Grant Thornton

Corporate Governance Review 2023

Why we do it

Strong governance creates value

Companies with stronger governance have

- **43%** more operational efficiency
- **3.4x** more cashflow
- **2x** more shareholder returns

How we do it

- **22** years of unique insight
- **252** company reports analysed – 96 FTSE 100 + 156 FTSE 250
- **263** data points analysed per company
- **1** peerless database of corporate reporting

Welcome

Fair, balanced and (un)assured

How many times does your annual report contain the word 'assurance', and could each mention expose your company, stakeholders, and directors to risk?

With some reports in our 2023 corporate governance study using the term over 100 times, boards are using it to provide stakeholders with a sense of reliability, credibility and accountability. However, definitions are too limited: in some instances, assurance might mean adherence to exacting global standards; in others, passing an internal checklist.

Failing to communicate the scope of assurance and its context within company governance invites misinterpretation. Though assurance standards exist, there is no meaningful check on their application. Boards must, therefore, challenge themselves to clearly define assurance for the reader.

Stakeholders are increasingly calling out inauthentic claims, including the UK Advertising Standards Authority (ASA), the Financial Conduct Authority (FCA) and Competition and Markets Authority (CMA).

Adding more levels of assurance is a tempting response. However, a more practical approach would be to aim for the right balance of assurance based on strategic priorities and stakeholder needs. This approach requires consideration of governance frameworks to provide clarity for stakeholders on where 'reassurance' and accountability is sufficient.

Meanwhile, it remains an overwhelming time for corporate governance and regulation – according to our research the average size of annual reports has increased by nearly 40% over the last 5 years, recent research in the Financial Times[1] note this trend too. It remains to be seen whether the scaled back proposed changes to the audit and corporate governance reform agenda and a renewed focus on the Stewardship Code will alleviate complexity.

Through this review, we address the key theme of assurance and provide a benchmark for many other aspects of corporate governance.

Our conversations with boards reveal a willingness to return to the purpose of annual reports: to give stakeholders a fair, balanced, and understandable overview of company performance and prospects.

We hope this review helps deliver that mission.

Sarah Bell
Partner, Governance and Board Advisory

Gabriella Demetriou
Senior Governance Practice Analyst

[1] https://www.ft.com/content/39b61879-341f-48b0-97d9-ed7fe9bbf0d2

UK Corporate Governance Code
Stop, start, keep doing

On 12 October 2023, the Financial Reporting Council (FRC) issued a record fine for auditing failures surrounding Carillion's 2018 collapse.

Just four days later, the UK Business Secretary scrapped new corporate governance legislation designed to prevent business failures of the exact same nature.

The potential changes to the FRC's UK Corporate Governance Code (the Code) would have potentially required companies to consider (on a comply or explain basis) areas such as an annual resilience statement, distributable profits figure, material fraud statement and triennial Audit and Assurance Policy statement (AAP).

The announcement substantially influenced the proposed revision. While it will retain its core proposal on internal controls, it will discard changes supporting the scrapped legislation's focus on assurance and resilience.

Other requirements will continue in different forms. For example, companies will need to provide a material fraud statement to protect themselves from the 2024 Failure to Prevent Fraud offence.

Key questions

- How comfortable is your board with the incoming requirement for more explicit controls reporting?
- Are you reviewing the effectiveness of your internal controls more than once or twice a year?

Contents

Get the most out of this report. How does the reframing of the FRC's reforms shape your corporate governance design?

This report reveals how 252 FTSE 350 companies reported on their applied governance practices in 2023. It analyses how purpose and strategy inform performance, prospects, culture and assurance, and the integration of ESG into business models. We invite you to use the data, expert commentary, and questions to guide boardroom discussion.

Report card

How 2023's annual reports fared

Good

95% stated company purpose

96% described how they monitor culture

87% offered detailed information on the outcomes of board evaluations

86% linked risk to strategy

86% adopted the Code-recommended employee engagement methods

75% explained where they did not comply

63% said they gained independent external assurance on ESG and non-financial information

Could do better

50% offered insightful information on internal controls

40% used three or more metrics to measure culture

40% gave good insight into their S.172 considerations

39% fully complied with the 2018 UK Corporate Governance Code

29% identified board skills, experience and succession planning as a priority

27% provided insight into the development of a diverse pipeline

16% measured progress and impact of their purpose

Assurance in an uncertain context

Stakeholders focus on corporate claims

Investors

14% of shareholder resolutions in 2023 related to ESG/regulatory concerns or failure of the board to deliver on ESG commitments, compared to 0% in 2021.

Regulators

ESG reporting has been the focus of over 20 Advertising Standards Agency enforcement actions and 13 securities litigation cases since 2019 under the UK's Financial Services and Markets Act (FSMA) 2000.

Consumers

87% of UK adults surveyed believe that it is important for businesses to act responsibly regarding society and the environment, surveyed in 2022 (April - August) by Glow, a consumer research body/company[2].

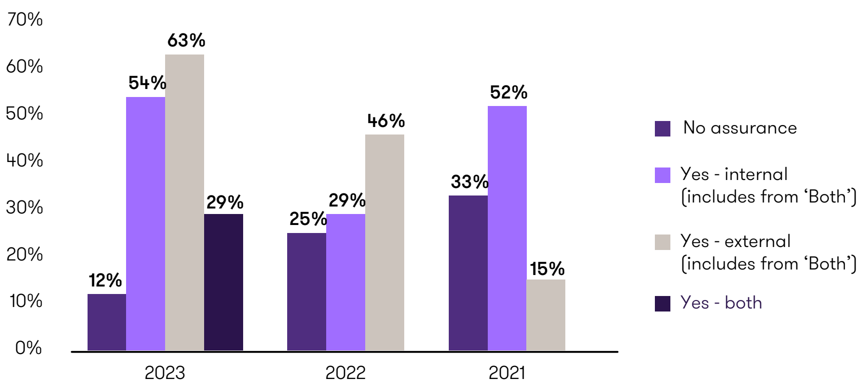
Investor insight

We conducted some research to gain a sample of FTSE 350 investor views to establish clarity around the use of the word 'assurance' in the front end of the annual report.

There is a general investor view from the research that companies are not clear on what information in the front end of the annual report is assured noting that references to:

1. Internal assurance (i.e. second and third line) was somewhat clear in terms of scope
2. External limited assurance wasn't very clear
3. External reasonable assurance wasn't clear at all

Assurance over ESG and non-financials



In the face of stakeholder scrutiny, boards are keen to prove authenticity. The proportion of companies stating that their ESG and other non-financial information was assured leapt from 67% in 2021 to 88% in 2023. Equally, the proportion of companies declaring some form of external assurance has also leapt from 15% in 2021 to 63% in 2023.

While this is superficially good news, our data also shows that 50% of companies do not provide an insightful description of their internal control process reviews. Moreover, there was no information on the levels of external assurance for 21% of ESG information in the 252 reports in our study set.

Simply put, companies are claiming data is assured but are not sufficiently transparent about definition and context.

2 https://campaign.glowfeed.com/srs_foodgrocery_uk

The problem of defining assurance

Assurance is the buzzword of 2023 annual reports, but what exactly does it mean?

Q&A with Paul Holland, Head of ESG Assurance Services, Grant Thornton UK LLP

How can limited assurance engagements be relied upon to provide a meaningful level of comfort, and what factors impact the level of assurance provided?

The level of comfort often comes down to the skill and experience of the assurance practitioner. A skilled practitioner will have a better understanding of what could go wrong in a reporter's processes around data capture, processing, management, and reporting. That knowledge is key to designing appropriate assurance responses, as well as adding value to the client with feedback about their processes and controls. Assurance should always be meaningful, whether it is limited or reasonable.

The factors that can impact the level of assurance are the choice of the reporter, their resources and time. However, the reason for undertaking limited assurance should not be that the quality of information would not stand up to the scrutiny of reasonable assurance. It should always be technically possible to undertake reasonable assurance where a decision has been made to obtain only a limited level of assurance.

How much do limited assurance engagements vary between providers, and what could this mean for reliance?

It is hard to tell as you can only comment precisely on your own approach. However, there are certainly poorly worded opinions out there, often muddling limited and reasonable assurance language, and not making clear reference to the methodologies used to measure the subject matter. Opinions should be precise about the subject matter, the reporting criteria, and the work performed. They should not include inappropriate or irrelevant inherent uncertainties.

