TUC

Changing the world of work for good

TUC comments on the Wates Corporate Governance Principles for Large Private Companies

September 2018

Introduction

The Trades Union Congress (TUC) exists to make the working world a better place for everyone. We bring together more than 5.6 million working people who make up our 48 member unions. We support unions to grow and thrive, and we stand up for everyone who works for a living.

The TUC has a long record of involvement in corporate governance debate. We recognise that corporate governance has a direct impact on the priorities and decisions of the boardroom, and thus on the lives of our members and all those who work in companies. When companies are thriving, corporate governance and practice influences the company's employment model and the extent to which the workforce shares in the company's success. When companies fail, company workers bear a heavy share of the fallout, losing their jobs and livelihoods – which for some will lead to the loss of homes and health.

There has been an increased focus on corporate governance reform in recent years, driven in part by a number of high profile corporate scandals and failures, including Sports Direct, BHS and more recently Carillion. In all of these cases, which include both private and listed companies, the damaging impact on the company's workforce or former workforce has been at the heart of public and political concern.

Unfortunately, poor corporate practice in relation to the workforce cannot be put down to 'a few bad apples'. Overall, poor employment practices have increased in the UK over the last decade, as illustrated by the increase in employment insecurity, low and stagnating levels of pay and the fragmentation of employment relationships[1]. There are few decades in the past century about which it could be said that employment conditions were, overall, worse by its end than at its beginning. This record blights the reputation of UK employers today and poor workforce practices remain a significant factor in low rates of public trust in business.

This growth in exploitative employment practices has taken place despite strong evidence of the contribution of positive workforce relationships to company success and financial results. For example, a comprehensive study commissioned by the government in 2014 suggests that improvements in workforce wellbeing will result in improved profitability and financial performance, as well as improvements in labour productivity and the quality of outputs or services[2]. Ensuring that short-term financial pressures do not spawn corporate practices that are economically and socially damaging in the long-term should be an important aim of corporate governance.

Reflecting widespread recognition, including from government, that corporate governance must be reformed to give greater emphasis to company stakeholders, the revised

---

[1] See figures in The gig is up, TUC 2017 https://www.tuc.org.uk/research-analysis/reports/gig and Shifting the Risk, TUC, 2018 https://www.tuc.org.uk/research-analysis/reports/shifting-risk

[2] Does Worker Wellbeing affect workplace performance? Alex Bryson, John Forth and Lucy Stokes, NIESR, BIS, October 2014 https://www.gov.uk/government/publications/worker-wellbeing-and-workplace-performance

Corporate Governance Code for listed companies published in July has a significantly increased focus on stakeholders. Principle D says that "the board should ensure effective engagement with, and encourage participation from, [shareholders and stakeholders]", while Principle E says that "the board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success. The workforce should be able to raise any matters of concern". Code Provision 5 says that the annual report should describe how the interests and matters set out in section 172 of the Companies Act have been considered by the board. It also sets out three methods for engagement with the workforce and stipulates that if the board has not used one or a combination of these, it should explain its alternative arrangements and why they are considered effective.

As noted in the consultation document, the impact of companies on their stakeholders is as great for private as for listed companies – yet private companies, regardless of their social and economic footprint, are subject to significantly lighter corporate governance and non-financial reporting requirements than listed companies. The TUC has long argued that non-financial reporting requirements should not differentiate between private and listed companies. While there will be some differences between corporate governance requirements for listed and private companies stemming from their different share ownership structures, these relate to shareholder, rather than to stakeholder, relationships. It is unacceptable for private companies, and particularly large private companies employing thousands of people, to be subject to lighter corporate governance requirements in relation to their relationships with their workforce and other stakeholders than listed companies.

The TUC has valued the opportunity to contribute to the Wates Principles of Corporate Governance for Large Private Companies (henceforth the Wates Principles) through membership of the coalition of organisations that advised on their formulation. We note, however, that the coalition was comprised primarily of organisations that represent private companies in their different forms, and was very short of organisations that could be said to represent stakeholder groups affected by corporate practice. The TUC was pleased to host a roundtable for unions and the FRC to discuss the draft Wates Principles in July. This submission reflects the points raised at the union roundtable and will focus primarily on our belief that the Wates Principles should be comparable to the Corporate Governance Code, in particular in relation to stakeholders and the workforce. This is explored further below.

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

Other than the tiny minority of companies that have no employees, a company's relationship with its workforce will always be highly significant in terms of its impact both on the company and on the workers who make or deliver its products or services:

- The impact of workforce relationships on company performance is highly significant and well-documented by academic research[3].

