuring

While strategy is often reviewed, measured and refined, often the governance elements that frame the decision-making environment aren't. Governance structures are critical to enable a greater pace of change and underpin sustainable outcomes.

When is it relevant – Issues around the implementation of strategy, a significant change event meaning that your current governance framework is no longer fit for purpose, or you want to check that you have the right structures in place given future strategic objectives.

Value add to client – We facilitate the design and implementation of governance frameworks which balance the greater needs of stakeholders, manage risk, enable performance and support innovation.

Types of solutions

- Governance/organisational design
- Development of frameworks, policies and procedures
- Group risk appetite identification and embedment
- Internal control reviews and redesign
- Performance and incentivisation measures restructuring and implementation
- Cultural measurement assurance
- Seconded/company secretary
- Support designing governance frameworks that align to strategy

Board effectiveness

For your business to succeed, your board will need to navigate tough conversations. You want to do things right, and also do the right things. The first job of any external board review is to make sure you've got the basics covered and you're not putting your business at risk. Equal attention should be given to the value add element of the board dynamics. If the dynamics in the boardroom aren't working, it can undermine the value of the sum of the parts and, ultimately, how effective the board is as a leadership team.

When is it relevant – Assessment of the effectiveness of the board and/or support in the learning and development of the board or individual members.

Value add to client – External assurance over the board in terms of structure, capability and function, and a fresh perspective on how the board can sustain high performance.

Types of solutions

- Independent board effectiveness reviews
- Secretariat support
- Executive individual and team coaching
- Facilitation of retreats and away days
- Team effectiveness and individual skills diagnostics
- Stakeholder performance dashboards
- Board training, regulatory compliance and governance workshops
- Benchmarking
- External communications

How we can help

Our governance and board advisory team brings its board governance and shareholder relations team together with business psychologists, executive coaches and leadership development specialists.

We support organisations in shaping fit-for-purpose governance structures that build trust and integrity with stakeholders; ensure dynamic performance through leadership for the future; and create environments in which their people and operations can thrive.



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Corporate governance
review 2019



Getting smart
about governance



Corporate governance and
company performance



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