Engagements that follow a recognised standard, such as International Standard on Assurance Engagement (ISAE) 3000, should be performed to a consistent level. However, there is limited regulation of assurance in practice, especially outside of the regulated audit firms. As a result, report readers need to be careful about wording that states assurance is performed "by reference to" or "in accordance with" a methodology "based" upon ISAE 3000. This might be clever wording to disguise that the work was not actually in accordance with ISAE 3000 or that the assurance provider may not be confident about whether it has or has not.

What does the growing investor appetite for ESG mean for assurance practitioners?

ESG information is inherently more challenging to measure than financial information. There is a general challenge to the credibility of ESG reporting that it either doesn't have any assurance, or worse, it has assurance that is not meaningful.

In my view, there are too many examples of poorly scoped, defined, or articulated assurance engagements that expose the reporting entity to risk. ESG is already a board-level issue, but there is increasing scrutiny from investors, other finance providers, regulators, and other users of ESG information over the quality and clarity of ESG reporting and the associated assurance. This will drive organisations that do not want to be left behind toward clearer, more meaningful assurance.

I expect to see some larger organisations begin to move toward reasonable assurance over aspects of their ESG reporting. We will also see an acceleration in the rate of change in the uptake of assurance, with more organisations recognising its value and necessity. We will see more assurance scoping that includes narrative reporting as well as key performance indicator (KPI) reporting, for example, over Task Force on Climate-related Financial Disclosures (TCFD) reporting.

Internal control insights

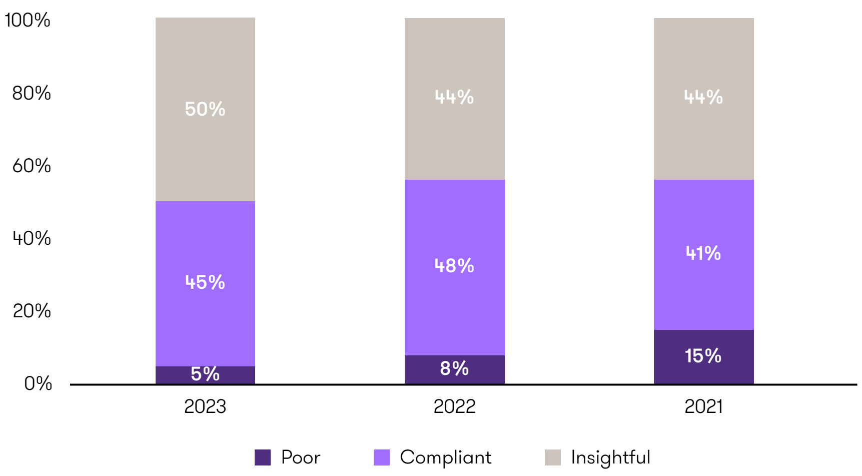
The number of companies offering insightful information on internal controls has increased from 44% in 2021 to 50% in 2023. This likely results from 49% of companies doing early work ahead of the updated Code.

This is not wasted work. The keen appetite for reform suggests that some boards view the proposed changes as good for business rather than a further layer of reporting. They will also be prepared should governments refocus on internal controls in future legislation.

Investor insight

One of the investors we spoke with found that in best practice, companies are very clear and explicit as to what content in the report has been subject to different levels of assurance and what the boundaries of the organisation were with respect to different aspects of sustainability reporting.

Level of information provided on internal control process review



Too big to be balanced and understandable?

The average FTSE 100 annual report now stands at 237 pages and contains a higher word count than Dickens' *A Tale of Two Cities.*

This is not necessarily a readability problem: arguably, stakeholders dip into specific sections rather than read reports from cover to cover.

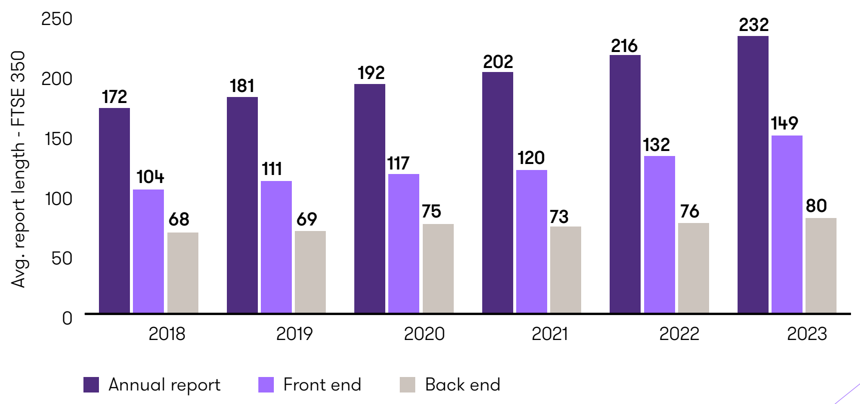
Boards want to be seen as helping stakeholders navigate increasing swathes of information: over half the reports in our 2023 analysis used cross-referencing to demonstrate the relationship between risk and KPIs rather than repeat information.

However, burgeoning reports require extra time, commitment and resource. Companies must have the person-power to present 'front of book' data accurately and fully detail how it is assured.

Questions for boards

- Are you applying the same level of assurance to financial and non-financial information?
- Is your annual report too big to be understandable and balanced?
- How will you define assurance (in every mention) to make your report understandable?
- Does your team have the expertise and capacity to process and explain new volumes of information?

FTSE 350 Annual report length (avg) - 6 years



Purpose and culture

The struggle to make purpose authentic

Companies are keener than ever to shout about purpose, with 95% of 2023 annual reports outlining an overarching ambition.

However, these claims do not appear to be integrated into the fabric of the business, with weak links to strategy. Only 16% of companies showed how they measure the impact of purpose compared to 23% in 2022.

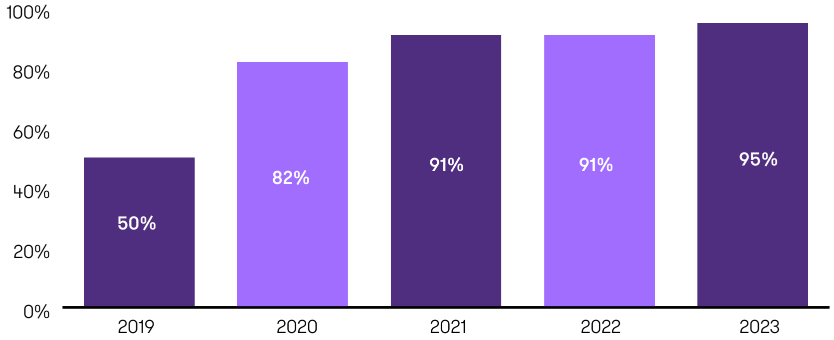
This is not to suggest subterfuge, more that boards are struggling to measure the sometimes abstract nature of purpose. A recent survey revealed that although CEOs understand the power of purpose, they struggle to make it live and breathe within their organisation.

Questions for boards

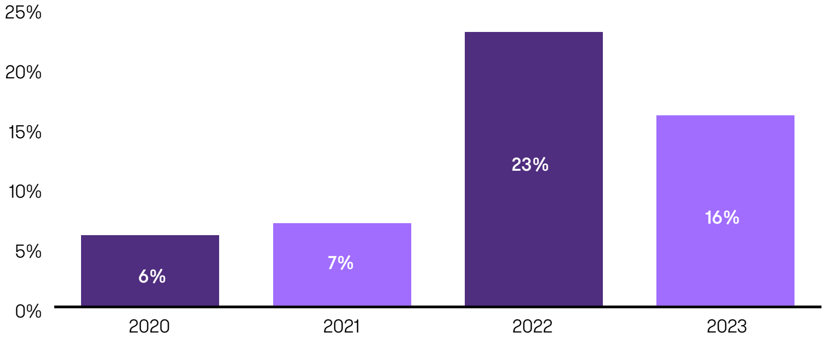
- Is your purpose a strapline or something that guides decision-making and strategy?
- Can you push your purpose into a SMART measurement – if not, is it really a purpose?
- Is purpose able to guide you through changing current and future environments?

