This paper is a personal response to the consultation invited by BEIS on the Green Paper on Corporate Governance.

My credentials

I have been involved in the wider debate around corporate governance in the UK since the early 1990s when I worked for a time with the Ashridge Strategic Management Centre and had some involvement with Tomorrow's Company. I had previously worked as head of planning in a FTSE 100 company and have since served on the board of a substantial private equity backed company and chaired the board of a privately owned company with turnover of £100 million. I have chaired the boards of two NHS Trusts which, although in the public sector, in many respects follow the governance model of the private sector and as a consequence may face pressure to respond to any changes to the prevailing governance model the private sector.

Support for IoD/TUC/ICGN/ICSA proposals for reform

Before turning to my own responses to specific questions in the Green Paper, I would like to express my support for the proposals submitted in a letter dated 23rd January to the Prime Minister by the Institute of Directors, the TUC, the ICGN (international Corporate Governance Network) and ICSA representing Company Secretaries. I was consulted on the drafting of this letter and fully endorse the sentiments of the signatories:

"We are united in our recognition of the importance of Section 172 of the Companies Act. This requires directors to promote the success of the company for the benefit of shareholders, and in so doing to have regard for the interests of workers, consumers and other stakeholders. However, there is no effective mechanism for policing this law, which means that if companies, - particularly private companies where there is little or no institutional shareholder oversight do abuse the law, they are not always held to account. This gap in our governance system has allowed the poor practice of some to undermine people's trust and confidence. Filling that gap need not result in undue constraint or costly legal action. In other walks of life, a regulator exists to whom the aggrieved can make complaint and have that complaint adjudicated. Establishing a similar regime for companies would deliver economic benefits, as well as greater fairness, and we note the evidence that those companies which do find ways to incorporate stakeholder views also tend to be more successful in terms of their financial performance.

"These comments are true for all companies, particularly so for large private ones, which make an important economic and social impact, but may lack external shareholder oversight. Over the past twenty-five years, public companies have reformed their governance, incorporating independent voices in board decision making and reporting on their overall performance. We believe that those benefits should also apply for large private companies and welcome the government's intention to address the issue.

"One of the most contentious governance issues is that of executive remuneration. It is not likely that one single measure will remedy the problem. But perhaps what is most important is the government's, in particular, your own voice in demanding that companies, their remuneration committees, advisers and shareholders, recognise the problem, and resolve a better, and perhaps a simpler regime for corporate pay, which can command broad support.

"As bodies representing international investors, professional directors, governance professionals and workers we will each be making more specific responses to your Green Paper. However, as a united voice at a very minimum, we would urge you to: -

- *Create a mechanism which allows those whose interests should supposedly be protected by the law, to make complaint and find an appropriate remedy.*
- *Ensure investors and stakeholders are appropriately involved in the governance of that mechanism.*
- *Strongly encourage, or mandate larger private companies to apply the principles of independence and transparency which have worked for public companies.*
- *Help encourage frameworks for executive pay which are more broadly acceptable, and recognise that it, like other aspects of corporate governance will require a long term focus, from directors, investors, stakeholders and government*."

Responses to specific consultation questions

My responses to the individual questions posed in the Green Paper should be seen as supplementing the core proposals above.

Executive pay

1. Do shareholders need stronger powers to improve their ability to hold companies to account on executive pay and performance? If so, which of the options mentioned in the Green Paper would you support? Are there other options that should be considered?

Please see the response to question 3, below.

2. Does more need to be done to encourage institutional and retail investors to make full use of their existing and any new voting powers on pay? Do you support any of the options mentioned? Are there other ideas that should be considered?

Please see the final part of my response to question 3, below.

3. Do steps need to be taken to improve the effectiveness of remuneration committees, and their advisers, in particular to encourage them to engage more effectively with shareholder and employee views before developing pay policies? Do you support any of the options set out in the Green Paper? Are there any other options you want to suggest?

Remuneration committees have failed over the past thirty years to prevent the top managers of large companies increase the "economic rent" they extract from their employers. Too many remuneration committees have exhibited the "Lake Wobegon effect", (named after Garrison Keillor's fictional town where "all the children are above average") with a race to the top as everyone feels to need to pay executive directors in the top quartile. Greater accountability, or at least threat of challenge from those to whom they are accountable, is needed. Measures worth of consideration include the opportunity for remuneration committees to be dismissed by a vote of shareholders or, in line with final part of the

response to question 7 below, their recommendations should be subject to an employee vote in addition to potential rejection by shareholders. (As remuneration committee member myself, I have always asked whether and how we could justify the salaries of the top management team to front-line staff).

