Who we are

We are tomorrow's company, a not-for-profit think tank, which aims to shape the way organisations of tomorrow think, work and act, inspiring and enabling business to be a force for good. As such, we produce research pieces and organise collaborative events with the aim of providing leaders with far-sighted and relevant insight about difficult issues. Most recently, we have launched our new inquiry Is This Progress?, which will address what we have identified as a growing gap between shareholder and stakeholder expectations.

We welcome the opportunity to respond to the consultation on the Wates Corporate Governance Principles for Large Private Companies. Governance has been a key focus for tomorrow's company for many years. In responding to this consultation, we draw on our collective knowledge and that of our engagement with our partners, and a number of reports, including: NEDs – Monitors to Partners, Tomorrow's Chairman and Bridging the UK engagement gap through Swedish-style nomination committees.

Consultation questions

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

Overall, we believe that the principles and the guidance address a fair enough range of key issues in corporate governance of large private companies to provide a framework for those companies who choose to adopt it.

We feel that the primary challenge the Principles face is their requirement to be applicable to a wide range of different companies and company types. This requires them to be 'all things to all people' and in doing so the Principles have to be deliberately high-level, broad statements. Although including the guidance goes some way to address this by expanding on what could be included in the Principles, it leaves some key issues of corporate governance not being highlighted sufficiently. These are highlighted in the table below.

Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?	
Composition	Areas relating to nomination and succession planning. We can appreciate that in the case of private companies this absence may be in large part due to a lack of consistency with how these issues are faced in different companies, but given the focus placed on composition, more should also be included about how those directors are found, and how the board ensures effective succession. The Principles alone do not mention how composition occurs, only that it is important.

Composition	We would suggest some additions/tweaks to the wording in Principle two relating to board size to make the statement broader and connect it better to composition and to the strategic needs of the business, i.e. the size <u>and overall composition</u> of the board should be guided by the scale, complexity <u>and strategic needs</u> of the company. This would encourage boards to think more broadly about the composition of the boards beyond just size.
Composition	To support Principle two the guidance could consider including more on what makes an effective Chair and the importance of having an effective chair of the board if it is not included elsewhere.
	Principle two includes mention of evaluation of directors but limits this to individual evaluation in the guidance. Given the importance of board effectiveness as measured by how well the board are operating as a whole, the wording could be amended to state 'individual <u>and collective</u> evaluation of directors should demonstrate whether each director continues to contribute effectively'.
	Although the guidance to Principle two mentions competency this is not mentioned in the Principle. We would suggest that the Principle be amended to state 'with individual directors having <u>the competency</u> and sufficient capacity to make a valuable contribution.
Responsibilities	We feel that, particularly given it is referenced in the guidance, there is an opportunity to expand Principle 3 to include specific reference to stewardship of the company and/or long-term value creation. This would encourage companies to consider how their corporate governance (here defined by the boards' policies and procedures) are contributing to the board and company's wider purpose, as well as their internal effectiveness.

2. Are there any areas in which the Principles need to be more specific?
Overall, we think there are several occasions in the principles and guidance where the wording is confusing, and does not provide the right level of specificity or detail to be most helpful to companies and boards. We outline details of these below.

2. Are there any areas where the Principles need to be more specific?	
Purpose	We feel that the focus on purpose is important, and has the potential to provide a valuable framework to discuss other vital areas of governance such as culture, values, strategy and business model. However, we feel the current wording does not always make the most of this potential. This is in large part due to it being vague on what is meant by purpose, and some confusion between the importance of a company establishing its purpose in order to be successful (and the board being responsible for doing so) and the board having a clear purpose (something we would define perhaps more helpfully as a 'board mandate'). This distinction is particularly important given that many of the companies that will be covered by the principles are subsidiaries of much larger organisations, where the company purpose will be defined by a higher-level board, and instead the focus here will be on board mandate – are the board clear on their own purpose.
Purpose	The definition of 'purpose' as it is written is confusing and a bit circular or tautological. For instance, by stating 'by promoting purpose the board establishes a rationale for existence' –it could be argued that 'rationale for existence' is the same as purpose. It is therefore unclear if that is what the principles are trying to imply, or if they are saying that by establishing purpose they further establish their licence to operate. From our perspective we would agree with both of these articulations but think the guidance needs to be clearer about its stance on exactly what it means by purpose (and the purpose of purpose!)

