

Department for Business, Energy and Industrial Strategy Committee issues report on Corporate Governance



On Wednesday, 5 April 2017, the Department for Business, Energy and Industrial Strategy Committee issued a report as output to its Inquiry on Corporate Governance launched on 16 September 2016.

Background and context

On 5 April 2017, the Department for Business, Energy and Industrial Strategy ('BEIS') Committee ('the committee') published its report ('report') setting out the results of its inquiry into a wide range of corporate governance related matters. The report can be found at the link below.

<https://www.publications.parliament.uk/pa/cm201617/cmselect/cmbeis/702/702.pdf>

Since the committee commenced its inquiry, the Government has consulted on similar areas through the BEIS Green paper on corporate governance and executive pay.

The committee received written evidence from 170 individuals and organisations and sought oral evidence from a cross-section of those respondents.

The Report represents a comprehensive and balanced analysis of the responses for reform. Recognising that the UK's strong but flexible corporate governance regime makes it an attractive place to invest and do business, the Committee is not suggesting that company law be reframed (which might introduce uncertainty into UK markets) but that many of the changes be introduced through the UK Corporate Governance Code ('code'). As such, the Report provides a set of recommendations that, in their totality are significant, even radical, while going with the grain of UK corporate governance practice.

The Committee is also recommending a more robust enforcement regime, giving the Financial Reporting Council ('FRC') additional powers and suggests re-establishing the FRC to reflect its expanded remit.

The Report looks at the evidence for reform and makes recommendations in the following areas:

- Directors' duties and enforcement.
- Investor and company engagement.
- Transparency and the role of advisors.
- Private companies.
- Executive pay.
- Composition of Boards.

Details of the analysis set out in the Report, and the Committee's recommendations, are set out below, together with PwC commentary.

What happens next?

The consultation on the BEIS Green Paper ended on 17 February 2017. We expect the Report to be influential in the outcome from the Green Paper, given the cross-party consensus of its authors. It is anticipated that the Government response to the consultation will be published in Summer 2017, with responsibility for implementation of a number of reforms transferred to the FRC. Any proposed legislative reforms will be included in a White Paper (together with the relevant impact assessment and possibly draft legislation).

Summary of recommendations

Directors' duties and reporting

- Improved reporting on how companies have met their s172 obligations, setting out how they have had regard to different stakeholder groups and to the consequences of their decisions for the long term.
- FRC to traffic light companies by reference to quality of their governance and to have broader enforcement powers against companies and directors.

Investor and company engagement

- Enhanced role for The Investor Forum in routine dialogue.
- Stakeholder panels encouraged, and boards to be required to report on how they are engaging with stakeholder groups.
- Stewardship Code to be clearer on what constitutes good stewardship, to require disclosure of voting records, and to call out poor performance of stewardship on an annual basis.

Transparency and role of advisors

- Government to consult on enhanced disclosure of information about advisers on transactions above a threshold size.

Non-executive directors

- Code to outline best practice in professional support and training for directors.
- Clear identification where directors have specific responsibilities, including how they will be held accountable for those.
- Non-executives to demonstrate they can devote sufficient time to the role, particularly when acting on a number of companies' boards.

Private companies

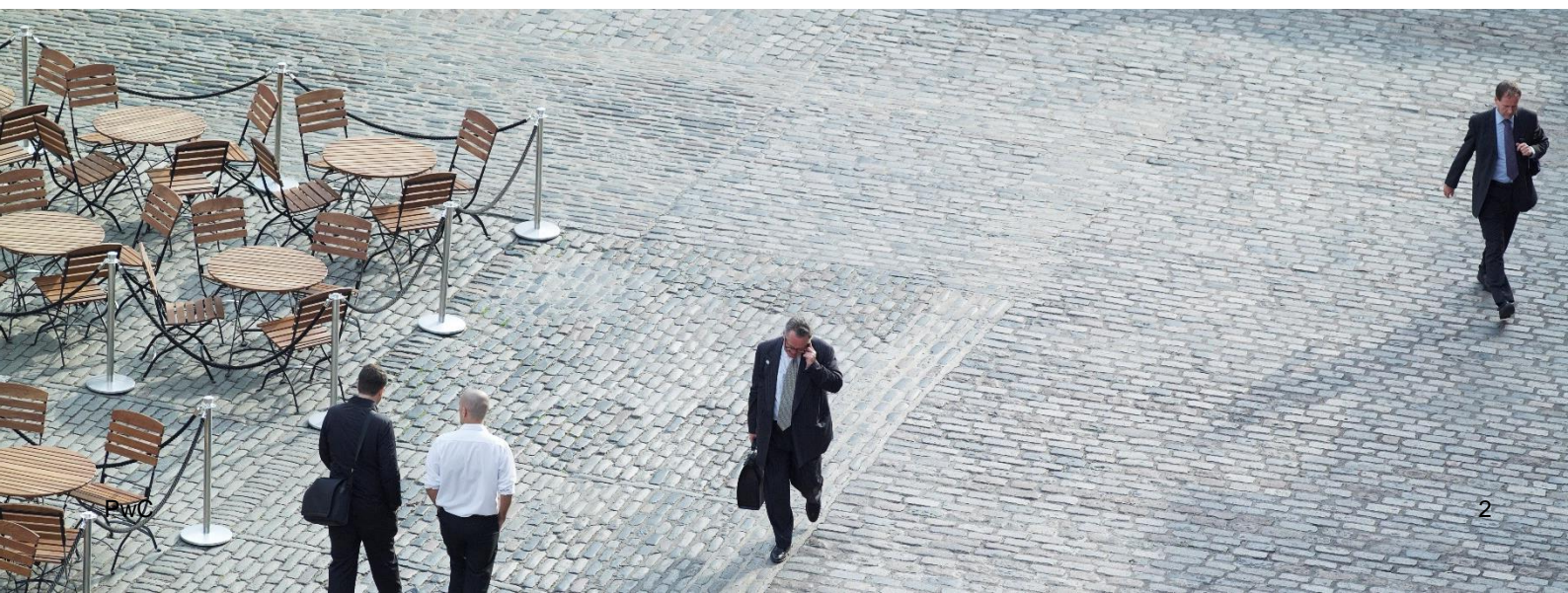
- FRC to develop a voluntary corporate governance code for large private companies.