[3] ibid

- Most workers have only one employer, on whom they depend for their livelihood and therefore their standard of living, including their home, food and other necessities.
- The majority of workers work full-time and spend a large proportion of their working hours in work. The experience of work is therefore a highly significant contributor to wellbeing across society.

The mutual dependency at the heart of the employment relationship and the strength of impact that a company can have over the lives of its workers mean that the workforce merits a greater focus within the Principles.

The TUC believes that the Wates Principles should include a principle that focusses specifically on the workforce and should encompass both the quality of employment relationships and workforce voice. A sensible starting point for this would be the revised Corporate Governance Code for listed companies given, as argued above, there is nothing that distinguishes private from listed companies in terms of their workforce responsibilities and impacts.

As noted in the introduction, the damaging impact of corporate practice on company workers or former workers has been at the heart of the recent corporate governance scandals that have led the government to propose the establishment of corporate governance principles for large private companies. As also noted, poor employment practices are not limited to a small number of cases and have unfortunately become more prevalent across the UK over the last decade[4]. The union roundtable on the Wates Principles discussed the prevalence of companies in sectors ranging from care to construction failing to comply with basic legal requirements, including payment of the national minimum wage. It is therefore imperative that the Wates Principles do all they can to encourage companies to adopt high standards of employment practice to reverse this trend and reduce the risk of future scandals.

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

The TUC believes that Principle Two on board composition should include reference to worker directors, taking its lead from the Corporate Governance Code for listed companies.

Worker directors would bring experience and a perspective that would enhance the ability of the board to make decisions in the long-term interest of the company. Their presence would help to avoid groupthink and would increase social diversity on boards. It would also be highly likely to contribute to increased gender and ethnic diversity too (in Germany, for example, worker directors are more likely to be female than other board members)[5].

---

[4] See evidence in The gig is up, TUC 2017 https://www.tuc.org.uk/research-analysis/reports/gig and Shifting the Risk, TUC, 2018 https://www.tuc.org.uk/research-analysis/reports/shifting-risk

[5] For more evidence on the impact of worker directors and proposals for how this could be implemented in the UK, please see All Aboard Making worker representation on company boards a reality, TUC, 2016, available at https://www.tuc.org.uk/research-analysis/reports/all-aboard-making-worker-representation-company-boards-reality

The Wates Principles should reflect the Corporate Governance Code for listed companies and refer explicitly to the contribution that workforce directors can make in the boardroom[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?

The Principles as drafted propose that the board should establish a policy on transparency of remuneration structures to enable accountability to key shareholders. This is inadequate and out of kilter with recent moves to increase pay transparency through gender pay gap reporting and pay ratio reporting.

Stipulating that remuneration structures should take pay and conditions elsewhere in the company into account without any corresponding disclosure that would allow the workforce to judge whether this has been carried out is all but meaningless and unlikely to have an impact on remuneration practice. It is the workforce, rather than shareholders, who are best placed to judge whether their pay and conditions have been taken into account in setting directors' pay.

The ability to be paid extremely large sums of money without public disclosure and scrutiny is frequently cited as a reason why some choose to work for a private, rather than a listed, company. This Principle does nothing to change this. The TUC believes that the Wates Principles should ask companies to report on their pay ratios using one of the methodologies set out in the requirements for pay ratio reporting for quoted companies[7]. In addition, the Principles should ask companies to set out and explain their employment model, including their approach to workforce pay and contracts.

As drafted, the principle on remuneration amounts to a signal of remuneration as usual and will allow egregious remuneration packages for directors to remain in place alongside precarious contracts and low wages for company workers.

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

The TUC believes that the Principles should explicitly ask companies to report on how stakeholder engagement and interests have been taken account of in board decision-making, and to set out the most significant examples in relation to key stakeholders. The examples given should include both those where stakeholder interests were protected or enhanced by company decisions, as well as those where other considerations meant that stakeholder interests were not given priority.

---

[6] See paragraph 54 in FRC, Guidance on Board Effectiveness, July 2018 https://www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF

[7] The Companies (Miscellaneous Reporting) Regulations 2018 http://www.legislation.gov.uk/uksi/2018/860/pdfs/uksi_20180860_en.pdf

This would dovetail well with the new legislative requirement for company directors to explain how they have had regard to the interests and matters set out in section 172 of the Companies Act 2006.

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

The TUC believes that this is an area that should be strengthened within the Principles and would support the Principles asking companies to report on the methods used for the engagement of their key stakeholders.