The struggle to make purpose authentic

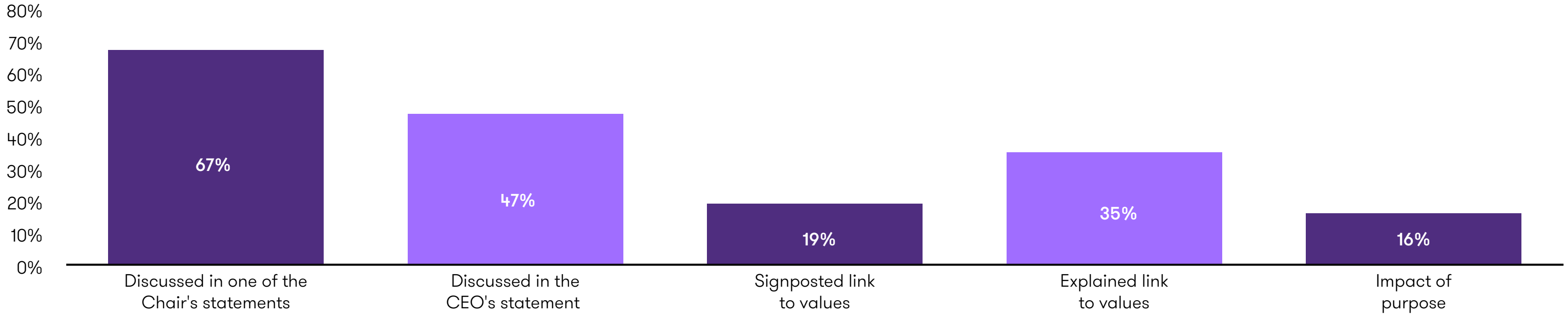
Companies that state purpose



Companies that showed how they measure the impact of purpose



How purpose is demonstrated as part of the business - 2023



Culture measurement gets broader

There was a significant uplift in the proportion of companies using three or more metrics to measure culture in 2023 compared to 2022 (18% to 40%).

In addition, there was an increase in the diversity of metrics, with companies relying less on repurposing traditional people measures, such as staff turnover and health and safety data. This demonstrates improved connectivity between culture and business models.

For example, the percentage of companies using customer satisfaction/complaints as a culture metric grew from 7% in 2022 to 13% in 2023. The increase was partly driven by financial services companies, reflecting new Consumer Duty obligations impacting the industry as of July 2023.

Companies risk culture echo chamber

Thriving company culture goes further than employees: it influences how organisations interact with all stakeholders, including customers, regulators, the media, and suppliers.

However, our 2023 analysis of annual reports showed that companies favour internal rather than external metrics to measure culture.

This imbalance puts boards at risk of operating in an echo chamber and potentially failing to fulfil S.172 of the Companies Act. However, there are positive signs that boards are acknowledging this: compared to 2022, there was a 33% average increase in the use of a customer KPI, with 41% of companies now using one or more measure and the number of companies using a supply chain-related metric to measure culture doubled to 8%.

Average mentions of internal and external measures in 2023 reports

3.7
mentions of internal measures, such as employee surveys, absenteeism/retention, diversity, health and safety.

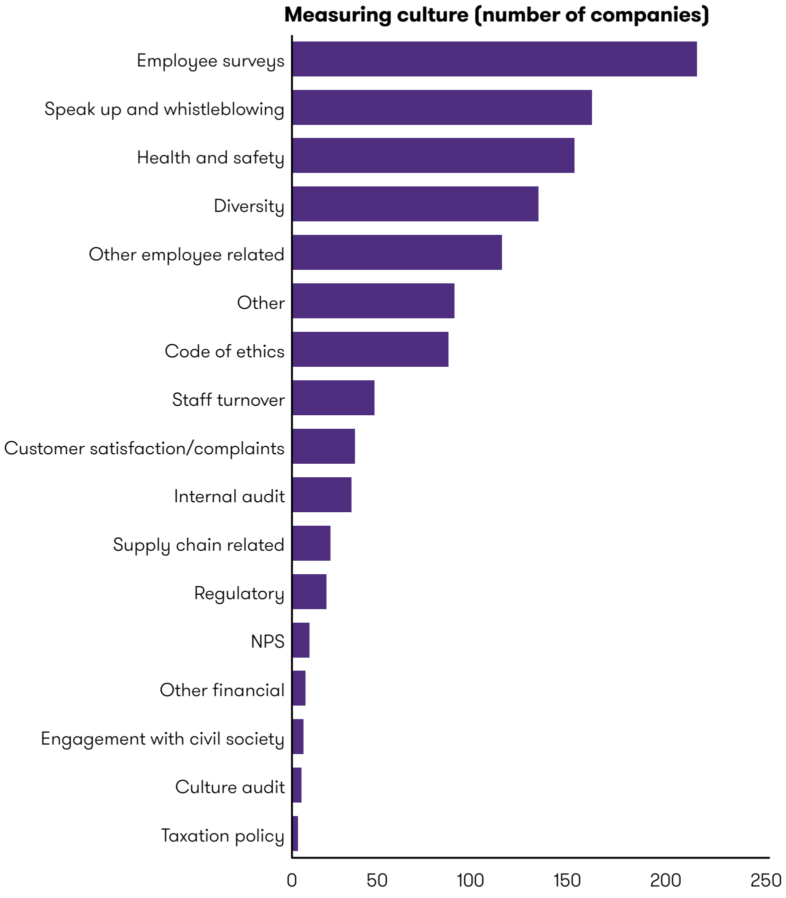
0.4
mentions of external measures, such as customer satisfaction, Net Promoter Score (NPS), regulatory infringements, taxation policy, and supply chain.

Questions for boards

- S.172 encourages diversity of stakeholder opinion: are you seeking to get the right balance of internal and external measures on culture?
- When it comes to culture, are you reporting on areas for improvement as well as positive developments?

Culture

Culture metric	2023 (%)	2022 (%)
Employee surveys	84	88
Speak up and whistleblowing	62	75
Health and safety	59	67
Diversity	51	56
Other employee related	44	45
Other	34	36
Code of ethics	33	39
Staff turnover	17	25
Customer satisfaction/ complaints	13	7
Internal audit	12	13
Supply chain related	8	4
Regulatory	7	2
NPS	4	7
Other financial	3	1
Engagement with civil society	2	4
Culture audit	2	4
Taxation policy	1	2



Q&A with Jacky Griffiths, ESG Lead Business Risk Services, Grant Thornton UK LLP

What is best practice for embedding culture measurement into an organisation?

Best practice requires the use of internal and external data for measuring culture and understanding how different stakeholders experience your organisational culture. It's important to use both qualitative and quantitative and have a variety of data points in place, for example, customer surveys, customer complaints, employee engagement/feedback, analysis of themes from exit interviews and whistleblowing reviews to name a few. What and how you're measuring are both important. To measure an organisation's culture, it's not enough to do employee engagement surveys once a year. You must adopt a holistic approach, using both lead and lag metrics and using outputs of these measures to introduce or change processes, tools, and interventions within the organisation to support the continual process of embedding the desired culture.

There's an increase in diversity of culture measures, but how can effective methods be sustained over time?

The short answer is by applying the 'S' lens in ESG where organisations are reporting on the make-up of their senior leadership team, what would it take to report on this across the whole organisation.

To be effectively sustained over time, Inclusion and Diversity (I&D) must be embedded throughout the organisation, not just at the upper levels of management. I&D reporting isn't going away; the need for reporting will only increase over time, so organisations need to really understand their employee makeup and continuously monitor it.

If you have started reporting on one aspect of ESG, why not do it across the board? The resources, time and effort are already in place. Create a plan, give it time to work, and then update it annually. Monitor your reporting throughout the year and include it in Management Information (MI) packs to boards for best practice.

What do you see happening in the future in terms of embedding and measuring culture?

Culture will feature higher on leadership agendas as ESG activity and reporting requirements increase. While regulation has and continues to focus on the environmental agenda, the social impact agenda is becoming an important lens to report against. Stakeholders are making decisions on an organisation based on what is being reported in annual reports. Reporting including both qualitative and quantitative data with a supporting narrative will feature as part of an organisation's reporting requirements. Thus, leadership teams continue to review their governance of culture in an organisation to better understand what is supporting or impacting on their ability to embed the desired culture. Sustainability is becoming more of a key part of an organisation's DNA and for a business to deliver its ESG ambitions, it requires activity to be aligned to the organisation's strategy and culture.

Reporting and measuring will need to be embedded across the organisation; I expect that in the future measuring the social agenda will involve extra detail beyond reporting statistics. Regulators will start to ask for the narrative about the social agenda at an organisation. Just like ESG, culture needs to be aligned to everything in a business, throughout supply chains, in customer service, as well as across the workforce. Regulations alone cannot drive this.

Spotlight on best practice: linking culture and purpose

Intertek was one of the 56% of companies that detailed the vital link between its business model and culture.

Its approach to culture is evidenced throughout its business via board and executive accountability, clear values and purpose, and strategic, sustainability and governance framework disclosures. Its annual report details several metrics, explaining their relevance to monitoring and measuring its culture. These include health and safety, employee engagement, site visits, voluntary employee turnover and diversity and inclusion. They are clearly linked to risks, and the board discusses in detail how it further assures itself that Intertek's culture continues to travel in the desired direction and is aligned with its purpose, policies, practices and processes. Its discussion cross-references key parts of the report, helping demonstrate its cohesive approach to its culture.