Pay

- FRC to review Code to encourage replacement of LTIPs with simpler deferred stock plans.
- Code to include a requirement for a binding vote the following year when a company receives more than 25% vote against the remuneration report.
- Employee representatives on remuneration committees should be encouraged.
- Remuneration committee chairs should have served as a member of the committee for at least a year before taking on the role.
- Companies to report on their overall people and pay policy.
- Pay ratios between CEO and senior executive and CEO and median employee to be disclosed.

Composition of boards

- Half of new senior executive appointments in FTSE 350 companies to be women from May 2020.
- Legislate to publish information about the workforce including by ethnicity and pay band.
- FRC to develop improved guidance on cognitive diversity.
- Annual report to include information on board diversity and approach to enhancing diversity.
- New board appointments to be made through open advertising and external search.



Promoting good corporate governance

Directors' duties and reporting

Section 172 of the Companies Act 2006 requires directors to have regard to the interests of certain stakeholders, while promoting the success of the company for its members as a whole. The Report notes that, whilst section 172 strikes a fine balance between the interests of shareholders and stakeholders and is generally thought to be fit for purpose and understood, there are doubts as to the extent to which it is enforceable.

The Report also acknowledges that, while now is not the time to be updating the law in this area, the promised guidance on how section 172 should be complied with was never published and the focus now should therefore be on ensuring that directors are demonstrably taking their duties seriously. The Report suggests that this can be achieved by requiring more specific and accurate reporting around how directors have exercised their duties, supported by robust enforcement.

Recognising the risk, in imposing more reporting, of boiler plate statements, the Report suggests that the Code should be updated to require Directors to report in an 'accessible, narrative and bespoke form' on how they have complied with their duties under section 172, citing the Modern Slavery Act Statement as good model to follow.

Rather than adding to the disclosures contained in Annual Reports, the Committee encourages the use of digital communication, throughout the year, and suggests that the FRC be empowered to push back on the use of boiler plate statements (see Enforcement and a stronger enforcement body below).

Committee recommendation

'We recommend that the FRC amends the Code to require informative narrative reporting on the fulfilment of section 172 duties. Boards must be required to explain precisely how they have considered each of the different stakeholder interests, including employees, customers and suppliers and how this has been reflected in financial decisions. They should also explain how they have pursued the objectives of the company and had regard to the consequences of their decisions for the long term, however they choose to define this. Where there have been failures to have due regard to any one of these interests, these should be addressed directly and explained.'

PwC view: As stated in our response to the Committee, we agree that there needs to be more emphasis on the existence and the practical application of section 172. It is right that boards place greater focus on seeking input from stakeholders in a systematic way, and build this into reporting on how they meet their responsibilities under section 172. This will increase board focus on this important area and we welcome the flexible approach adopted by the committee.

To encourage that meaningful reporting and to enable the key messages to reach key readers, we strongly support a push for digitalisation; an approach we have taken ourselves. Companies are devoting a growing amount of energy in communicating with a wide range of stakeholders online and via social media and are quickly aware of any social criticism of their behaviour. This is having a significant impact on their accountability and is a trend that is likely to continue.

