

## REVIEW OF THE IMPACT OF THE COMBINED CODE Financial Reporting Council

Marks & Spencer is pleased to have this opportunity to respond to the FRC's consultation on the impact and effectiveness of the latest Combined Code on Corporate Governance (the "Code"), which came into effect for reporting periods beginning on or after 1 November 2006.

We support the FRC's review into whether the Code is enabling UK companies to be led in a way which facilitates entrepreneurial success and the management of risk.

Our comments are set out below. By way of background, we also enclose our full response to the Code, as published on our website; together with our 2007 Annual Report and How we do business Report which aim to give our shareholders, and other stakeholders a clear view of:

- our business and our financial results;
- the rigorous plans we set ourselves and the progress we are making;
- our approach to governance and our responsibilities;
- and the people who make it happen.

### QUESTIONS RAISED BY THE FRC CONSULTATION

#### 1 Does the Code support better Board Performance over time?

The Code's primary principle that every company should be headed by an effective Board has provided a foundation or rather a 'discipline' from which companies can then review their performance and ways of working. The Code supports better performance but does not generate or initiate better Board performance on its own. The key to ensuring improved Board performance over time is that the Chairman and Board members see the true value from investing time in this key area. It is about an attitude of mind, rather than a particular process and the Code and disclosure can be the catalysts to instigating this work. The Code cannot operate in a vacuum – but it is a helpful discipline and can identify where, perhaps, routine maintenance might be needed.

A review of Board performance allows the Board to stand back and focus on its main objectives, drivers and measures and, most importantly, its behaviours, skill, mix and dynamics as a team. Over time, it should focus on key areas that make for a really effective Board. These include:

- Strong Chairman and CEO
- Good relationship between Chairman and CEO
- Strong independent NEDs who contribute and challenge
- Good teamwork and respect
- Proper use of time (balance between strategy and operations)
- Efficient secretariat/governance support
- Ability to learn from their experiences.

The Code can help to hold all these key elements together – to provide the 'glue' and the framework which then allows the directors to focus on the areas that will enhance their performance.

However, to sustain performance, it must not be seen as simply a "compliance – one-off exercise". Each year the Board should look to build on its previous findings and establish a "living action plan", owned by the Chairman, as a way of embedding a performance management attitude into the Boardroom. As the Code has developed over time into a document that focuses on more than specific structures and controls, it has provided a greater opportunity to support Boards in other areas, eg people and relationships. The Code provides the vehicle for helping this to happen – but the level of improvement and its sustainability, will lie with the commitment and approach of the Chairman and Chief Executive, together with a belief that Board performance is fundamental to business success.

Board performance review can be seen as a matter of extending the practices already embedded within the organisation to the Board. It is the attitude and spirit of how it is executed that determines the outcome. Confidence in the integrity and quality of management on the Board is an essential ingredient for investor commitment. Companies which are well governed and operate in a sustainable way will have the attitude and transparent processes in place to support their long-term health and shareholder value – Code or no Code.

#### 2 Is the "comply or explain" approach working effectively?

The Code has provided an effective tool to set out latest best practice and track developments over time. The “comply and explain” approach has given companies the flexibility to review their governance structures and to adopt the approach which best fits their current situation. In other words, it recognises that “no one size fits all”.

The Board is accountable to shareholders for the long term success of the Company. The Code provides the framework for constructive engagement with shareholders and institutional investor bodies. This has been the most helpful development in recent years where progress has been made both by Boards, in explaining how their governance works in practice, and by institutional investors, through their willingness to listen. The application of legislation is a much more rigid approach and can be detrimental to both companies and investors, as demonstrated by Sarbanes-Oxley.

The Code has matured into the principal reference document, not only for companies, but also for investors. Representative bodies have also adopted the “comply or explain” approach when setting out their own governance expectations. This saves time and helps focus the dialogue on the principal points of difference on both sides.

It does take time to set out the reasoning for departure from the Code. However, this is in the Board’s interest as it encourages a wider consideration of the issue beforehand and hopefully leads to better governance. The requirement to disclose also helps focus the mind on what is in the best interests of the company.

Some institutional investors and many commentators still take a ‘black and white’ approach to compliance and do not accept that sometimes ‘shades of grey’ are more appropriate. More consideration could be given to the quality of the explanation where companies explain rather than comply. Also, in stating compliance with the Code there are some matters that are less important. For example, when a director is unable to attend an AGM as a result of unavoidable personal commitments.