Business model connectivity

Business Model – connectivity

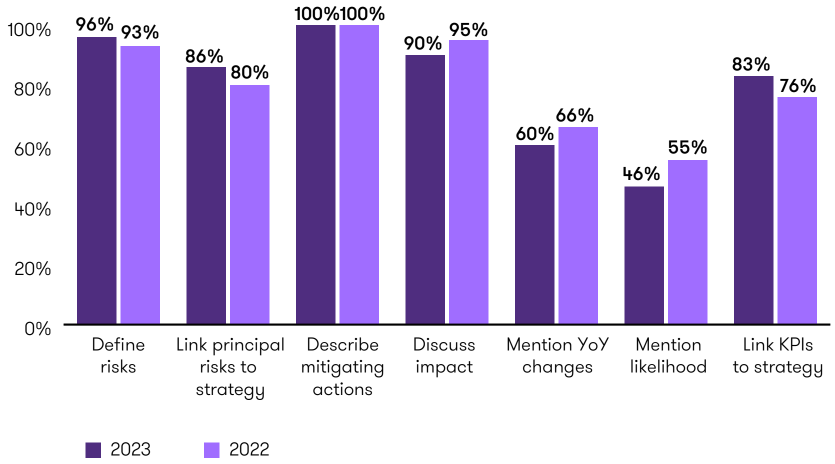
80%

provide good, detailed insight into the business model (2022: 83%)

85%

link strategy to business model with 52% describing the link in detail and 33% cross-referencing (2022: 89%, 51%, 38%)

Companies disclosing Risks and KPIs



70%

provide good and detailed insight into forward-looking plans and business development (2022: 84%)

30%

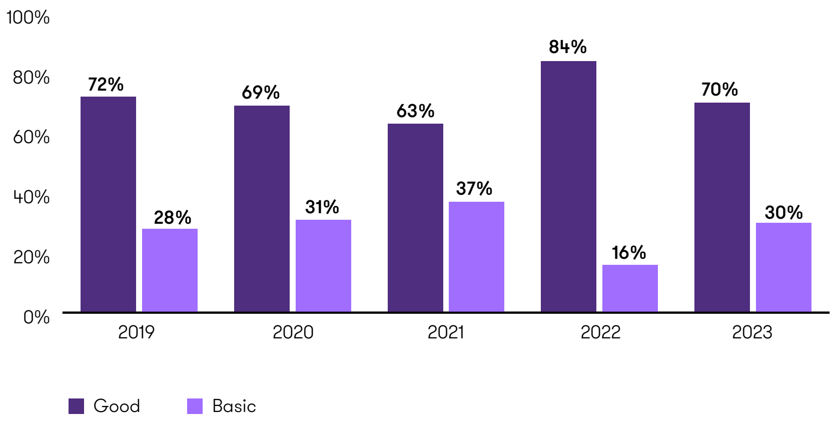
now provide little or generic information on future plans and business development and opportunities, an almost 88% increase (2022: 16%)

The 2023 cohort of companies presented a holistic view of their business model, with 86% describing how various risks were likely to impact strategy. Likewise, almost all reports identified risks and mitigating actions.

However, this clear picture of the status quo comes at the expense of the future for some. 30% of reports provided little or generic information on three-to-five-year plans, business development opportunities, and emerging risks. This is at odds with the new direction of the FRC's code of conduct, which encourages long-term planning regarding fraud and resilience.

The limited forward planning disclosures could indicate that boards are preoccupied with present operations amid a climate of geo-political tension, a pattern we have seen before. At the height of the Covid-19 pandemic in 2021, 37% of reports provided llimited three-to-five year disclosures, compared to 16% in 2022, an arguably more stable year.

Ratings each year for companies reporting on future impact and opportunities



Efficiency or oversight?

Some 10% of annual reports contained identical risk disclosures to the previous year. Meanwhile, 20% of companies made no changes to their viability disclosures.

While some stakeholders might attribute this to efficiency, a lack of updated information may ring alarm bells for others, with statistics for meaningful reporting on purpose impact and longer term disclosures trending down.

Questions for boards

- Are you disproportionately focusing on near-term risk?
- Are you hiring a diverse skill set orientated not just in the needs of the business now but in three-to-five plus years?
- Are you using the same risk disclosure from the last year because the risks are genuinely the same?

Environmental, Social, and Governance (ESG)

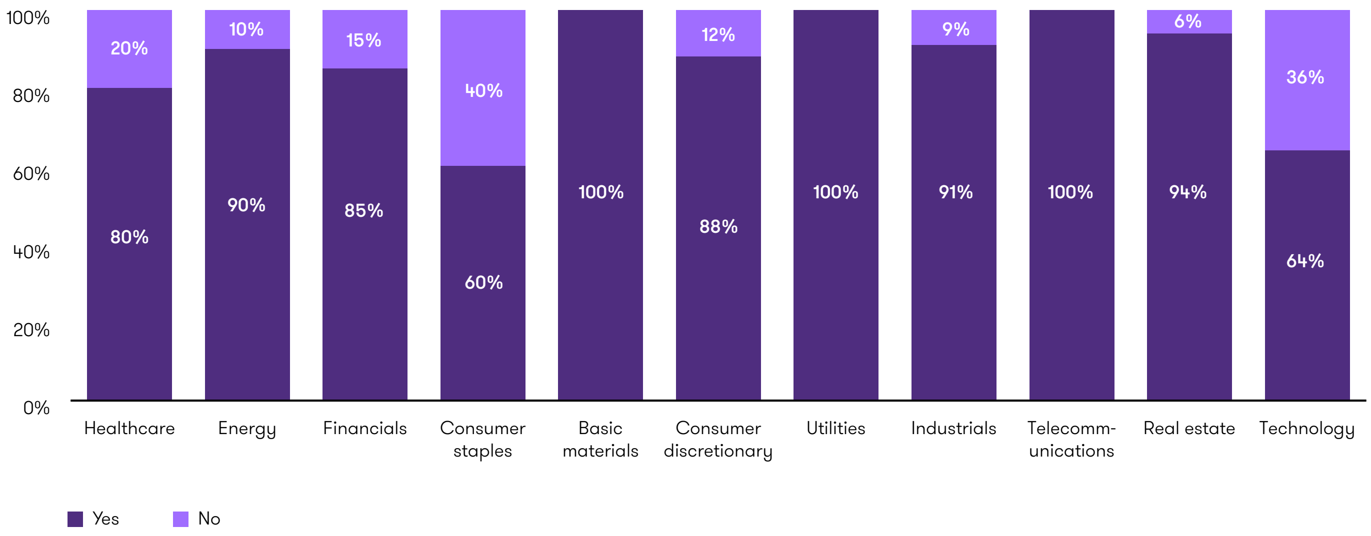
ESG takes centre stage

ESG has firmly emerged from the wings cutting across all areas of the business model from strategy, finance, stakeholder engagement, risk and public relations (PR).

In 2023, more reports explained the connection between strategy and sustainability (2023: 89% v 2022: 82%).

At the same time, fewer reports referenced United Nations Sustainability Development Goals (UNSDGs) compared to 2022 (2023: 63% v 2022: 69%). This may suggest that companies are eschewing generic box-ticking to better align their ESG reporting with specific business or industry needs.

Companies who have integrated sustainability into strategy by industry



Environment is the new social

In 2023, the 'E' in ESG continued to grab the limelight from 'S', where purpose and culture often sit.

There was an 11 percentage point (pp) increase in boards linking environmental issues to risk in 2023 v 2022. In the same period, there was a 2pp rise in the number of boards connecting social issues to risk. This still marks a steady incline, but more can be done to link social to KPIs and remuneration.

Companies have rolled back their focus on company culture, with those tying it to executive annual bonuses halving (7% in 2023 v 15% in 2022).