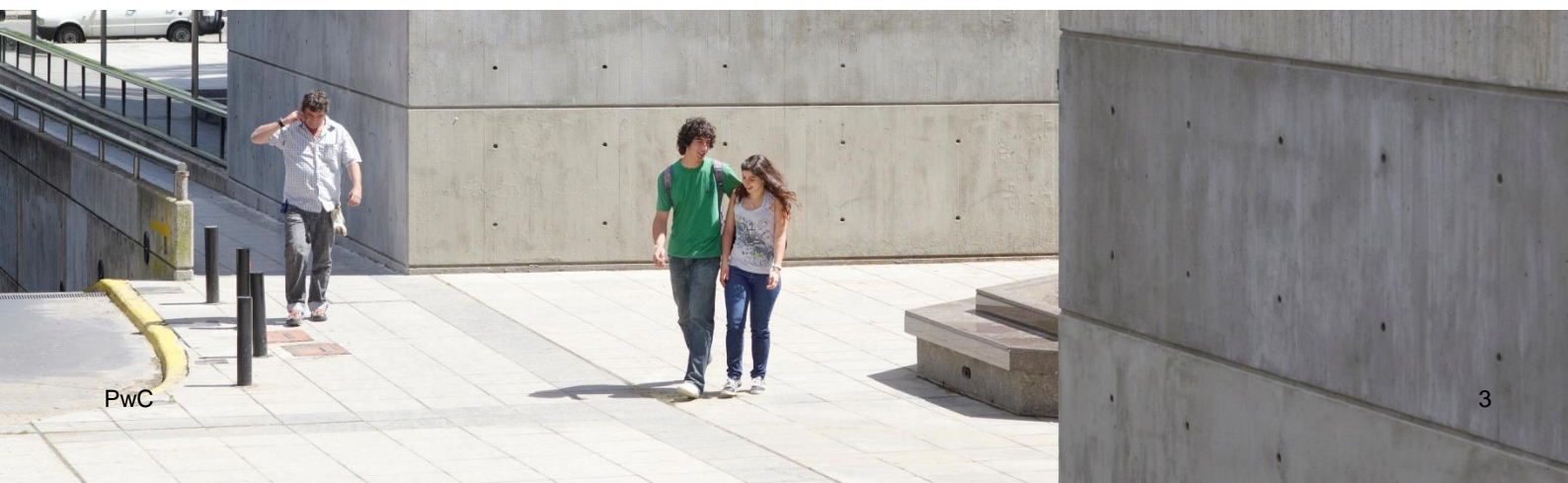
Enforcement and a stronger enforcement body

The Report states that the proposed reforms have two aims: encouraging best practice and transparency; and the enabling action to be taken where standards are not met.

At present the FRC's remit and power only extends to monitoring strategic reports and financial statements and they can only take action against accountants, auditors or actuaries. The Report suggests that the FRC's powers therefore be extended to enable them to pursue breaches of section 172 by any director.

Those additional powers would follow an escalation approach, starting with the power for the FRC to engage and hold directors to account; Where that engagement is not successful, the FRC would be able to report publicly to shareholders on the failings of the board, or individual directors, and then pursue legal action if there was still a lack of satisfactory engagement. The Report also suggests that the Secretary of State should be more willing to exercise its existing investigatory powers where there are concerns of misconduct within companies.

The Committee has considered the Institute of Directors' ranking of FTSE 100 companies according to a set of corporate governance metrics, and the Report indicates a desire to make that a more formal exercise, using a simple traffic light system, for the FTSE350. The Report suggests those metrics should be developed with the involvement of a regulator as well as business organisations.



Committee recommendations

'We recommend that the Financial Reporting Council works with business organisations to develop appropriate metrics to inform an annual rating exercise. This should publicise examples of good and bad practice in an easy to digest red, yellow and green assessment. Companies must be obliged to include reference to this rating in their annual reports.'

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

PwC view: Extending the FRC's powers is more practical than making legislative changes or establishing a new regulator. This will enable a proportionate, market led approach, with regulators, shareholders and directors working together.

We would suggest caution with introducing additional metrics. Many institutional shareholders have their own metrics. Introducing more may further embed the risk of a 'tick box' approach to governance, rather than indicating quality of underlying governance, and may conflict with the 'comply or explain' principle otherwise supported in the Report. The Report has recommended many additional powers for the FRC, which may need to be prioritised and adopted on a phased basis

Investor and company engagement

The Report notes the importance of engagement with investors and its role in improving corporate governance. However, from the evidence reviewed by the Committee, it was clear that the current quality of shareholder engagement is mixed.

The increasingly dispersed nature of share ownership has made investor engagement more challenging and the Report notes the work of the Investor Forum in supporting co-ordinated engagement between investors and companies.

The Report also acknowledges the value of less formal engagement, including allocating responsibility for shareholder engagement to one director, or greater use of digital engagement via online forums.

Committee recommendation

'We recommend that the Investor Forum seeks to become a more pro-active facilitator of a dialogue between boards and investors by engaging in regular routine dialogue in order to pick up on any widespread concerns, for example those identified by the new FRC rating system.'

PwC view: We support the use of the Investor Forum to provide a co-ordinated approach to investor engagement. It is an effective way of encouraging collective action in the otherwise fragmented shareholder base. However, the Investor Forum is still in its infancy (and only handled seven collective engagements last year).

Stakeholder advisory panel

When considering stakeholder engagement from the perspective of companies, one option suggested by the Report is a Stakeholder Advisory Panel, to be consulted by directors during the development of policies. The Report suggests that if handled properly this would not undermine the unitary board structure.