4. Should a new pay ratio reporting requirement be introduced? If so, what form of reporting would be most useful? How can misleading interpretations and inappropriate comparisons (for example, between companies in different sectors) be avoided? Would other measures be more effective? Please give reasons for your answer.

Any requirement to publish ratios should provide sufficient information about the overall distribution of remuneration across the organisation to allow meaningful conclusions to be reached. The limitations of using a single measure such as comparison with the median employee salary are well described in the Green Paper. Headline figures relating to workforce quintiles – for example either the mean or median for each of the five quintiles in an income distribution in a firm – would provide enough information to address the shortcomings of a single ratio.

5. Should the existing, qualified requirements to disclose the performance targets that trigger annual bonus payments be strengthened? How could this be done without compromising commercial confidentiality? Do you support any of the options outlined in the Green Paper? Do you have any other suggestions?

I am not providing a response to this question.

6. How could long-term incentive plans be better aligned with the long-term interests of quoted companies and shareholders? Should holding periods be increased from a minimum of three to a minimum of five years for share options awarded to executives? Please give reasons for your answers.

Longer holding periods are desirable to encourage decision taking by executives that reflect the long term interest of the company.

Strengthening the employee, customer and wider stakeholder voice

7. How can the way in which the interests of employees, customers and wider stakeholders are taken into account at board level in large UK companies be strengthened? Are there any existing examples of good practice that you would like to draw to our attention? Which, if any, of the options (or combination of options) described in the Green Paper would you support? Please explain your reasons.

All three of the options for reform proposed in the Green Paper have substantial drawbacks. They are all unlikely to deliver better outcome than those which would arise from employing executive directors who understand that their duty is to promote the long interest of the company by simultaneously meeting the needs of customers, suppliers, staff and being sensitive to their local communities (who have access through their elected representatives to local and central government institutions whose decisions affect the company).

- Advisory panels are essentially a variant on the supervisory board model that operates in some other European countries but, for example, that offered no protection for VW against its recent scandals. Consultative panels can have merit, but do not necessarily guarantee the

transparency described in the Green Paper and experience of consultative processes in the public sector suggests that they are as likely as not to induce cynicism among stakeholders.

- Appointing individual non-executive directors to champion particular stakeholder groups may be appropriate for some companies. Chairs and appointments committees should in any case endeavour to create a board with expertise among non-executive directors in areas that are important to the company, including understanding of particular stakeholder groups. However, moving to the point that individuals have a specific duty to represent the interests of a particular stakeholder group undermines the unitary board principle that is the bedrock of our current form of corporate governance.

- Appointing representatives of stakeholder groups further conflicts with the unitary board principle. The directors of a company are jointly and severally responsible for the welfare of the company and not for any specific stakeholder group. Furthermore, appointment of stakeholder representatives raises the question of their ability to represent all the various stakeholders in a particular category: for example, employees in a large company are likely to be diverse, spread across many skills, locations, and levels of experience and tenure in the company, with the consequence that their interests may be diverse and on some issues in conflict, limiting the ability of an individual or small group of individuals to represent them all.

There are, however, two measures that would help to address the objective reflected in the question above without undermining the intrinsic merits of the unitary board within the existing UK corporate governance framework:

- The proposal for an ombudsman style of regulator to whom stakeholders can address concerns, as set out in the letter to the Prime Minister on 23rd January, would go some way towards ensuring that stakeholder interests are taken in to account, by providing a means of challenge and potential channel for redress.

- The proposal for employee polls on the appointment of directors that I set out in my letter published by the Financial Times on 3rd November 2016 would further assist in ensuring that boards recognised their wider accountability, without conflicting with the unitary board principle, and would further demonstrate to the public that they should do so:

  "*There is a way for [the Prime Minister] to secure representation of worker interests on boards without appointing worker representatives. Submitting the appointment of directors to a vote of all employees, in the same way that they are subject to the approval of shareholders, would demonstrate an equality between shareholders and employees. In practical terms, it would force chairmen, nomination committees and large shareholders to consider the balance within the board, demonstrate that the slate of directors represent the interests of the company as a whole, and avoid the nomination of directors to whom the label "toxic" could be attached and whose inclusion could result in rejection in the employee ballot."*

8. Which type of company do you think should be the focus for any steps to strengthen the stakeholder voice? Should there be an employee number or other size threshold?