Sustainability and connectivity

	Environmental and climate	Employees	Social
Risks	**70% 2023** 59% 2022	**81% 2023** 82% 2022	**23% 2023** 21% 2022
KPIs	**61% 2023** 48% 2022	**57% 2023** 51% 2022	**20% 2023** 15% 2022
Rem (bonus + LTIP)	**52% 2023** 45% 2022	**22% 2023** 24% 2022	**25% 2023** 19% 2022

Top 4 Social and Remuneration (bonus and LTIP) KPIs from our research

	Social – KPIs	Social – bonus	Social – LTIPs
1	Positive impact/social value (£/$ or number of people or hours)	Diversity (%)	Senior leadership diversity – gender and ethnicity (%)
2	Social programmes delivered (number delivered or participants in each topic, e.g. gambling, nutrition etc)	Sustainable supplier, supply chain and sourcing and education programmes (number trained/enrolled)	External ESG benchmarking/certifications (rating/%)
3	Community investment (hours or £/$)	Community investment (hours or £/$)	Delivery of sustainability plan social aspects (%)
4	Progress against sustainability plan (% or £/$ or hours)	Development of sustainability plan/roadmap (number)	Operational (local jobs and entrepreneurs supported, financial education, coverage and connectivity, sustainable/non-HFSS products developed)

Report card
Assurance
Purpose and culture
Business model connectivity
Environmental, social, and governance (ESG)
Board composition, development and risk
Code compliance
Five priorities for boards in 2024
Make your corporate governance drive results
Methodology

Boards prepare for new frameworks

26% of reports acknowledge or mention the CSRD or ISSB frameworks currently in development (2022: 7%)

Q&A with Laura Gardner, Associate Director, Financial Accounting Advisory Services

How is sustainability reporting expected to evolve going forward?

I expect sustainability reporting to expand from primarily focussing on climate-related financial disclosures to encompass broader sustainability topics relevant to an organisation such as biodiversity, human rights, labour practices, and business ethics in addition to more comprehensive reporting on social impact.

In June 2023, the International Sustainability Standards Board (ISSB) issued its first sustainability reporting standards:

- IFRS S1 'General Requirements for Disclosure of Sustainability-related Financial Information'
- IFRS S2 'Climate-related Disclosures'

IFRS S1 "requires an entity to disclose information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium and long term." IFRS S1 therefore has a much broader scope than the current Task Force on Climate-related Financial Disclosures (TCFD) recommendations applicable to FTSE 350 companies and I recommend organisations start preparing for this as soon as they practically can.

Some FTSE 350 companies will also be impacted by regulations being introduced in jurisdictions outside the UK. One of the most high-profile developments being the Corporate Sustainability Reporting Directive (CSRD) within the European Union. The CSRD introduces the concept of double materiality. This requires companies to consider impacts, risks and opportunities that are financially impactful (outside in) and have an impact on people and the environment (inside out). This diverges from the financial materiality approach upon which IFRS S1 is built albeit there is likely to be significant cross over between the two. I encourage organisations to undertake horizon scanning to identify upcoming international regulations and maximise efficiencies by identifying areas of commonality.

What trends are expected for 2024 and what can people do to prepare?

The acceleration of nature loss globally is eroding the vital natural assets on which society, business and finance depend. In September 2023, the Taskforce on Nature-related Financial Disclosures (TNFD) published its final disclosure framework and guidance aiming to "enable business and finance to integrate nature into decision making, and ultimately support a shift in global financial flows away from nature-negative outcomes and toward nature-positive outcomes." I expect a number of FTSE 350 companies to begin to report (at least partially) in line with the TNFD recommendations in 2024.

An increasing number of organisations, including FTSE 350 companies, have made public commitments to reach net zero. In my experience to date, transition plans have tended to lack in detail and quality, limiting the ability of stakeholders to assess their credibility. Investors have been calling for standardised, high-quality plans to make better-informed decisions about how to allocate capital. In response, the Transition Plan Taskforce (TPT) launched the final TPT Disclosure Framework in October 2023 which sets out good practice for robust and credible transition plan disclosures. I expect FTSE 350 companies will look to expand their transition plan disclosures in the coming year as they work through the TPT Disclosure Framework and the implications for their current transition plans, with some looking to be early adopters in 2024.

Report card
Assurance
Purpose and culture
Business model connectivity
Environmental, social, and governance (ESG)
Board composition, development and risk
Code compliance
Five priorities for boards in 2024
Make your corporate governance drive results
Methodology

Companies are unclear on who is accountable for sustainability

Accountability is crucial to the success of any business strategy, including sustainability.

It is, therefore, no surprise that utilities and energy companies – which are intrinsically involved in energy transition – handle sustainability at board level.

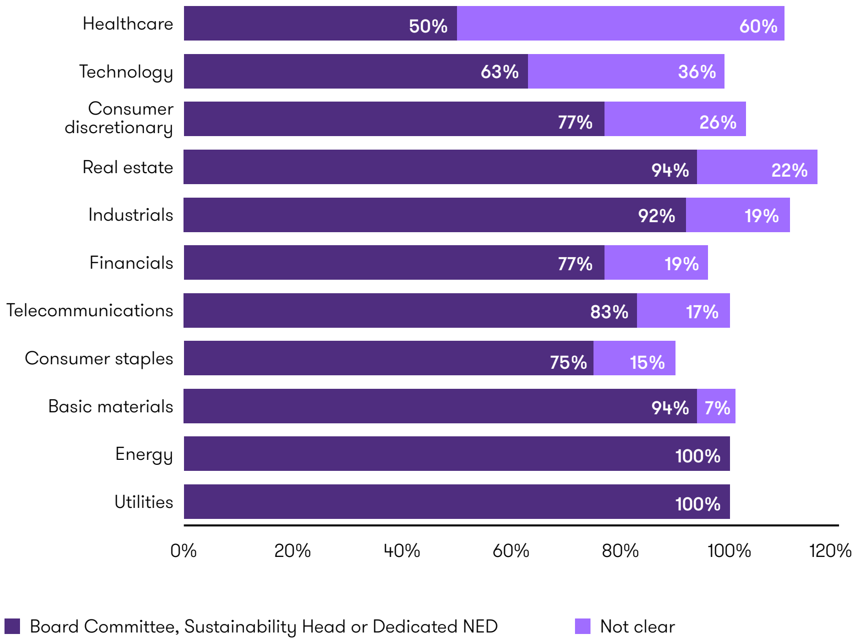
Of some concern was the number of reports that did not detail the person or group ultimately accountable for ESG. Healthcare, technology and consumer goods companies were at the lower end of the market. However, the lack of information may be due to poor communication within the report rather than a lack of accountability, which itself raises issues given the consumer-facing nature of the industries.

In the case of healthcare another viewpoint is that, as a socially concerned industry, it has baked ESG accountability into all corporate levels before the term became fashionable. This state of maturity has removed the need for separate governance.

Questions for boards

- Regulation aside, do you understand how ESG integrates and informs your strategic risks and opportunities?
- Are you explaining the above to stakeholders and outlining where (and why) you plan to reassure on rather than assure data?
- Who is ultimately accountable for shaping and integrating sustainability within your organisation?
- Are you clear on how your organisation will respond to the current evolving regulations – will double materiality, as an example, be driven at a qualifying entity level or will a group narrative be developed as a guide?