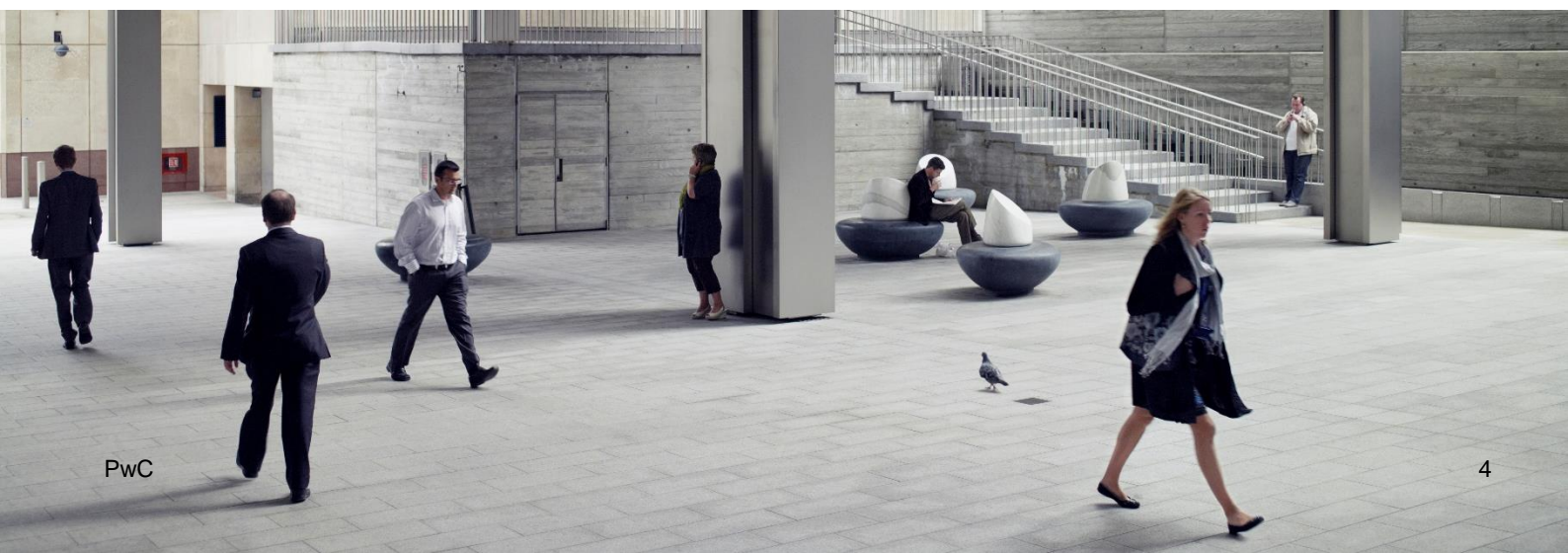
The Report notes the importance of placing equal responsibility on investors, stating that whilst the Stewardship Code has led to greater transparency around the performance of institutional investors, further action and 'sharpening up' is required.

Voting records

On a similar theme to the Stakeholder Advisory panel, the Committee heard evidence that disclosure of voting records by fund managers, which is best practice under the Stewardship Code, was not always complied with.

Committee recommendations

'Stakeholder advisory panels can be a useful forum in which meaningful collaboration, consultation and dialogue with all stakeholders can take place. We urge companies to consider establishing such bodies. We recommend that the Code should be revised to require a section in annual reports detailing how companies are conducting engagement with stakeholders.'



Committee recommendations (cont.)

'We recommend that the FRC reviews its Stewardship Code with a view to providing: more explicit guidelines on what high quality engagement would entail; a greater level of detail in terms of requirements; and an undertaking to call out poor performance on an annual basis.'

'We recommend that the FRC includes in its revised Stewardship Code stronger provisions to require the disclosure of voting records by asset managers and undertakes to name those that subsequently do not vote.'

PwC view: We note the Committee's endorsement of Stakeholder Panels but welcome the acknowledgement that other models are available. In our experience, stakeholder engagement practice varies across different sectors, countries and type of company, which is why maintaining flexibility for businesses to engage with stakeholders in a way that is appropriate for them is, in our opinion, critical.

It is helpful to place equal emphasis on companies and investors around engagement, and give more impact to the Stewardship Code which, up until now, has been largely a desk-top exercise.

Transparency and the role of advisors

There were mixed views in the responses to the Committee regarding whether greater transparency was necessary in respect of companies' advisors. While it is recognised that it is the responsibility of professional bodies to monitor and enforce professional standards in their respective fields, transparency is regarded as essential in improving public trust.

Committee recommendation

'We recommend that the Government consults upon new requirements on listed and large private companies to provide full information on advisors engaged in transactions above a reasonable threshold, including on the amount and basis of payments and on their method of engagement.'

PwC view: It will be important to ensure that any approach is helpful and does not hinder the seeking and giving of independent advice. There must also be no confusion that the Board remain accountable for its decision making.

Non Executive Directors

The Report notes that while there is no legal distinction between executive and non-executive directors, in practice the roles do vary. In particular non-executive directors must be willing and able to challenge management and executive directors, supported by the right culture within the boardroom, driven by the chair.

The Report concludes that a change in the law is not required at this point, instead suggesting that all directors, but particularly non-executives, are provided with appropriate training to support them in their roles and that the effectiveness of non-executives, in particular, be assessed each year as part of the board evaluation process.

Committee recommendations

'We recommend that the FRC includes best practice guidance on professional support for non-executive directors when it updates the Code and that companies include training of board members as part of reporting on their people or human resources policy.'

'We recommend that the FRC updates the Code to provide guidance on how companies should identify clearly and transparently the roles of non-executive directors where they have particular responsibilities and how they should be held to account for their performance. We further recommend that NEDs should be required to demonstrate more convincingly that they are able to devote sufficient time to each company when they serve on multiple boards.'