It is imperative that in relation to the workforce reference is made to two-way and regular dialogue that allows the workforce to speak collectively. Coming together collectively and independently of management allows workers to speak anonymously and therefore generates a more accurate representation of workforce views. In addition, it is simply not possible for management or the board to engage with every worker on an individual basis, so collective dialogue has significant practical advantages and is an essential element of meaningful workforce engagement. And importantly, a collective approach gives the workforce greater power and legitimacy.

Trade unions are the main means through which workers form a collective view independent of management and the role of trade union representatives is to represent workforce views and interests to management. It is essential that the role of unions is clearly referenced within the Principles.

The union roundtable held in July discussed examples of how unions, through their experience within the company combined with their representative role, can contribute to improved company performance alongside protecting workforce interests. For example:

- Unions warned of the risks created by practices at RBS before the company's collapse in 2008; had their warnings been heeded, significant damage to both the company and the wider economy might have been avoided.
- In response to the scandal of blacklisting and the poor employment practices endemic in much of the construction sector, Unite has developed a Construction Charter, which a growing number of local authorities and employers have signed up to, which commits signatories to direct employment status and nationally agreed terms and conditions of employment on their projects.
- Community contrasted the experience of steel workers in SSI, which gave its workforce just a few days' notice of the closure of its Redcar steelworks on Teesside, with those in Tata Steel, which worked with unions to find an outcome for its Port Talbot steel works that protected jobs and secured a £1billion investment plan.

While numerous other examples could be given, the general point is that unions play a vital role improving how companies are run through their role in raising workplace standards and bringing workforce concerns to the attention of management. The evidence for the positive impact of unions ranges from significantly better health and safety outcomes, greater use of family friendly working practices, higher workforce pay, the prevalence and impact of training and smoother management of change in unionised workplaces[8].

7. Do you agree with an 'apply and explain' approach to reporting against the Principles? If not, what is a more suitable method of reporting?

The TUC agrees with an 'apply and explain' approach to reporting against the Principles. As the consultation document notes, the Principles are pitched at a very high level and opting out of them would not be acceptable.

These Principles are the first in the UK to address corporate governance in private companies and adherence to them is not mandatory. This has contributed to a wish to keep the Principles at a high level so that private companies choose to adopt them voluntarily. While this is understandable, there is also a danger that this means the Principles have little or no impact on corporate practice. If the Principles do not lead to higher standards of practice within private companies they will have failed.

The reports from companies on how they are applying the Principles will be the one output stemming from these Principles that can be used to shine a light on standards of corporate governance and practice within private companies and judge the efficacy of the Principles. It is important that monitoring and enforcement measures provide an incentive for accurate reporting to avoid the danger of 'whitewashing'.

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?

If monitoring is to provide an incentive for good corporate governance and practice within private companies, it is important that the monitoring process is comprehensive and reported accurately within the public domain. It is also important that it has some visibility and that company stakeholders who wish to comment on how their company is applying the Principles are able to feed into the monitoring process.

Clearly, this has resource implications that will need to be resolved.

---

[8] For recent primary research on the impact of unions please see Alex Bryson and John Forth, The added value of trade unions - New analyses for the TUC of the Workplace Employment Relations Surveys 2004 and 2011, October 2017 https://www.niesr.ac.uk/publications/added-value-trade-unions-new-analyses-tuc-workplace-employment-relations-surveys-2004. A round-up of evidence of the impact of unions on a range of areas including those cited here is presented in Janet Williamson, The role of workforce representation and involvement in good work in Working Well: Perspectives on Good Work and Why it Matters, IPA, 2018 https://www.ipa-involve.com/working-well-perspectives-on-good-work-and-why-it-matters

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 set out above, other than in relation to shareholder relationships, the TUC does not believe that weaker corporate governance requirements for private companies are justified. As the consultation document notes, private companies and their owners enjoy the very significant benefit of limited liability, which means that the costs of company failure falls on other company stakeholders and the state when it occurs. Society is entitled to expect high standards of corporate practice in return for this incomparable business benefit.

The draft Wates Principles are considerably shorter, less detailed and generally lighter that the Corporate Governance Principles for listed companies. The TUC does not believe that this differentiation is justified; we believe that the Corporate Governance Code for listed companies should have been taken as the starting point for the development of these principles for private companies, and then adapted as appropriate for the differing ownership structures.

Nonetheless, we recognise that developing corporate governance principles for private companies for the first time is an important step. We believe that the Principles should be seen as the start, not the end, of a process of raising standards of corporate governance and practice across privately-owned companies.