

Investment Association response to the FRC's consultation on the Wates Corporate Governance Principles for Large Private Companies

The Investment Association (IA) welcomes the opportunity to respond to this consultation on introducing corporate governance principles for large private companies.

The IA was represented by Andrew Ninian (IA Director for Stewardship and Corporate Governance) on the Coalition Group which developed these principles. As the consultation notes, the draft principles are the result of detailed discussion among Coalition Group members who represent a broad range of stakeholder opinion. The IA was pleased to have participated in the Coalition Group and to have contributed learnings from best practice governance for listed companies. The IA supports the draft principles as a fair representation of the Coalition Group's discussions.

The IA is the trade body which represents UK investment managers. The IA's 250 members collectively manage over £6.9 trillion on behalf of clients. As significant investors in UK listed companies, our members have extensive practitioner experience of the UK corporate governance system and its strengths and weaknesses and are keen to continue to contribute this experience to the development of corporate governance principles for large private companies.

Private companies are essential players in the UK economy, contributing to productivity, employing millions of individuals and having a positive impact on wider society and economic growth. The UK needs a business environment that stimulates innovation, attracts talent from around the world and where entrepreneurship is fostered – such a business environment will help create and grow private companies. It is even more important to secure this environment after the UK leaves the European Union. It is essential that both private and public companies operate with high standards of corporate governance to promote their long-term success and the success of the UK economy. However, recent instances of corporate failure and concerns over governance have damaged the public trust in business as a whole.

It is appropriate for the Government to encourage private companies to consider their licence to operate, to build greater trust amongst stakeholders, and to ensure that they are managing risk in line with good corporate governance principles. The directors of private companies have the same duties to promote the success of the company for the benefit of its owners.

Investors have exposure to private companies through private equity and debt placements and many private companies will eventually take the decision to become listed. It is in the interest of investors therefore to ensure high standards of corporate governance in public and private companies.

The Coalition Group has developed strong principles that strike the right balance between setting high expectations for private companies and respecting the variety of different ownership structures among these businesses. There are some areas where IA members think that these principles could be strengthened to reflect the central concern that private companies should be able to explain how their governance mechanisms are appropriate for their ownership structure and promote the long-term success of the company.

- **Long-termism**



In March 2016, the IA published the 'Productivity Action Plan'¹ which sets out how UK productivity can be improved through more long-term investment. The Productivity Action Plan sets out how all actors across the investment chain could focus on creating more long-term investment, with the aim of improving productivity of the UK economy. As long-term investors, our members believe that companies that are sustainable in the long-term will deliver better returns and this long-term focus should be central to a company's purpose. We suggest this long-term approach should be emphasised more in Principle One, in recognition of the link between a company's purpose and its long-term success.

- **Director integrity**

An essential characteristic of any board member, whether of a private or publicly listed company is to act with integrity to promote the long-term interests of the company. The Corporate Governance Code for listed companies focuses on the importance of directors acting with integrity, and we feel that this could be emphasised under Principle Two on board composition.

- **Board renewal**

Another important area for boards of private and public companies to consider is the value of fresh thinking on the board. Private companies have a range of governance structures appropriate to their particular ownership structures and circumstances, so specific provisions on tenure may not be appropriate. However, the longevity of the board as a whole should be considered in terms of balancing the need for corporate memory and commitment to the company with the need for fresh thinking, new skills, and independent challenge. The need for companies to consider the appropriate level of board renewal could be emphasised in the final paragraph for the guidance of Principle Two.

- **Different ownership structures**

There are a wide variety of private companies, differing in size, ownership and legal structures. Principle Three should more explicitly acknowledge that a board's understanding of its corporate governance responsibilities and accountability will reasonably differ because of these differing size, and ownership structures. Both the principles and associated guidance should require the board to outline how the approach to accountability and independent challenge adopted by the company is appropriate given the company's ownership structure and size.

The IA is supportive of the approach taken by these principles on Executive Remuneration and the stakeholder voice in decision making. These are important areas of corporate governance for all companies.

- **Remuneration**

Private company boards must set remuneration structures that are aligned to the sustainable long-term success of a company, taking into consideration the pay and conditions elsewhere in the company. The guidance for Principle Five on Remuneration meets these aims. We would caution against introducing further, potentially more restrictive, directions for private companies on remuneration as it is important that accountability is appropriately aligned with the ownership structure of the company.

¹ The Investment Association, Productivity Action Plan, 2016:
<https://www.theinvestmentassociation.org/investment-industry-information/current-initiatives/productivity-action-plan/>



- **The stakeholder voice in decision making**

If done properly, stakeholder engagement will strengthen the business and promote its long-term success to the benefit of stakeholders, the company and shareholders alike. It is important for both private and public companies to consider how they engage with material stakeholders, how they will take their views into account when making decisions, and, importantly, how any board decisions will impact on these stakeholders. These views should be used to inform the decisions that the company takes, whether about the products or services it provides, or about its strategic direction, its long-term health, and its relationship with its workforce and the society in which it operates. The IA and ICSA has produced guidance, 'The Stakeholder Voice in Board Decision Making'², to help company boards think about how to ensure they understand and weigh up the interests of all of their principal stakeholders when taking strategic decisions. In this guidance we have stressed the importance for companies to consider how they engage with *all* material stakeholders, and not only employees. The guidance for Principle Six on stakeholders suitably reflects this approach.

IA members believe that the credibility of the principles need to be safeguarded by appropriate enforcement mechanisms to ensure that their application is taken seriously. The 'apply and explain' approach proposed should ensure that companies give meaningful testimony on their application of the principles, rather than taking a 'tick-box' approach to compliance.

In the first instance, a thematic review would be an appropriate way to identify best practice and areas where companies' are failing to demonstrate their application. This would inform an assessment of what enforcement mechanisms could be needed and where the principles may need to be strengthened. In addition, the Principles should be reviewed within three years to ensure that they are meeting the needs of companies and other stakeholders.

The IA is committed to the continued development of good governance measures for large private companies and further careful observation to ensure that the principles are having the desired effect. We look forward to continuing to work with the Coalition Group, its Chair, and the FRC on this important work.

² The Investment Association and ICSA: the governance institute – The Stakeholder Voice in Board Decision Making – strengthening the business, promoting long-term success, 2017: <https://www.theinvestmentassociation.org/assets/files/press/2017/2017-09TheStakeholderVoiceinBoardDecisionMaking.pdf>