Accountability for ESG in the organisation across industry



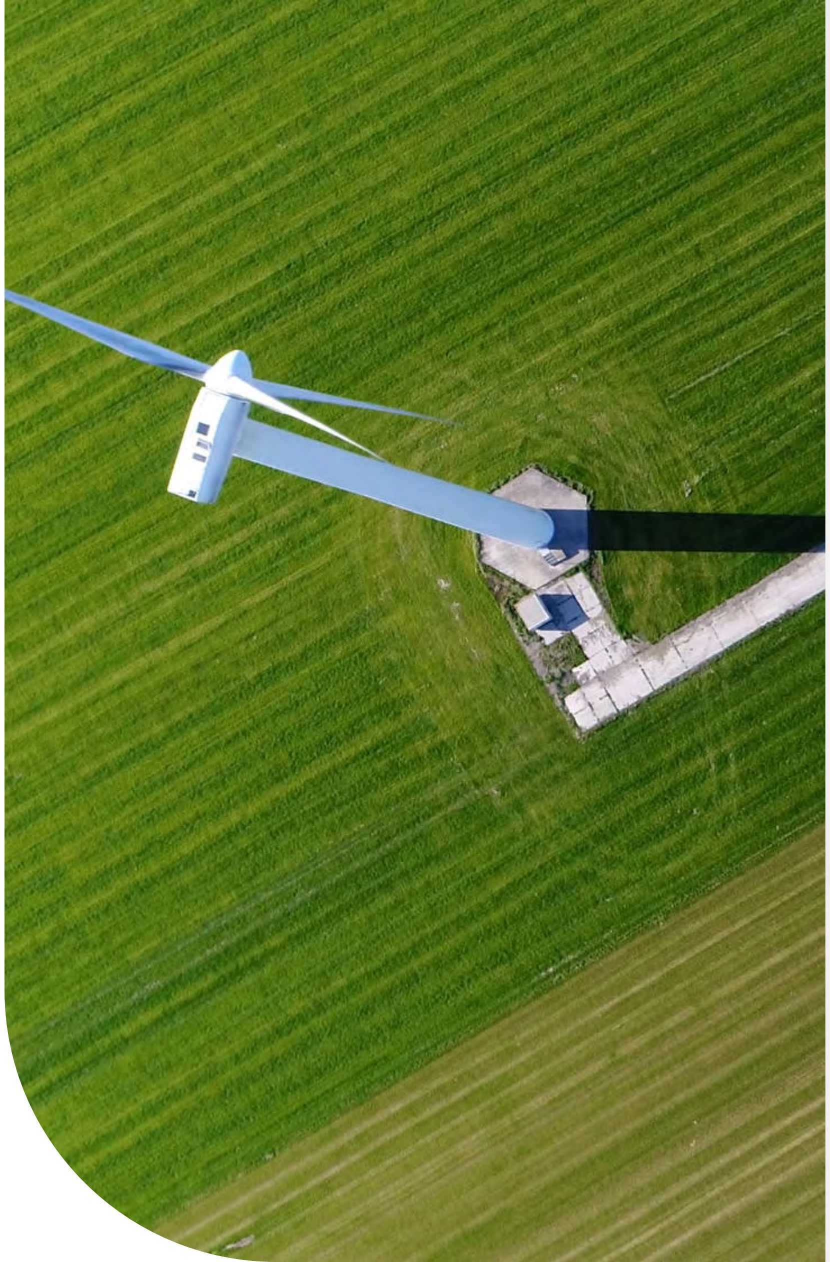
Spotlight on best practice

Sustainability and strategy linkages

Reckitt's embedding of sustainability is discussed in its report through linkages to both its purpose – A cleaner healthier world – and strategy. Its report demonstrates how and why sustainability is a strategic imperative to its business and outlines clearly, and with specificity, their desired goals/targets to deliver on their ambitions as part of their growth strategy. Its annual report also describes these goals within the business's main set of KPIs, including zero waste to landfill (healthier planet), product innovation for sustainable products and purpose-led brands (purpose led-brands) and social impact investment (fairer society), elevating these ambitions to equally strategically imperative ones as financial performance.

Sustainability/business model

Unilever's 'Compass Strategy for Sustainable Growth' integrates and links purpose, culture, sustainability, strategy and financial success with a variety of 'How to win' indicators. These include purposeful brands, raising living standards in their value chain, regenerating nature and agriculture and becoming a beacon for equity, diversity and inclusion. Their disclosures effectively cross-reference discussions around the delivery and performance of these throughout their annual report, demonstrating the integration throughout the business.



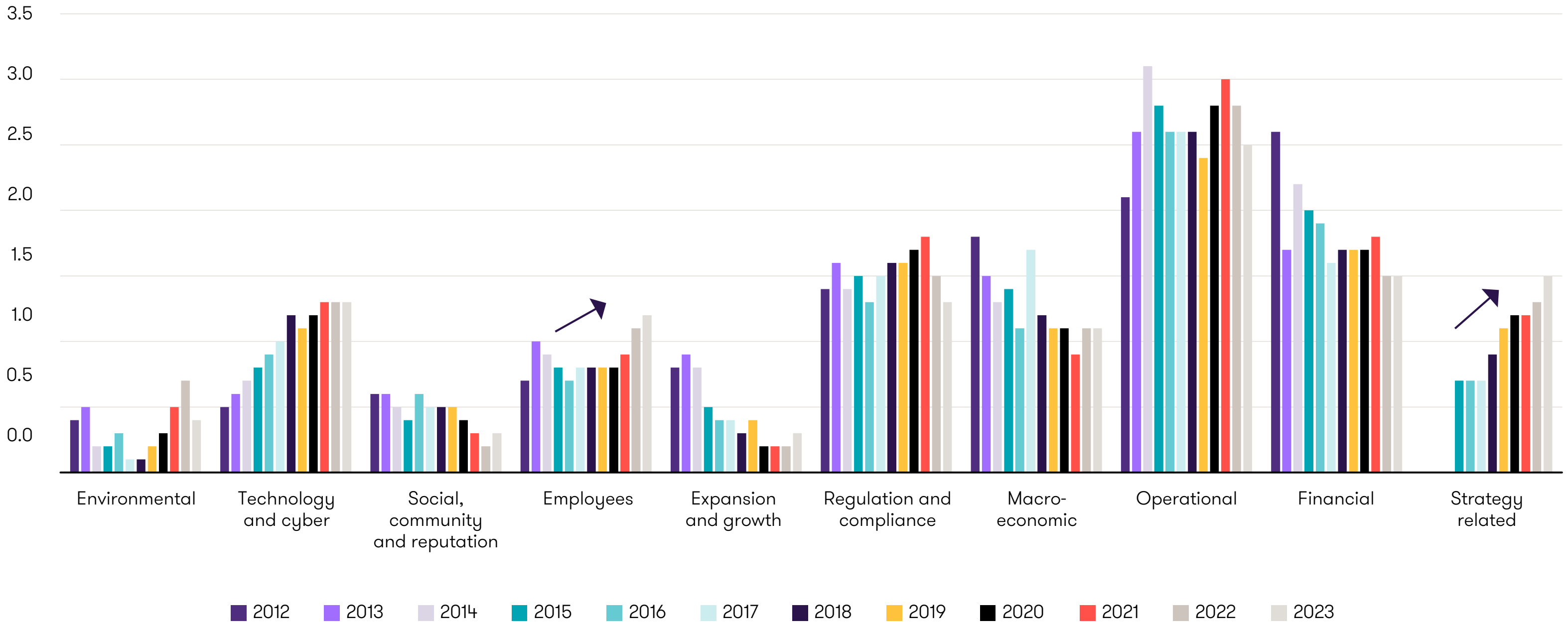
Board composition, development and risk

Board skills misaligned to key risks?

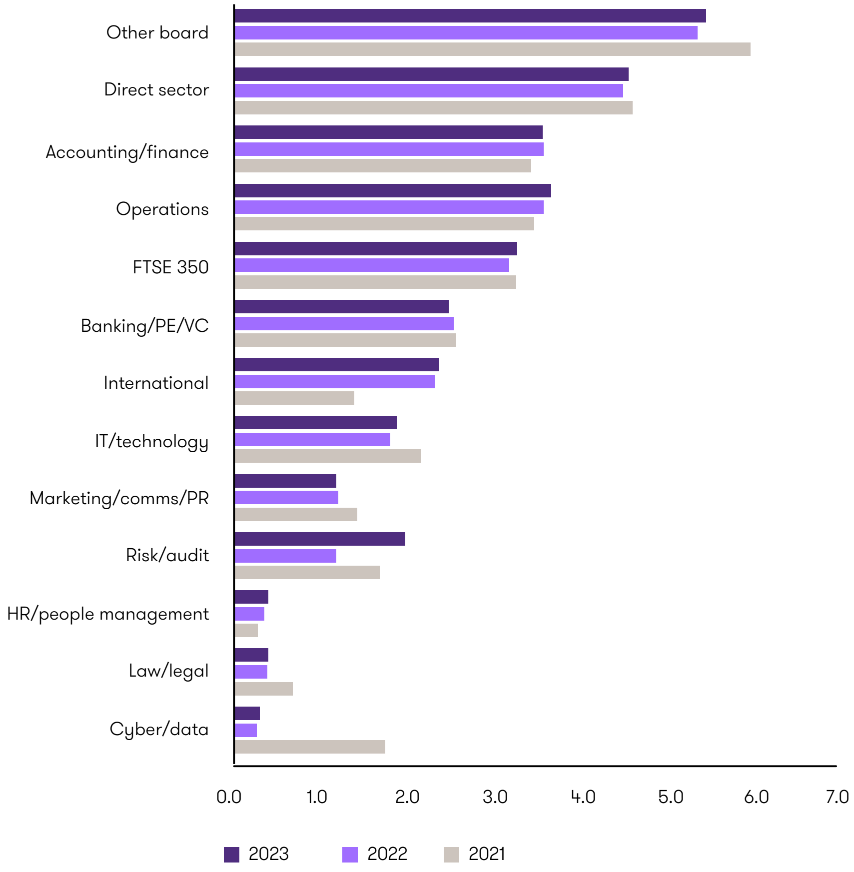
As noted in last year's report, boards need to be clearer on how their skills and learning and development programmes support alignment with the organisation's developing threats.