PwC view: Our response to the Committee noted that the role non-executives play in fulfilling their duties does often differ in practice from the role of executives. In our experience, this does not undermine the concept of the unitary board (which we believe must be maintained), but instead enhances the diversity of debate and challenge within the boardroom. Encouraging appropriate training and support for non-executive directors makes sense.



Private companies

The Report notes that, whilst the legal duties of directors are the same, irrespective of company type, private companies are subject to minimal reporting requirements, which has led to a lack of transparency around how private company boards operate.

The Committee also acknowledges that due to the lack of separation of ownership and control, private companies do not need to be subject to the same requirements as listed companies. However, given the significant presence in the community, and large employee base that some private companies have, the Report has recommended that a Corporate Governance Code be introduced for the 100 or so private companies with more than 2,000 employees.

The Report is clear that the Code would be voluntary, follow a comply or explain approach and should be light touch in terms of content, focussing on revenues, compliance with section 172, company structure, executive pay, numbers of employees and pension scheme contributions. In addition the Report suggests that reporting against the Code could be done via website disclosures rather than annual reports.

Finally the Committee has acknowledged that in the absence of 'independent' owners to hold directors to account, a new regulatory body would need to be established to monitor (using a risk-based approach) compliance with the code.

Committee recommendation

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

PwC view: Developing a voluntary code that is fit for purpose for private companies can be welcomed, although it must be done in a way that is proportionate and does not act as an impediment to investment in a crucial sector for the UK economy. Having one code that suits all private companies, with input from the IoD, Institute for Family Business and private equity/venture capital is going to present practical difficulties and the resultant framework must reflect the diversity of that community.

We note and welcome, therefore, the proposed voluntary approach (before any move to a mandatory regime) to the code for private companies, as well as the suggestion that the disclosures relating to the Code feature on a website rather than the annual report.

Pay

Addressing pay concerns

The Report concludes that the evidence suggests that high and unwarranted executive pay needs to be addressed for the benefit of society as a whole. It observes that an environment in which levels of pay for those at the top increase at a rate that vastly exceeds increases for ordinary employees is inconsistent with the Prime Minister's vision of an economy working for everyone.

The Committee suggests that effective corporate governance is a better means of tackling excessive pay than Government intervention and recommends reform to:

- The structure of executive pay.
- The process by which it is agreed.
- Pay reporting.

Structure

The Committee's evidence indicates that incentive-based pay forms a higher proportion of executive pay in the UK than in most other European countries (but acknowledges that the proportion of incentive-based pay in the US is higher).

The Committee supports the view that there should be a move towards a simpler construct (with a heavier reliance on basic pay) but believes that genuinely stretching bonuses that incentivise performance, rather than rewarding routine achievement, have a part to play.



The evidence provided to the Committee supported the view that long-term incentive plans ('LTIPs') have added complexity and unpredictability to pay determination and may have contributed to the escalation in executive pay quantum. Respondents reflected on the prevalence of LTIPs and the sense that there was a FTSE model that had to be followed.

The Report concludes that LTIPs should be phased out as soon as possible, with no new LTIPs agreed from the start of 2018 and no existing arrangements renewed. The Committee expresses a preference for restricted stock awards, vesting over a period of at least five years with a restriction on sale over the vesting period.

Committee recommendations:

'We recommend that companies make it their policy to align bonuses with broader corporate responsibilities and company objectives and take steps to ensure that they are genuinely stretching. Policy in this respect would be considered by the FRC in their corporate governance rating system.'

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

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

PwC view: We do not accept the Committee's premise that levels of executive pay in listed companies are completely unjustified or continue to spiral out of control. We do however agree that the disparity in pay levels has contributed to a breakdown in trust that must be resolved. Moreover, pay structures have become overly dependent upon a standard pay-performance model, which can have unintended consequences and contribute to short-termism.

We have been advocating greater flexibility in long-term incentive design for over a decade and support the Committee's recommendation to amend Schedule A to the Code (which sets out best practice in incentive design). However, banning LTIPs is too extreme a response. They can work well in some cases and are prevalent globally. In a number of cases, they will remain appropriate. A strong endorsement for long-term restricted stock plans will helpfully shift the debate in this area, and may help unblock investor differences.

Shareholder engagement on pay

The Report cites relatively high average shareholder support on remuneration reports and pay policies (93% and 94% respectively) since the new regime was introduced in 2013 but suggests that there remains a fundamental misalignment between the views of ordinary shareholders and those of investors (and proxy agents). The Committee refers to signs in the early part of the 2017 AGM season of greater shareholder engagement on pay, but reflects that this will not necessarily, of itself, act as a restraining force.

The Report suggests that the most effective remedy lies in more transparency, better reporting, more employee involvement and tougher enforcement. The Committee states that the current scale of opposition does not, at present, warrant annual binding votes on pay levels, which it believes would potentially add uncertainty and cause distraction. The Committee's preference is for a binding vote on pay awards in the following year for those companies that receive support of less than 75% on the advisory vote in any year.

Committee recommendation

'We recommend that the FRC revises the Code to include a requirement for a binding vote on executive pay awards the following year in the event of there being a vote against such a vote of over 25% of votes cast. This requirement should be included in legislation at the next opportunity.'

