All-Party Parliamentary Corporate Responsibility Group
To promote debate and understanding of corporate responsibility
in the community, environment, marketplace and workplace.

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Rt Hon Greg Clark MP
Department for Business, Energy & Industrial Strategy
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Corporate Governance Green Paper

Dear Greg,

We are writing to you on behalf of the All-Party Parliamentary Corporate Responsibility Group to offer some suggestions in response to the Government's Green Paper on corporate governance.

We start from the standpoint that the ultimate aim of corporate governance must be to help ensure that companies are run for the benefit of their members, whilst appreciating the importance of engaging with their stakeholders and firmly focussing on long-term wealth creation. The best corporate governance framework will support this objective and be clearly seen to do so, thereby helping to restore public trust in business.

We welcome the Government's Green Paper and trust the Government will focus on supporting sustainable growth by encouraging responsible business practice rather than simply "reigning in excess". Regulation has a part to play in business by providing a level-playing field of minimal standards, but too prescriptive an approach to corporate governance can result in a box-ticking approach that is less effective in practice than an approach which gives companies room to develop their own structures and policies for achieving agreed ends. As much as punishing the bad, the Government's role needs to increasingly encourage and, importantly, recognise and share the good.

We should not lose sight of the fact that UK corporate governance is rightly highly respected worldwide and any reforms introduced should build on this success, rather than seeking to sweep away much of what has been gained in recent decades. We believe the "comply or explain" approach is worth preserving with the caveat that proper explanations, which can be scrutinised and considered by all stakeholders, should be required of companies pursuing alternatives approaches. This should not, in itself, discourage responsible, alternative approaches and it is in companies' best interests to offer reasonable explanations and seek thereby to secure the support of their stakeholders.

We believe certain improvements to UK corporate governance are now justified, but any decisions taken by the Government must bear in mind the ultimate need to support a long term approach to wealth creation. All decisions taken on contentious issues such as executive remuneration should be linked to an assessment of long-term corporate success.

We believe a 21st century UK corporate governance framework now requires: steps to encourage greater transparency and accountability in order to enhance public trust in business and improve business decision-making; clarification of company directors responsibilities as set out in Section 172 of the Companies Act 2006; clarification of the duties of investment intermediaries; and efforts to improve the alignment of the Stewardship Code with Government best practice guidance and other international frameworks, such as the UN Principles of Responsible Investment.

As a first step, we believe the Government should encourage all large listed companies (with more than 500 employees) to set up a Stakeholder Advisory Panel (SAP), on a "comply or explain" basis. The SAP's remit would be to provide constructive challenge to the Board as a "critical friend" with a shared interest in the long-term success of the company. The SAP should be seen as a resource to support company executives and Boards rather than as a threat to the decision-making of the executive team. Companies would be free to appoint the members of the SAP so long as all key stakeholder are represented on it, including employees, investors, suppliers, customers and representatives of the local community in which the firm is based. However, where companies do not have an employee representative on the Board of directors, we believe at least one third of the membership of the SAP should consist of employee representatives given their very direct interest in the long-term success of the business; shareholders might represent another third; with suppliers, customers and community representatives making up the final third of SAP membership. SAPs should be sufficiently resourced so as to be able to challenge the strategy and performance of the business and provided with as full information about the company as possible subject to commercial confidentiality. To ensure that company directors and executives take SAPs' views seriously, rather than simply paying lip-service to consultation and accountability, SAPs should be able to publish an annual statement in their company's annual report in which they set out their own assessment of the company's performance over the last year in terms of creating long-term value for all stakeholders. SAPs should meet the senior executives (CEO & CFO) at least once a or twice a year, but might meet more regularly (quarterly/monthly) with either all the non-executive directors (NEDs) or the NED with responsibility for stakeholder engagement.
We believe the creation of SAPs would significantly improve decision making in companies by ensuring that all stakeholders can contribute information and advice. SAPs would also support employee engagement, with associated improvements in staff recruitment, retention and productivity; and contribute helpfully to restoring public trust in business. They would also give investors regular opportunities to provide feedback to companies as strategies are developed, which could mean less reliance on the "nuclear" option of negative votes at AGMs or indeed the withdrawal of capital.

We hope the Government will support this view of the role of SAPs, not least because it gives the Government an effective means of demonstrating that it really does champion the interests of employees and consumers in a balanced approach to business. We hope the SAP proposal will also be welcomed by all responsible businesses. In particular it may be welcome to those companies which are reluctant to include employee representatives on their Board.

Just as we would prefer the Government to encourage large companies to establish SAPs, as a more flexible alternative to requiring companies to have employee representatives on corporate Boards, we would prefer the Government to establish targets for diversity on boards – including women and ethnic minority representatives – rather that impose mandatory requirements. We also believe, however, that companies should be required to report on this issue in the annual report and explain why, if their Board membership does not meet the targets set by Government, and what, if anything, they are doing to rectify this for example, through their recruitment and talent management policies.