Purpose	Although we appreciate that it is unhelpful to compare the Wates' principles with the UK Corporate Governance Code (particularly given that they should be measured by what makes them different as much as the same) by comparison the Code is more explicit on how purpose is defined. By stating that *"A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society",* it effectively takes a stance on providing a definition of purpose, which is more explicit than in the Wates' principles that simply states that "*An effective board promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose."* We have noted in our recent publication on company purpose – The Courage of their Convictions that it is becoming increasingly fashionable for businesses to focus exclusively on purpose, and phrases like 'purpose driven companies' or 'purpose driven culture' now abound. But there is a danger of oversimplifying the importance of purpose, as it is not just any clear purpose that matters. If the Wates principles are to encourage better corporate governance and in doing so encourage boards to have consideration for how a company impacts its employees, suppliers, customers, the environment and wider society, it should refer to why a focus on purpose is important. It could also be helpful to reference some areas of purpose that might be applicable – such as sustainable success, value creation, wealth creation, purpose beyond profit, *etcetera* (while making it clear that there are different definitions of purpose for every company). Overall, we are concerned that the current articulation of 'purpose' risks being meaningless in its' attempt to be applicable to any company.
Purpose	In articulating the strategy and business model we would argue that this should be articulated to the organisation and also to relevant stakeholders and shareholders where appropriate – not just internally focused. We acknowledge that companies will necessarily need to have freedom to communicate this as they see fit (particularly those who are not required to produce a strategic report) but transparency with shareholders and stakeholders around strategy should be encouraged as part of the principles.

Composition	We would advise further tweaks to the guidance to make it clearer what is meant, as the wording throughout the guidance to Principle two is convoluted. The sentence: "An effective board embraces diversity, promotes accountability and incorporates objective thought that promotes appropriate constructive challenge and effective decision-making" although comprehensive, seemingly attempts to combine a range of ideas about board effectiveness in one sentence (promoting accountability/incorporating objective thought/promoting constructive challenge/effective decision making) and therefore loses the essence of what it is attempting to say. The wording of this could be made much simpler, and by extension much easier for companies to apply to their circumstances and report on. It is also not clear how and for what reason 'embracing diversity' is included in this, and the extent to which this refers to board diversity. We are unclear how a board would demonstrate that they are 'embracing' board diversity. Given that diversity is included as a separate point later in the guidance we would recommend this be removed at this stage.
Composition	We feel a focus on competency of the directors and board is an essential part of corporate governance, and would recommend a tweak to the wording to make this more effective. The sentence structure: 'All directors should collectively demonstrate a high level of competency' instead makes the guidance on competency confusing. We would argue that the statement could be changed to say either '<u>All directors should demonstrate</u> a high level of competency' or '<u>Directors should collectively</u> demonstrate a high level of competency'. Although this seems a trivial 'grammar' point, the difference between treating the board as collective of competent individuals or measuring the competency of a board as a whole states two different definitions of an effective board.
Composition	The final statements in the guidance on Principle 2 that relate to diversity could be better aligned with the Principle if by reiterating the importance of skills, background, experience and knowledge.

Responsibilities	We feel that the wording in the guidance to Principle 3 could be simplified to make it easier to understand, follow and/or reference in a report. In places it becomes tautological rather than practical, for example: "delineation of responsibilities ensures the shareholders, board and senior management have clearly defined roles": we would argue that delineation of responsibilities <u>is</u> having defined roles and *vice versa*. we would argue that 'clear corporate governance practices' and 'company leadership working together to deliver long-term value' are aspects of good stewardship, and the wording would be better stated that these 'promote' stewardship, (rather than 'giving insight' to, which is more aligned with reporting). We are unsure as to what the next sentence ('Corporate governance can guide decision making powers, detail succession planning….') is intended to mean. We agree that corporate governance can guide decision making powers (although this has been outlined in the sentence before), but feel that both succession planning and engagement are two entirely separate (although important) points that should be highlighted as such. One way to address this would be to acknowledge succession planning as a specific area, and discuss engagement with a parent company later, in Principle Six. We are unsure what is meant by 'Independent challenge can allow for industry experience and objective decision-making'

3. Do the Principles and guidance take sufficient account of the various ownership structures of private companies, and the role of the board, shareholders and senior management in these structures? If not, how would you revise them?

Yes, we believe that the high-level nature of the principles makes them applicable to the wide range of ownership structures of private companies. Our only comment would be in relation to our points above regarding Purpose – establishing purpose will vary significantly between different kinds of companies and this ompanies that are a subsidiary of other companies (and therefore have less influence and responsibility over the purpose of their organisation)

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?

We are not totally clear how what is currently outlined in the Principles will provide stakeholders (as an aside, we're curious as to why the question is framed only in relation to shareholders) greater visibility of remuneration structures than is already provided by companies. Although there are some well-intentioned statements in the Principle and it will require companies to, at the minimum, state that they have structures aligned to the success of the company, the wording as it currently stands does not necessarily encourage more visibility.

If there is appetite and intention to encourage visibility around workforce pay and directors pay, then this principle will need to make more explicit reference to visibility, transparency and/or reporting. We also note that there are references to gender pay reporting in the guidance, and this could also mention pay ratio reporting.

We would also highlight that the Grant Thornton Governance Review finds that the remuneration report is typically the longest and most detailed aspect of the annual report, the highest quality and the most likely to include accountability (an introduction from the Chair, etc.) They argue that this is in part due to the legal requirements to publish their remuneration policies, and the pressure on remuneration in general which already exists for listed companies. The Principles' more general and high-level approach is likely to give shareholders and stakeholders the same amount of visibility or transparency.

