



CORE submission to Wates Principles on Corporate Governance for Large Private Companies Consultation.

CORE is the UK civil society coalition on corporate accountability. We aim to advance the protection of human rights with regards to UK companies' global operations by promoting: higher standards of conduct; compliance with the law as part of a more effective regulatory framework; and improved access to remedy for people harmed by UK-linked business activities. We welcome this consultation and the opportunity to submit a response.

1. Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?

The preface to the Wates Principles consultation recognises that large private and public companies present comparable risks to a wide range of stakeholders, such as workers, customers, pensioners, supply chains and the community. However, despite this the Wates Principles are significantly weaker on director obligations towards stakeholders than the new FRC Corporate Governance Code.

Different ownership structures amongst the very largest private companies do not of necessity lead to reduced risks towards – and impacts on – stakeholders. While we recognise that private companies are not a homogenous group and that consequently some provisions in the Corporate Governance Code may not always be appropriate, recent corporate scandals show the need for equally high standards in directors' obligations to stakeholders. The collapse of large private company BHS, for instance, led to the loss of 11,000 jobs and left a £571m pension deficit.¹

The Wates Principles should follow the 2018 Corporate Governance Code in requiring directors to “understand the views of the company's other key stakeholders and describe in the annual report how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making.” All directors share the same legal obligations under section 172, and it is unclear why some directors of large companies should not have to explain how stakeholder interests have been considered. This information will be of interest to all those affected by the operations of the company.

2. Are there any areas in which the Principles need to be more specific?

The guidance for Principle One states that ‘a successful company should be directed by an effective board that develops a strategy and business model to generate sustainable value’. The guidance should clarify what is meant by ‘sustainable value’. At a minimum there should be a recognition that sustainable value must include avoiding negative impacts on human rights and the environment.

While business models can create sustainable value, they can also generate risks to human rights, the environment or stakeholders. For instance, some suppliers can be put under pressure by companies demanding shorter delivery times and making unpredictable orders, potentially leading to labour abuses. The guidance should stress that boards must consider

¹ <https://www.theguardian.com/business/2016/jun/02/bhs-rescue-bid-fails-putting-11000-jobs-at-risk>

how their business models can generate risks and how they can be adjusted accordingly. In this regard it would be appropriate to move paragraph 1 of the guidance under Principle Six² to Principle One. The language should be strengthened to state that companies ‘should’ consider the potential negative impacts of their business model on stakeholders.

The guidance needs to stress that an integral part of generating social value is acting to prevent negative impacts. For this reason, the language in the guidance for Principle One paragraph 3³ should be strengthened. The board should make clear that misconduct is not acceptable and should lead by example. The language used here – ‘discouraging’ – is too weak in this context.

It would also be useful under Principle Four to include a clear reference to the need for boards to not only address risks to the company, but also to understand and manage the risks that the company’s activities can pose to stakeholders and the environment. These have typically been understood as externalities, but this is an outmoded approach. Increasingly, regulation (e.g. s. 54 of the Modern Slavery Act 2015 and the Non-Financial Reporting Directive 2014) places an obligation on businesses to demonstrate how they understand and address these risks.

International human rights agreements, conventions and law place legal and moral obligations on companies, and it is incumbent upon all business to incorporate these responsibilities in their decision-making processes. In seeking to regulate and improve the conduct of large private companies in the UK, the Wates Principles should refer to these international standards. The Wates Principles should refer to the United Nations Guiding Principles on Business and Human Rights (UNGPs) which clearly outline the business responsibility to respect human rights.⁴ In May 2016 the Government re-stated its expectation that businesses comply with the UNGPs.⁵ The UNGPs also serve as a useful guide for businesses on how to manage risks and ensure they generate sustainable value over the long-term.

Finally, Principle Two should make it clear that all-male boards are incompatible with running a 21st century company. As Sir Philip Hampton has said “...we must significantly increase the number of women in senior leadership roles if we are to harness the skills of women for the benefit of business and the UK economy.”⁶

4. Do the Principles give key shareholders sufficient visibility of remuneration structures in order to assess how workforce pay and conditions have been taken account in setting directors’ remuneration?

Principle 5 makes welcome reference to the need for boards to consider their gender pay gap reporting and to take pay and conditions throughout the company into account when designing remuneration structures. The Principle should go further and encourage boards to look at pay policies across the company. Instead of focusing only on executive pay, the Principle should

² ‘Large private companies create their own social, economic and environmental impact, but are also affected by changes to their operating environment. Sustainable business benefits wider society, and large companies have a responsibility to create and sustain long-term value for a variety of stakeholders. This could include consideration of how a company’s activities may impact future stakeholders’

³ ‘A successful company should be directed by an effective board that develops a strategy and business model to generate sustainable value ... This includes discouraging misconduct and unethical practices, and promoting behaviour that balances short-term needs with long-term aspirations.’

⁴ https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

⁵ <https://www.gov.uk/government/publications/bhr-action-plan>

⁶ <https://ftsewomenleaders.com/>

encourage directors to consider how particular decisions and business models effect pay levels amongst those directly and indirectly employed by the company.

There is a trend amongst UK companies towards outsourcing employment, and there are now an estimated 740,000 people working through employment agencies⁷, 450,000 who earn most of their income through personal service companies⁸, and 500,000 people in bogus self-employment in the UK.⁹ Decisions to utilise models of indirect employment can have an impact on pay levels and boards should be expected to consider this impact.