The risk associated with employee recruitment and retention has increased over the past year. At the same time, mentions of board skills related to HR and people management have not increased, as highlighted on the graph overleaf. There has been little year-on-year movement to close the gap between board skills and perceived risks.

Risks (average mention)

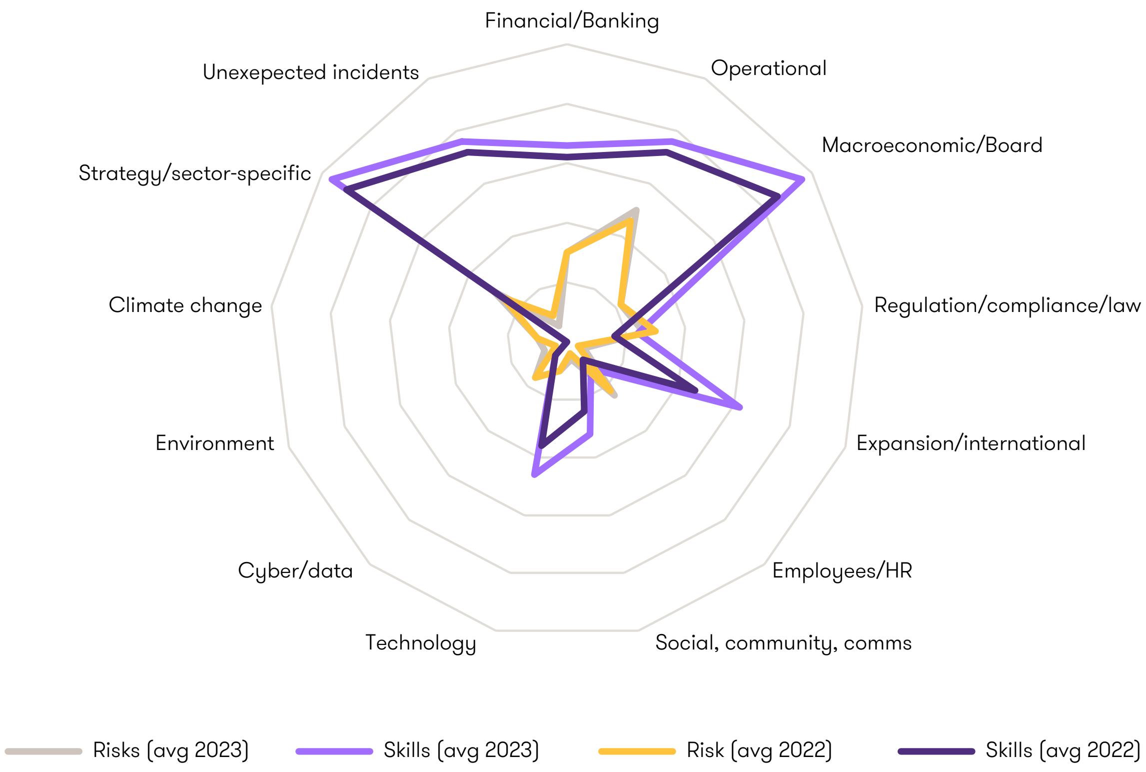


Board skills (average mention)



Board skills – composition

FTSE 350 skills v risk



Q&A with Karen Brice, Director, Governance

What conflicts are you seeing in the market in terms of prioritisation with board composition and board composition compliance?

From more traditional boards there is still some resistance to the value of quotas, but most we speak to now recognize the benefits of having diverse board members with the fresh perspectives and skills they bring. The value is seen in the quality of the discussion, the ways in which wider perspectives are incorporated or challenged, and above all, in decision-making.

How can boards address the tension between composition for now and succession and composition for the future?

This isn't an 'either'/ 'or' answer – it's about overlap. Rotation shouldn't be seen as purely about tenure, NEDs, just as executives, should be able to recognise when their expertise may not be delivering the same degree of value and share their thinking with the chair. Likewise, composition, dynamics and getting the right degree of healthy tension is the role of the chair, it is their responsibility to ensure the composition of the board generates the most productive group dynamics to deliver value.

Board selection and succession planning rarely incorporate an annual gap analysis activity that looks at strategic shifts in the market and in organisational performance. This could require new skills and experiences, or different styles of thinking. Additionally, selectors frequently rely solely on primary skills and experience with candidates, without incorporating the all-important psychometric tests into the NED selection process. Strategic thinking, analytical, creative, and social skills are where all board members can add additional value.

Given the human capital agenda is rarely owned at board level, HRDs who come in to report on progress and results comment that the board's interest can be dominated by numbers and lagging indicators. Experienced eyes and ears stretch executive thinking around the degree to which they are building future capacity and skills at different levels. Likewise, if NEDs don't have access to the organisation in informal ways, the board can be operating in isolation, not seeing the full picture.

When it comes to a future-fit company and board (including future skills and succession planning), what challenges and blind spots do you see that boards should be addressing now?

Boards can at times be run by their agendas, rather than business needs. It is the chair's role to challenge the status quo and work with the CEO, prioritising the key themes. Likewise, everything should flow from the strategy. A well-constructed strategy will not only describe future direction but will also provide a road map with the necessary analysis that describes the necessary skills to keep the board and business ahead of the curve. This is for the board to own and form as a regular part of the agenda.

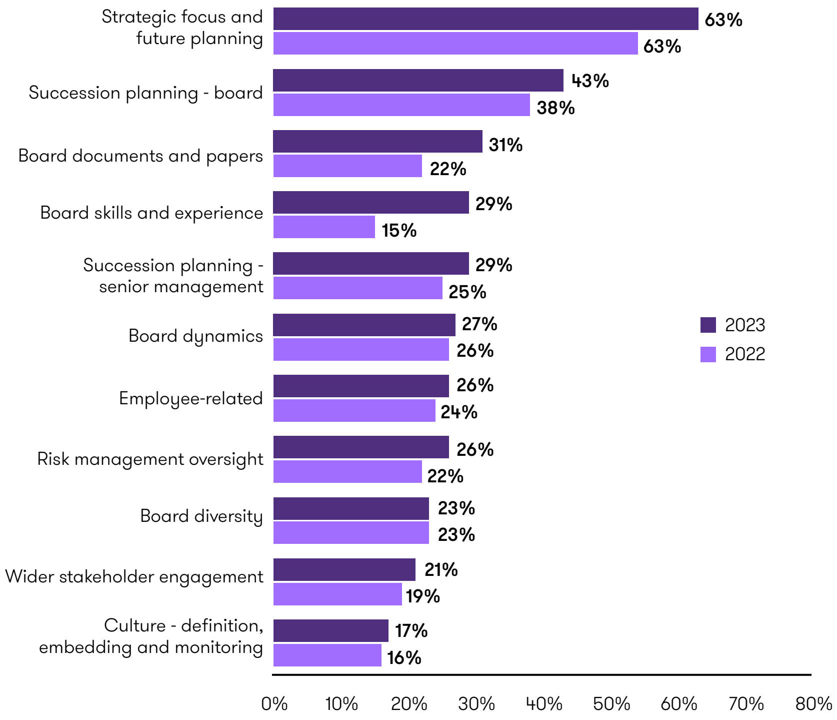
Strategy is often seen as a once-a-year theoretical exercise rather than a 'live' action planning process where the organisation's activities coalesce around the future business model ensuring progress is made against the set targets. Good quality Management Information (MI) looks at the ongoing work in value protection of today, along with value creation of tomorrow.

Organisational effectiveness plans should be developed alongside the succession to ensure the trio of succession, skills and development are regularly being refreshed. However, as we have already said, technical and leadership capabilities, along with business experience, no longer suffice for the most ambitious of organisations. Individuals in line for senior or executive succession require proven experience in building robust organisations, leading transformation, and resolving crises. Business life is about connecting with the wider world, and NEDs and executives alike need to be able to articulate how their exposure to external environments have enabled them to develop a deep sense of commercial expertise. 'Group think' and unconscious bias still exists in many more than the most traditional of boards and is one of the most dangerous forms of compliance we see at boards.

So, boards should not only focus on identifying the next NED or executive, but also examine what the future organisation will need to ensure it delivers value and growth. Only in this way, will boards limit the risks of being blindsided by actions that can impact future plans. Board cultures are becoming less formal, with deference giving way to mutual respect. That takes time to achieve, but succession planning should always strive to achieve what it is supposed to deliver; that being a dynamic culture where board members are created equal and can contribute equally, whatever the challenges.

Board effectiveness – assurance v development

Development areas identified from board evaluations - %



Questions for boards

- Does the board's skill set match the principal and emerging risks facing the company?
- Do you spend enough time on future strategy?
- Are you building a companywide skill set to seize future opportunities through capability, capacity, or learning and development plans?