However, because the ‘comply or explain’ approach seems to be working overall, institutional investors are better placed to support companies when minority interests make an approach, for example the recent requisitioning of resolutions by activist investors at the Summer 2007 AGMs of Tesco (supply chain labour) and Vodafone (capital structure).

The disciplines generated by the Code of transparency and consultation also have wider application throughout the organisation, for example when reviewing employee benefits (Pension Fund Trustees) wider stakeholder engagement (How we do business Committee) and customer safety (Fire, Health and Safety Committee).

### **3 Do disclosures in the Code in annual reports provide useful information to shareholders at proportionate cost to companies?**

There is a valid criticism that the amount of disclosure now required in annual reports is both time-consuming and costly. This is as a result not only of the Code but also of other requirements, such as accounting rules, Director’s Remuneration legislation and the new business review/OFR.

As an example, our 2007 annual report comprises 100 pages, roughly 30 of which relate to a general business review, 20 to governance and 50 to finance. The majority of our shareholders receive the short-form Annual Review, which comprises 44 pages, roughly 30 of which relate to a general business review, 7 to governance and 7 to finance. Our 1993 annual report comprised 56 pages and included our first response to the Cadbury Report on Corporate Governance, on one page.

There is also a danger that shareholders will fail to find the corporate governance disclosure meaningful or that important information will be lost in the additional pages of required reporting. We aim to tailor our information to the individual’s need by giving a summary of compliance in our Annual Review (1 paragraph), a detailed account in our Annual Report (9 pages) and a full response to the Code on our website (13 pages).

When we are required to give new information, we aim to make this as readily accessible as possible. A recent example is the reporting on ‘Principal Risks and Uncertainties’. We have included a table in our Corporate Governance statement to give shareholders an insight into the outcome of our Group Risk Profile process.

The costs of printing and posting annual reports will be addressed through wider use of electronic communication – our position is set out below.

There is the additional cost of Board, Committee and management time in reviewing and reporting on Code compliance. With the appropriate governance support and structures in place, directors' time can be more properly focused on the Company's strategic development and performance, to generate long term shareholder value.

All in all the cost of compliance in our experience is proportionate to the benefits delivered by the Code's application.

### **Electronic Communication**

At our AGM in July this year we gained shareholder support for electronic communications as introduced by the Companies Act 2006. This recognises that the website has become a more effective tool for communication, providing more up-to-date commercial and business information, which can be tailored to the individual's need and will provide the following benefits:

- Cost-effective communications – print run and distribution costs will be reduced;
- Environment – reduction of wasted paper, printing and post;
- Website – enhanced communication and aligns shareholders with customers who are shopping on-line.

However, as our shareholders have an emotional attachment to M&S and our Report reinforces the brand as well as tells the investment story, we are considering sending a 'super-summary' report to those who default to e-communications in June 2008 to maintain their loyalty, their votes (20,000 proxy forms) and feedback (1,000 forms).

This will give us the opportunity to distil key business and governance messages for the majority of our private shareholders into a simple booklet thus providing useful information at proportionate cost to the company.

### **OTHER AREAS WE WOULD LIKE TO COMMENT ON**

#### **4 Chairman on Remuneration Committee as member**

Whilst we understand why some people may prefer to have the Company Chairman on the Remuneration Committee as a member, we are of the view that this could compromise their ability to act as the advocate for CEO reward and at the same time adversely impact on the authority of the Committee Chairman. The Chairman's presence at meetings as a non-member would appear to be more appropriate.

#### **5 CEO on Nomination Committee as member**

We feel more strongly that the CEO should be a full member of the Nomination committee (whilst retaining a majority of independent directors) as the CEO will be central to all decisions relating to future Board appointments and senior succession plans reviewed by the Committee. On those occasions where the Committee wishes to discuss CEO succession without the CEO present, it is a simple matter for the NEDs to meet independently.

#### **6 Chairman of more than one FTSE100**

Given the range of various posts that a FTSE100 Chairman could hold outside the FTSE100, we think it is rather arbitrary simply to restrict chairmanship to one FTSE100 company. We believe it is more a question of time commitment and requirement than specific roles.

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