PwC view: We welcome the Committee's rejection of annual binding votes; an escalation mechanism is a more proportionate response. However, we consider the 'one strike' approach too extreme and could have the effect of discouraging shareholders from voting negatively, because of the potentially 'nuclear' outcome. It would also give too much influence to voting recommendations from the likes of ISS. Instead a company should be given a year to respond to shareholder feedback and only be thrown into a binding regime, or experience other sanctions, in the event of a second year of low support.



Remuneration committees

The Committee believes that the best way of ensuring that the voice of the workforce is heard in pay discussions is to have employee representation on the remuneration committee and that consultation with workers throughout the organisation is a vital element in improving trust. However, the Committee recognises that this approach may not work for all companies and therefore should not be mandatory.

With regard to the accountability of the remuneration committee, the Report contends that remuneration committee chairs should be responsible for driving discussions aimed at delivering simpler structures and justifiable levels of remuneration. The Report suggests they should have previous experience on that committee before assuming the role of chair. Shareholders should be prepared to hold the chair of the remuneration committee to account if they have not engaged sufficiently to gain support of 75% or more for the remuneration resolutions.

Committee recommendations:

'Employee representation on remuneration committees would represent a powerful signal on company culture and commitment to fair pay. This option should be included in the Code and we expect leading companies to adopt this approach.'

'We recommend that any Chair of a remuneration committee should normally have served on the committee for at least one year previously. To further incentivise strong engagement, we recommend that the Chair of a remuneration committee be expected to resign if their proposals do not receive the backing of 75% of voting shareholders.'

PwC view: We do not believe that employees should sit on remuneration committees as a matter of course, and note that the recommendation would not be mandatory. However, this approach can work well for some companies.

In our view, the recommendation that the remuneration committee chair should have served on the committee for at least one year should not be mandatory but good practice, as there can be circumstances where it is not necessary or appropriate.

We believe that shareholders already have sufficient power to vote against the re-election of the remuneration committee chair and therefore this proposal that the chair should resign in these circumstances is unnecessary and in particular too extreme after only 'one strike'.

Pay reporting

The Report suggests that there could be improvements in reporting to improve comparability and accountability, for example, by presenting statistics in a consistent manner.

Separately, the Committee recommends that companies explain why they are using particular employment models and the steps taken to ensure that all workers are paid reasonably.

Having considered the evidence provided by respondents to the inquiry, the Committee has concluded that, on balance, pay ratios between the CEO and both the executive team and median employee should be published, on the basis that figures are generally readily available. The Committee is recommending that similar statistics should be published by organisations in the public and charitable sectors.

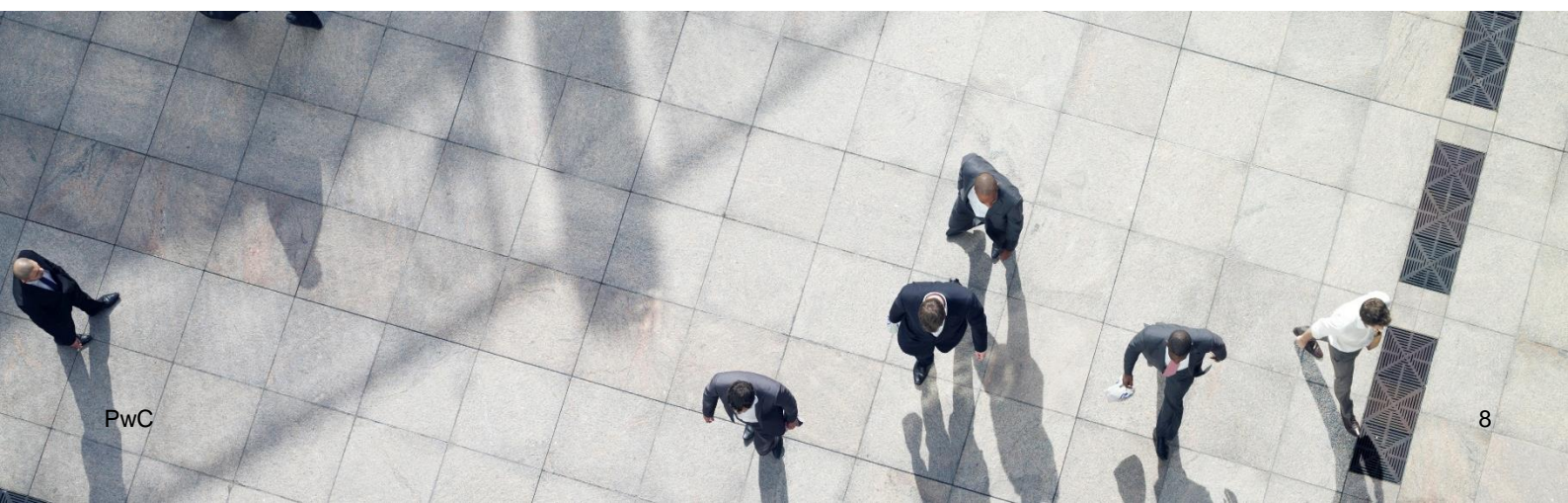
Committee recommendations

'We recommend that companies should set out clearly their people policy including the rationale for the employment model used, their overall approach to investing in and rewarding employees at all levels throughout the company, as well as reporting clearly on remuneration levels on a consistent basis. The FRC should consult with relevant bodies to work up guidance on implementing this recommendation for inclusion in the code.'