This should apply to all companies and sectors, irrespective of the nature of their form and ownership. Having served on the boards of both larger and smaller companies, I would endorse the 250 employee or £36 million turnover thresholds used for other purposes. Companies of this size and above should have little difficulty complying with most of the reform measures likely to be adopted.

9. How should reform be taken forward? Should a legislative, code-based or voluntary approach be used to drive change? Please explain your reasons, including any evidence on likely costs and benefits.

There is widespread support for the creation of an ombudsman style regulatory organisation, as reflected by the range of signatories to the 23rd January letter to the Prime Minister. Support for employee polls for director appointments has not yet been widely canvassed beyond the letters page of the Financial Times.

There is no prima facie case for any one of these approaches – a legislative, code-based or voluntary – to either of these proposals being more costly than another. The costs required for the establishment of an ombudsman organisation, when spread across UK plc, or for running employee polls should be fairly small.

However, there are differences between the approaches in terms of the prospects for securing change:

- A voluntary approach alone is unlikely to secure traction and would be likely to lead to adoption only by those companies whose corporate governance and consideration of all stakeholders is already exemplary.

- A code-based approach has worked reasonably well for publicly quoted companies in the UK hitherto, but not perfectly. It is unclear whether it would be sufficient to secure widespread adoption let alone compliance by large privately held companies.

- Legislation would be desirable to secure widespread compliance. However, in the absence of legislation, a widely-supported code would at least secure some progress and would have a declaratory power and allow for moral pressure to be applied.

Corporate governance in large, privately-held businesses

10. What is your view of the case for strengthening the corporate governance framework for the UK's largest, privately-held businesses? What do you see as the benefits for doing so? What are the risks to be considered? Are there any existing examples of good practice in privately-held businesses that you would like to draw to our attention?

The case is compelling. Currently legislation provides insufficient protection for minority shareholders and, as illustrated in cases such as BhS, for other stakeholders. Furthermore, failure to apply the same compliance measures to privately held companies in relation to stakeholders as those applied to publicly held companies would place the latter at a competitive disadvantage.

11. If you think that the corporate governance framework should be strengthened for the largest privately-held businesses, which businesses should be in scope? Where should any size threshold be set?

Having served on the boards of both larger and smaller companies, I would endorse the 250 employee or £36 million turnover thresholds used for other purposes. Companies of this size and above should have little difficulty complying with most of the reform measures likely to be adopted.

12. If you think that strengthening is needed how should this be achieved? Should legislation be used or would a voluntary approach be preferable? How could compliance be monitored?

There is no practical reason for not adopting a legislative approach. The misconduct of some high profile private enterprises in the past year illustrates the need for legislation. If companies are to benefit under statute from limited liability, their owners and managers should be prepared to accept the obligations that accompany this.

I anticipate that some commentators may object to the measures proposed on the grounds that they might reduce the international competitiveness of UK companies. This would be a red herring: the requirements are unlikely to be onerous are certainly not on a scale to place UK companies at a commercial disadvantage to those registered in other jurisdictions.

13. Should non-financial reporting requirements in the future be applied on the basis of a size threshold rather than based on the legal form of a business?

Yes. Please see response to Question 11 above.

Other issues

14. Is the current corporate governance framework in the UK providing the right combination of high standards and low burdens? Apart from the issues addressed specifically in this Green Paper can you suggest any other improvements to the framework?

The corporate governance framework in the UK is failing: many companies, both quoted and privately held, fail to comply with Section 172 of the Companies Act 2006. There have been egregious examples that have contributed to the decline in the trust of the public in large companies and to the Prime Minister's call for reform. The merit of Section 172 is that it not only addresses the obligations of the company to all its stakeholders but also directs the attention of directors towards what has for decades been recognised as best management practice in the form of the "balanced scorecard" approach. Far from imposing burdens, it enshrines good practice and should help redress the tendency for top management to manage the company in their own interests, which has been illustrated by the upwards – and almost certainly unmerited – drift in management rewards.

Support for compliance with Section 172 should be at the heart of any corporate governance reform. The proposal from the signatories to the 23rd January letter to the prime minister for a regulator to whom stakeholders could address concerns would both provide a mechanism for addressing concerns of stakeholders who felt their interests were not being taken into account and have enormous symbolic and declaratory influence by directing the attention of directors to their duties under the Act.