Boards should also justify executive remuneration packages in the context of pay across the company. The new pay ratio reporting requirement under the Companies (Miscellaneous Reporting) Regulations 2018 does not apply to large private companies, but the Wates Principles would be an appropriate place to encourage private companies to make voluntary disclosures. These disclosures could be used as part of the explanation of executive pay levels. Finally, because executive remuneration policies contribute to the overall distribution of resources across the company it is fair that workers take part in making these decisions. Principle Five should encourage boards to at minimum consult with workers on executive pay policies, and not only consider workers' views. The effect of the changes to the guidance suggested above would be to ensure boards look at executive pay in the context of pay practices overall, as envisaged by Principle Five.

Principle Five states that boards should 'promote executive remuneration structures aligned to the sustainable long-term success of a company'. While this is important, it is essential that the guidance makes clear that the Principles are not endorsing the current use of complex long-term incentive plans and share options that set very restricted performance metrics, often encouraging short-term decision making and financial engineering rather than responsible and effective governance. The Principles should encourage the adoption of different performance metrics based on ESG factors, systemic risks and stakeholder satisfaction. This would promote remuneration practices that better align with the long-term sustainable success of the company.

5. Should the draft Principles be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level?

6. Do the Principles enable sufficient visibility of a board's approach to stakeholder engagement?

As argued above, it is our view that large private and public companies present comparable risks to, and can have similar impacts on, stakeholders. The size of the companies likely to be reporting against these principles means that the risks are systemic and impacts significant. There is therefore no good reason the Principles' approach to stakeholder engagement should be different to that of the Corporate Governance Code.

It is welcome that the Principles encourage boards to meaningfully engage with their workforce and to have regard to that discussion when taking decisions. However, the guidance should be more specific on how boards should engage with all their stakeholders and how transparent they should be in respect of taking account of that consultation in decision-making. It is our position that companies should be required to place elected workers on their board. Only this

⁷TUC, Ending the Undercutters' Charter, 2017, <https://www.tuc.org.uk/sites/default/files/EndingtheUndercuttersCharter.pdf>

⁸ <https://www.thetimes.co.uk/article/philip-hammond-eyes-1bn-budget-raid-on-freelancers-9bm6lsjs6>

⁹ <https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/pressreleases/bogus-self-employment-costing-millions-to-workers-and-government/>

would constitute meaningful engagement that brings worker voice into the decision-making process. Having more than one worker on the board would ensure that their voice is not drowned out. This would ideally be used in conjunction with a stakeholder advisory panel.

The Corporate Governance Code recommends that boards use one or a combination of: a direction appointed from the workforce; a formal workforce advisory panel; a designated non-executive director, or an alternative arrangement. Although we do not agree with the flexibility granted in this case, we see no reason the Principles should not at a minimum follow the Code and adopt the same provision.

Although it is welcome that the Principles use the term ‘workforce’ instead of employees, it would be useful for the Principles to refer to other stakeholders as well, including supply-chain workers and local communities. Large private companies domiciled in the UK often have extensive international operations and supply chains, both of which can significantly impact vulnerable groups and communities. To mitigate against negative impacts to these groups, boards should make a thorough assessment of their risks, undertake engagement and consultation and establish early-warning systems. International standards on business and human rights such as the UNGPs provide clear guidance on how companies might manage these risks. As stated above, the Principles should advise that companies observe these standards.

8. The Principles and the guidance are designed to improve corporate governance practice in large private companies. What approach to the monitoring of the application of the Principles and guidance would encourage good practice?

The FRC should carry out an annual assessment of reports issues against the Principles. This would be an opportunity to highlight trends, good practice and areas for improvement. Other stakeholders with an interest in the quality of reporting, such as civil society or unions, should be given means to raise concerns and feed into this assessment.

One lesson learnt from recent reporting requirements is that official monitoring and assessment mechanisms are essential for scrutiny and high levels of compliance. The gender pay gap reporting requirement – that utilises a central registry for reports and is backed by enforcement measures – gathered almost full compliance.¹⁰ Yet three years on from the passage of the Modern Slavery Act – which does not provide for formal monitoring mechanisms – only an estimated two thirds of companies required to report under s.54 have done so.¹¹ Leaving companies to monitor their own responsibilities does not work.

9. Do you think that the correct balance has been struck by the Principles between reporting on corporate governance arrangements for unlisted versus publicly listed companies?

As we have argued elsewhere in this submission, there is no reason director obligations to stakeholders should be any less in large private companies than in publicly listed companies when they pose equally high risks. The recent tranche of corporate governance reforms issued by government do not, by and large, apply to private companies. This makes it even more essential that the Wates Principles require high standards of large private companies.

10. We welcome any commentary on relevant issues not raised in the questions above.

As will be clear from our consultation submission, we are of the view that the conduct of both public and private companies in the UK affects a wide range of stakeholders. As this is the

¹⁰ <https://gender-pay-gap.service.gov.uk/Viewing/search-results>

¹¹ <https://www.modernslaveryregistry.org/>

case, it is essential that business regulations and codes of conduct are drawn up in consultation with those effected. However, we are concerned that the Wates Principles were drafted by a group with very little stakeholder representation. This sends the wrong message and has the potential to delegitimise the Principles in the eyes of non-business groups. We welcome the round table that is being held with the FRC and the CORE Coalition at the end of this month as a step in the right direction, and we hope that the FRC will lead the debate on continued reform of the UK corporate governance framework.

ENDS

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