'We recommend that the FRC works with other relevant stakeholders on the detail and amends the Code to require the publication of pay ratios between the CEO and both senior executives and all UK employees. We further recommend that the Government requires that equivalent pay ratios should be published by public sector and third sector bodies above a specified size.'

PwC view: We support the proposal to require companies to disclose a people policy, meaning a greater focus on pay and fairness, but believe that a non-prescriptive approach to disclosure requirements generally gives rise to better quality reporting.

We do not support mandatory publication of pay ratios – They are not comparable and their disclosure implies that lower ratios are always better, which is not borne out by the evidence. We note the luke warm endorsement of the Committee and hope an alternative can be found. We believe there are better options, focussed on movement in pay relativities over time.



Composition of boards

Gender diversity

The Report reflects on the continued uniformity of boards and their lack of diversity, in which, unlike other areas of corporate governance, the UK is not a world leader. The Committee emphasises its support for the work of the Hampton-Alexander Review, particularly in respect of its recommendation that listed companies should be required to disclose the gender balance on the Executive Committee and amongst its direct reports.

Committee recommendations:

'We believe that the aims and targets of the Hampton-Alexander Review should go further and, in support of the Equality and Human Rights Commission's objective, we recommend that the Government should set a target that from May 2020 at least half of all new appointments to senior and executive management level positions in the FTSE 350 and all listed companies should be women.'

'Companies should explain in their annual report the reasons why they have failed to meet this target, and what steps they are taking to rectify the gender inequality on their Executive Committees.'

Ethnic diversity

The Committee notes the 'startling' statistics on ethnic diversity in FTSE 100 companies – Only 8% of positions are held by directors of colour and over three quarters of these are non-UK citizens – And that there are compelling arguments for increasing diversity to reflect the diversity of stakeholders.

Committee recommendations

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

'In accordance with the recommendation in the Parker Report, we recommend that the Government should legislate to ensure that all FTSE 100 companies and businesses publish their workforce data, broken down by ethnicity and by pay band.'

Cognitive diversity including social diversity

Evidence provided to the Committee shows that more diverse boards perform better over the long term, as directors with varied cultural backgrounds and life experiences can broaden a company's strategic perspective.

Committee recommendations

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

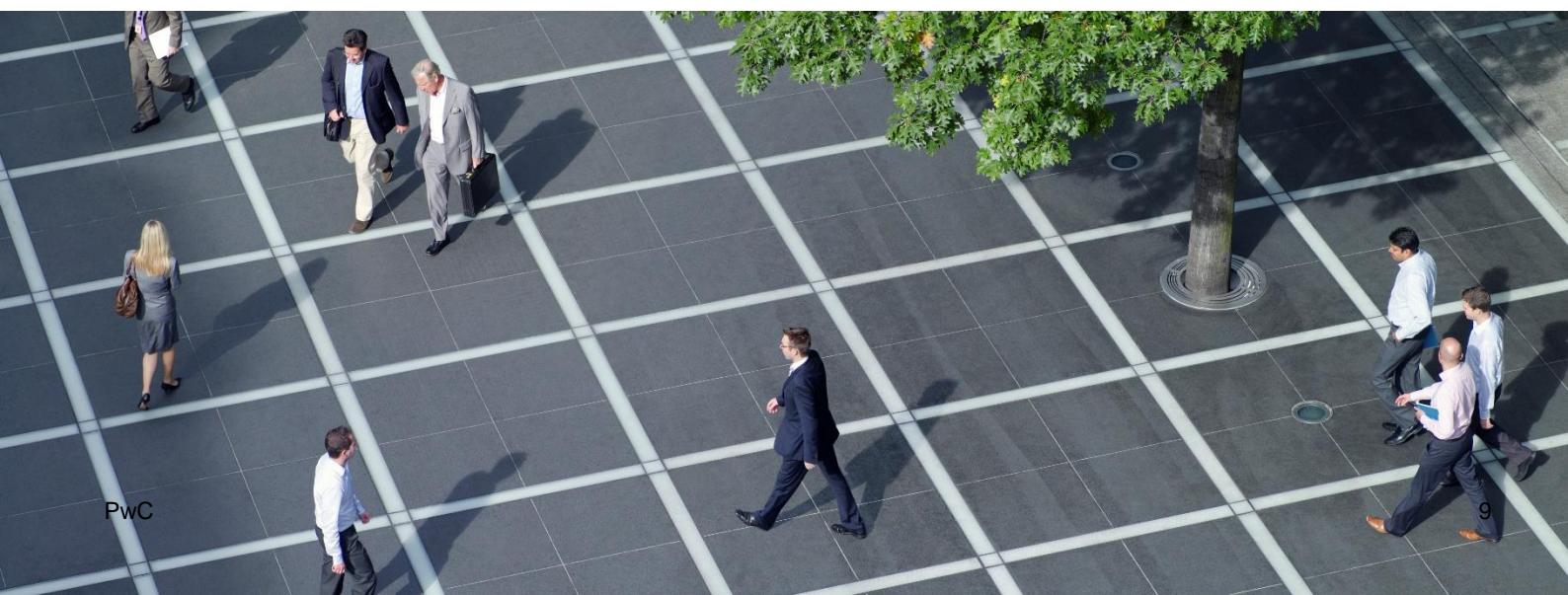
The pipeline of talent

The Report reflects a view that nurturing people within companies can result in a more diverse group reaching the top of the corporate sector who are more likely to be focused on the long-term strength of the business.