Code compliance

Is comply or explain working?

Companies have had five years to comply with the 2018 UK Corporate Governance Code. While the uptake is slow, lack of compliance tends to relate to timing issues rather than organisations adopting approaches that better fit their purpose and strategy.

Information	2023 reports that did not comply with the Code	Companies that explained non-compliance	Companies that gave a poor or average explanation of non-compliance
Alignment of executive pensions with workforce	39%	45%	55%
Chair's tenure limit	11%	43%	57%
Chair's independence requirement	8%	50%	50%

39% of companies complied with the Code in 2023

75% of those who did not comply provided detailed explanations

15% of the 252 companies in our study did not comply or explain

Were regulators looking at the correct code?

Annual reports should generate dialogue between stakeholders and investors.

In 2022, the (now defunct) Department for Business Energy and Industrial Strategy thought companies were not fulfilling this expectation. It launched the Restoring Trust in Audit and Corporate Governance consultation in response to the significant corporate failures of Carillion and BHS.

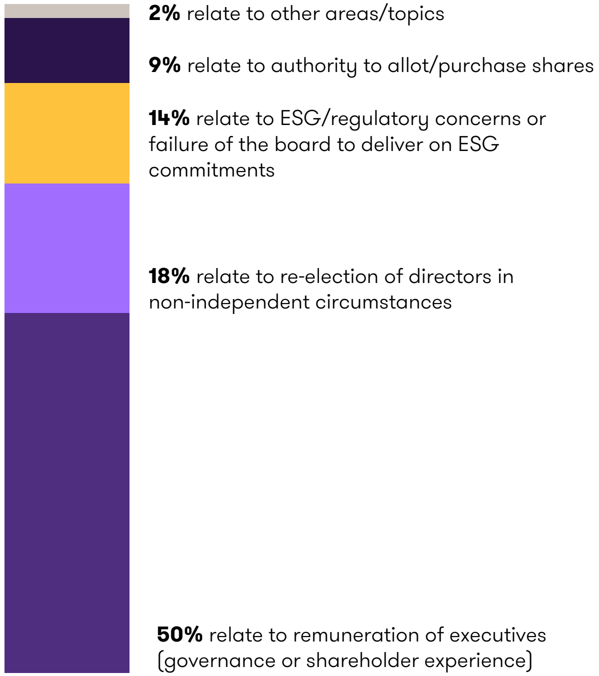
As a result, the government proposed changes to corporate governance regulation and invited the FRC to strengthen the Code accordingly. Then, in October 2023, the government said the changes were no longer necessary.

In the meantime, some companies had begun to prepare for the new guidelines. However, our conversations with boards showed limited stakeholder interest in the reforms. One frustrated board attempted to engage with shareholders on the Audit and Assurance Policy but received no response.

The FRC has also noted such concerns and is due to review the Stewardship Code in 2024. The hope is to create better collaboration and unity between boards and shareholders.

What's making shareholders sit up?

Shareholder resolutions



Five priorities for boards in 2024

1 Artificial Intelligence (AI), big data and cyber security

Organisations need to be clearer on what the opportunities and risks are to the business model of the developing landscape around this space - is it ways of working, skills, customer engagement, data protection, governance etc? Boards need to be clearer on the articulation of the potential opportunity and threat to the business. On average, 2023 annual reports made just one mention of technology and cyber security as a significant risk and less than one mention of technology and cyber security as an emerging risk.

2 Dynamic governance frameworks

Governance structures are typically reviewed every five to ten years. However, the best of boards are adding governance as a regular agenda item. This enables them to adapt their decision-making infrastructure to changing internal and external factors.

3 Horizon gazing

Boards are defining risk in terms of the present rather than the future. This can lead them to underestimate the impact of new technological, environmental, and social trends. Consequently, company strategy, culture and governance frameworks are ill-equipped to deal with change when it occurs. Boards must adopt a three horizon framework and ensure sufficient space to consider future stakeholders.

4 Diversity of skills

A skills shortage is one of the biggest threats facing UK companies. To ensure future success, organisations need to hire, train and develop the skills they will need in three-or-five-years' time. This is true both at board level and companywide.

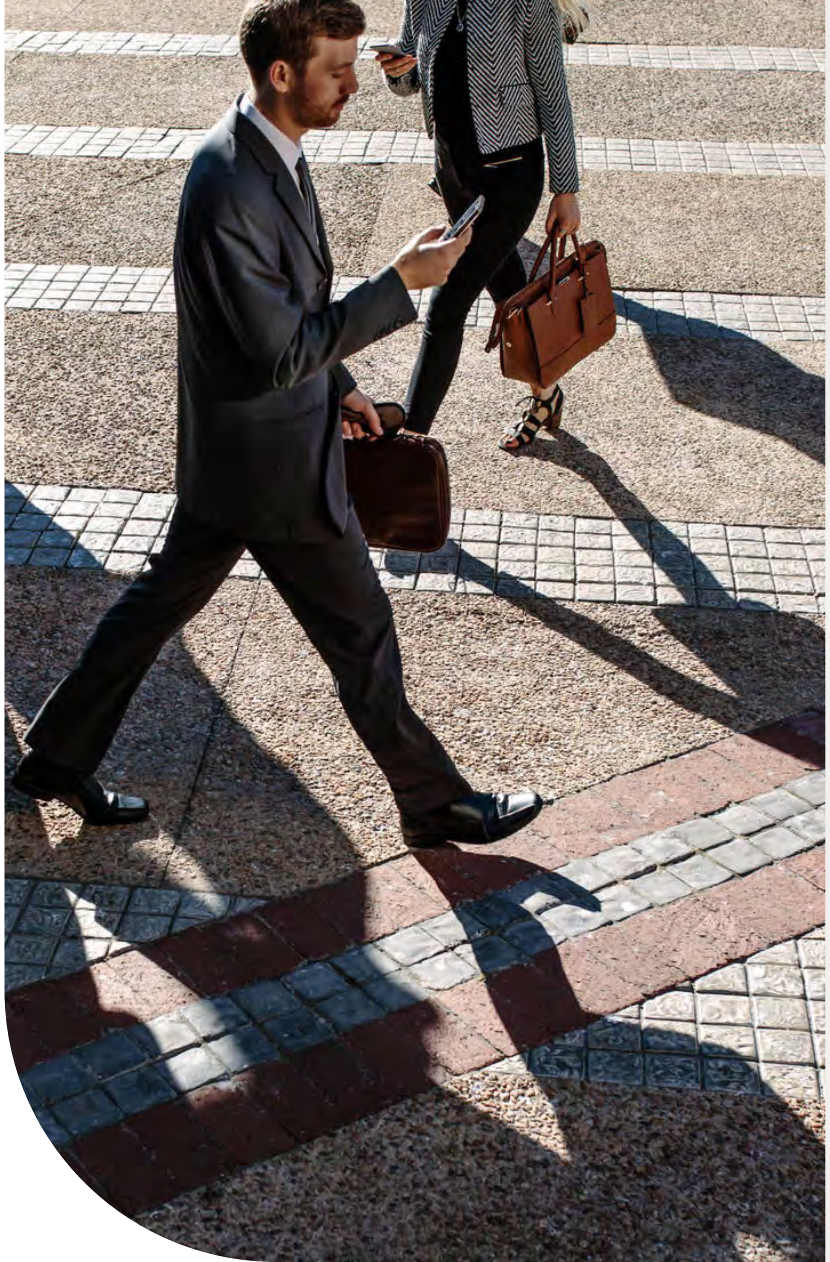
5 Fair, balanced and understandable communication with stakeholders

The biggest takeaway from our 2023 Corporate Governance report is that companies need to review their approach to assurance in terms of what is necessary and how it is reported. Though not easy, boards must take the opportunity to step back from increasing regulation to examine their approach and determine if communications are fair, balanced, and understandable.

Make your corporate governance drive results

To develop corporate governance that increases operational efficiency, shareholder returns and cash flow while reducing risk, please get in touch.

Contact us



Methodology

Our Corporate Governance Review has analysed, tracked, and captured best practice and emerging governance trends for over two decades.

We use data from the front end of 252 annual reports from FTSE 350 companies, who must apply the UK Corporate Governance Code 2018. Our analysis excludes investment trusts which follow the AIC Code of Corporate Governance. This data is a distillation of governance best practice.

With thanks to Laura Contaldo, Akanksha Narang, Serdar Akcay, Derick Asante, Erin Causley, and Alex Worters.

GRANTTHORNTON.CO.UK