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

Our comments to Questions 5&6 are presented as one, below, as a general comment on Principle 6 – engagement.
Overall, we welcome the explicit attention being paid in the Principles to stakeholder engagement as a key part of corporate governance, and feel that this emphasis answers well to the political motivations behind the establishment of the Wates Principles, and the re-focus being paid to Section 172 and a company's impact beyond profit.

However, we feel there is greater opportunity here to encourage creative thinking around stakeholder engagement:

- We believe that the Principle could avoid mentioning one stakeholder (as it stands it only states the workforce); instead it should state the importance of engagement with all its stakeholders, and then use the guidance to expand on who those stakeholders are.
- We note that there is explicit outline on workforce engagement in the guidance and we believe this should also include mention of other stakeholders and what effective engagement might look like for, for instance, effective shareholder/investor engagement, customer engagement, *etcetera*. At a recent series of consultation events, held by Tomorrow's Company and the Stewardship Alliance, four dialogues have been conducted with 75 participants including asset managers, asset owners, investment consultants, pension funds, investment institutions, businesses and advisory and representative groups. The aim of the discussion was to bring together representatives of the whole stewardship chain to discuss improvements and recommendations to better stewardship. From the roundtables, it was frequently pointed out that the voice of the 'stakeholder' is a broad concept, and that any one individual is at once a representative of many different stakeholder groups (being, for instance, an employee of a company, a shareholder of another through pensions investment, part of a supply chain of another, a customer, etcetera). We believe this should be acknowledged in the guidance, and companies encouraged to think creatively about how they are engaging.
- Our concerns expressed earlier regarding the discussion of purpose are also relevant here. The wording to Principle 6 which states "The board has a responsibility to foster good stakeholder relationships based on the company's purpose" – we are not entirely clear on how stakeholder engagement relates to purpose (in that the wording does not make this clear – is the intention to emphasise that companies should identify their stakeholders based on purpose or that what they engage with them on is related to purpose? Overall it is unclear what it is intended to add that is different to the first sentence. Although we agree that purpose should be a consideration when defining stakeholders and engagement (indeed the value of establishing purpose is that it should then be useful for all board decisions) we are not entirely convinced that the re-mention of purpose here is clear.

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

See above.

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?

We believe the apply and explain approach can have real value, will ensure it is treated as principle based and away from boiler-plating and tick box approach.
Overall, we are supportive of the apply and explain approach, and believe it has the potential to work as it should: by encouraging good governance and ensuring the principles can be useful for a range of companies.
We are concerned however that, even while the principles clearly state that the guidance is non-exhaustive and is not intended to be a checklist, the burden of reporting will fall to reports preparers, company secretaries, legal teams *etcetera*, and they will – naturally – look to the guidance for help on how to report.
Given this, we feel the committee should focus on ensuring that the guidance is clear and as helpful as possible to those who will be looking to it for reporting guidance. We have included above in our answer to points 1&2 a number of occurrences where we feel the wording does not do this. This could also be supported through supplying more examples as the ones provided in point 19 of the consultation which shows the breadth of ways different companies might approach it. If the guidance is not supportive to those responsible for reporting we are concerned that they will need to rely on a patchwork of information from the FRC guidance on Board Effectiveness, the UK Corporate Governance Code and other reporting guidance offered by professional services firms, which does not solve the problem of boilerplating.

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?
No comment or response.

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?
The primary concern of the Wates principles should be the extent to which they provide a framework that is sufficiently different from other Codes (to be useful to those companies who do not already use The Code or related codes such as the QCA code), while also being specific enough to the circumstances of privately-owned companies.

This does not necessarily answer the questions as to who the Principles are 'for': it has been noted in discussion with our partners that many of the companies that will be covered by the government's requirement are, for instance, subsidiaries of large plcs and are therefore likely to opt for the principles of the UK Corporate Governance Code or the QCA Code; similarly companies considering IPO may be more inclined to look to the Code even while they remain private. This is not in itself a problem; the UK Corporate Governance Code is one of the most respected in the world and companies opting to adopt it should be commended. However; it does present a challenge for the Wates' principles, wherein it has to be sufficiently different to the UK Corporate Governance Code in order to be useful to those companies which choose to adopt it, while also drawing on elements of its best practice.

We appreciate and acknowledge that this is the biggest challenge for the principles, and one that is only partly addressed by the current draft of the Principles. In general the issues we have flagged in our response relate in large part to the Principles' need to be applicable to a broad range of companies, and there being a lack of clarity over who exactly will use these principles and how the reporting process will work.

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

Overall we feel that there are some issues with the Code's attempt to be applicable to a wide range of different companies and company types, as we feel that this is requiring the Code to be 'all things to all people' and in doing so has to rely on very broad and general statements; at times leading to Principles that do not go far enough to be 'principled'. Given that the Principles' are intended to drive quality of governance in Private companies we feel this could afford to go further in outlining best practice.

Another way this could be addressed would be for the committee – perhaps in collaboration with relevant organisations such as the Institute of Directors, Institute for Family Business, CBI, etc; to commit to revisiting the guidance as it becomes clear the extent to which businesses are adopting the Principles and how they are reporting.