Committee recommendations

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

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



Worker representatives on boards

A number of respondents favoured the employee representation on boards but the Committee recognised the limitation of having a token representative rather than an employee selected to be a board director on their own merits.

Committee recommendation

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

Nomination committees and diversity

The Report suggests that there is scope for improvement in the approach of many nomination committees to the search for board candidates. There is also a recommendation that there should be minimum standards and consistency in the approach of external facilitators to board evaluation.

Committee recommendations:

'We recommend that the revised Code states explicitly that the procedure for the appointment of new directors to the board should be by open advertising and by an external search consultancy and detailed explanations should be given if one or both of these requirements is not met.'

'We recommend that the FRC should be given the extra role of overseeing the rigour of the evaluation process to ensure that it is genuinely independent, thorough and consistent across companies. The FRC should highlight best and worst practice among Nomination Committees.'

PwC view: We support the aim to increase gender and ethnic diversity in senior management positions.

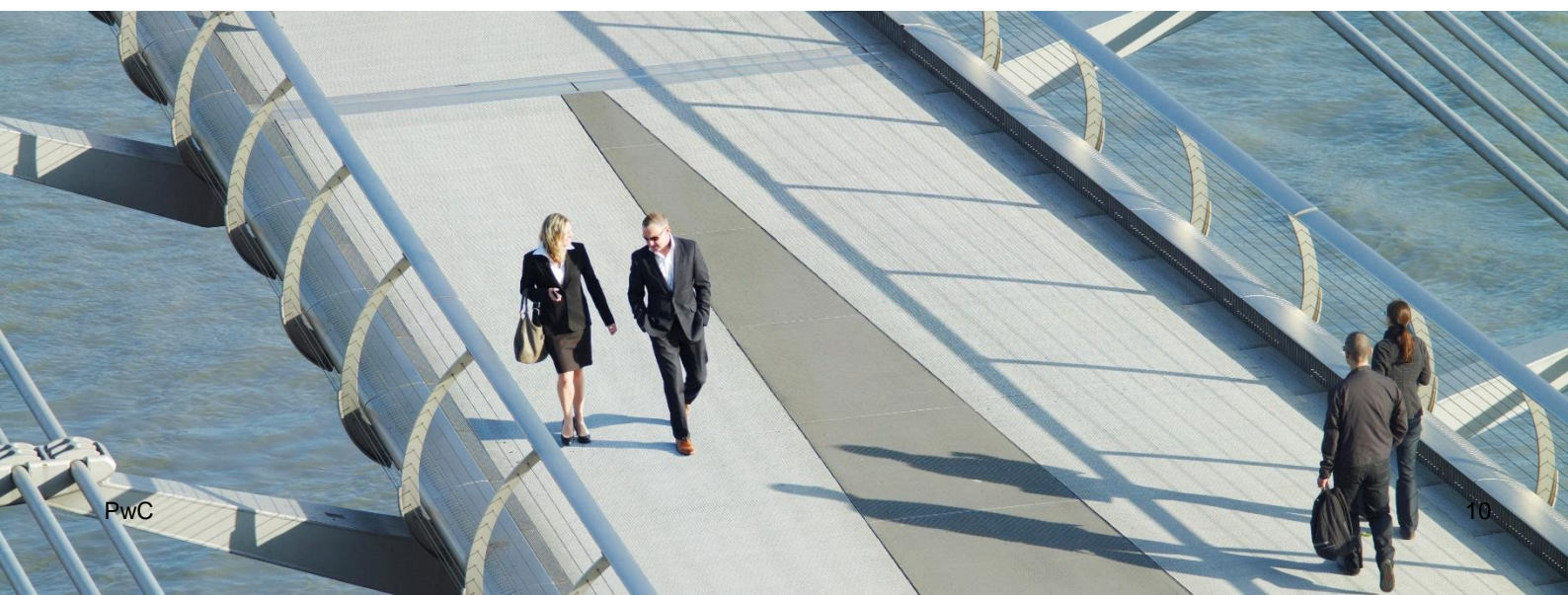
Requiring transparency of current levels of diversity across its various dimensions is a helpful way of forcing board focus and accountability on the issue. It is an approach we have adopted ourselves and have found it to be highly productive.

The Committee is right to identify the pipeline of executive talent as the critical issue to resolving long-term the issue of diversity on boards overall. Improving representation in senior executive positions is also the only way to accelerate progress in closing the gender pay gap.

Given the current position, the target – Of at least half of all new appointments to senior and executive management level positions in the FTSE 350 and all listed companies to be women, by May 2020 – Is likely to prove extremely difficult to achieve, and may be unrealistic, for many firms.

However, we are hopeful that the targets will act as a catalyst for firms to redouble their efforts across a range of areas (including in recruitment, promotions and, importantly, a level playing field for opportunities) to create a sustainable pipeline of diverse talent resulting in significantly greater numbers in senior positions in the years to come.

We do not believe that employee directors should be mandatory, although we accept they can be beneficial in some cases. We therefore support a voluntary approach in this area.



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