We also believe the Government could helpfully clarify and amplify the responsibilities of company directors as set out in Section 172 of the Companies Act 2007 so that directors are in no doubt that they are to act in the long-term interests of all stakeholders. We believe it would be helpful in this regard if Boards were required to report on how they have interpreted and discharged these responsibilities each year in the annual report. Increasing reporting requirements may be resisted in some quarters but it would give companies leading best practice an opportunity to demonstrate responsible leadership, eliciting investors' support, public trust and thereby encouraging other companies to follow suit.

Similarly, although the Law Commission has produced excellent guidance on the fiduciary duties of investment intermediaries, this certainly needs to be promoted more widely to ensure that investment intermediaries fully engage with the principle that they should take environmental, social and governance issues firmly into account when making decisions about long term returns. We believe such behaviour would be encouraged by requiring disclosure of institutional investors' voting records at AGMs and the extent to which they have made use of proxy voting.

We support the view that large, listed companies should be required to report on gender pay ratios. We also believe it is right that large, listed companies should be similarly required to report on the ratio of their Chief Executive's pay to median earnings of employees within the same firm. Remuneration Committees are already required to take into account both the CEO's contribution to the long-term success of the company and to have regard to the pay of other employees in the company. However the extent to which other employees' pay is actually taken into account by Remuneration Committees when setting CEO remuneration is not at all obvious to the public. Excessive executive remuneration is widely reported in the media and has certainly contributed to lower levels of public trust in business. While a handful of companies pay exceptional rewards to their CEOs and may be regarded as "outliers", the evidence shows that the ratio of CEO earnings to average earnings has become vastly wider in recent decades at a time when corporate performance in the UK does not justify it. This is a matter for concern and as action to date has clearly not successfully ensured that pay is clearly related to corporate performance and better returns for all stakeholders, we believe additional measures are justified. Being required to report pay ratios – of the CEO: median earnings of employees within the same firm - will improve transparency. We hope it will also encourage all Remuneration Committees and Boards to focus on talent and reward more broadly within their company so that all employees believe that they are benefiting from the corporate success to which they contribute, resulting in a more engaged and more productive workforce.

Support for executive remuneration as set out in clear pay policies is also likely to be forthcoming if the company has demonstrated that such remuneration is aligned with the interests of all stakeholders, not least by securing the support of its SAP. In the event of an adverse vote at the AGM (which could be less than 50%) on a company's pay policies we would suggest these should be immediately referred back to the Board and SAP to develop an acceptable compromise, which should be put to shareholders for approval as soon as possible. The current pay policies would continue to apply until such time as shareholder approval is secured.

We also strongly support the view that senior executives' total remuneration should be much more simply and clearly defined so that executives, investors and other stakeholders are in no doubt that pay and long-term performance are well aligned. We do not support external, arbitrary maximum salary caps, but we would, as a minimum, support requiring corporate pay policies for senior executives to state explicitly a maximum intended level of total annual remuneration and a multiple of performance to basic pay (excluding elements of pay related to the company's share price), based on stretching performance targets.

We do believe that improving corporate transparency and accountability will help to sustain a healthy corporate culture within our businesses, with attendant benefits in terms of corporate reputation and wealth creation. In order to ensure that corporate reporting is robust and can be relied upon, we support the view that the Financial Reporting Council should have the powers to secure information in order to enable it to test effectively the quality of governance information and, in particular, the explanations for companies' non-compliance with the UK Corporate Governance Code.

We would ask the Government to consider actively discouraging quarterly reporting by companies because we feel this contributes to an excessive focus on short-term metrics by both senior executives and some investors. Responsible businesses should be focussing on sustainable wealth creation and everything that is required to achieve this, not quarterly results.

As regards private companies, we believe the Government could play a valuable role in persuading large private companies that their best interests lie in responsible business practice and they can demonstrate that by adhering as closely as possible to the standards expected of large, listed companies.

In reality some of the best examples of responsible business practice, stakeholder engagement and use of long term capital are to be found with private companies. Many of these businesses simply adopt such practices because they make long term economic sense. We do feel that there could be great benefit if the Government were to identify such practices and share them more widely. Furthermore, smaller private companies do not have the funds to invest in developing responsible business practices outside those which they do instinctively. In such cases the Government should have a greater role in encouraging larger companies to mentor or give guidance to smaller companies.

Given the significant changes likely to be initiated by Brexit, including the need for the UK to establish new trading relationships with dozens of countries, we hope that governance initiatives will include retaining and developing the high standards that are expected of British companies when it comes to such issues as upholding human rights and fighting bribery and corruption. This would be relevant for the companies themselves and their supply chains.

Yours ever,

Sally Greengross　　　　Jonathan Djanogly

Baroness Greengross　　　　Jonathan Djanogly MP