CIPD

Report

July 2023

# The value of **people expertise** on corporate boards

The CIPD has been championing better work and working lives for over 100 years. It helps organisations thrive by focusing on their people, supporting our economies and societies. It's the professional body for HR, L&D, OD and all people professionals – experts in people, work and change. With almost 160,000 members globally – and a growing community using its research, insights and learning – it gives trusted advice and offers independent thought leadership. It's a leading voice in the call for good work that creates value for everyone.

Report

# The value of people expertise on corporate boards

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## Acknowledgements

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# 1 Introduction

It has become a cliché in corporate reporting to claim "our people are our greatest asset". Although it's undoubtedly overused, the meaning behind this phrase remains true. Any business action – from a major strategic decision to a routine customer service transaction – is initiated and enacted by people. The success (or otherwise) of any business is largely determined by people making the right decisions and executing them well.

As such, it's critical that boards have the ability and appetite to engage with, and have a good understanding of, the many complex people challenges faced by businesses. Indeed, a recent Gartner survey[1] found that workforce issues rated alongside digital technology initiatives as the top strategic business priorities for boards in 2023–24.

Despite growing expectations for competence around people issues to help with challenges such as closing the skills gap, attracting and retaining talent, equality, diversity and inclusion (EDI), and workforce mental health, our research shows that the majority of UK boards lack directors with people expertise. In all, 99% of companies have a chief financial officer or a finance director among their board members, but just 2% have an HR director as an executive board member. We also find that only 25% of FTSE 350 companies have HR expertise on their boards at all (both executive and non-executive).

This report looks at how people professionals interact with boards in three different roles: as senior managers (chief people officers or HR directors) advising the board, as executive directors on the board, and as NEDs on the board. It explores whether UK boards currently have the skills to meet key challenges ahead, what common errors people professionals see boards making, and how senior HR professionals can add value to board and company performance. Finally, we make recommendations for areas for further refinement in the UK Corporate Governance Code and guidance.

# 2 Why does people expertise matter?

> *"Finance used to be the limiting factor for strategy; now the limiting factor is people. It is no good coming up with a great strategy on paper if you can't then hire the people to deliver it. I am really seeing that issue in the boards I sit on."* **(Chair)**

In the UK, organisations face a challenging external economic environment, including stalled productivity and wage increases, the largest projected fall in living standards since records began,[2] a wave of industrial unrest, the evolving effects of the UK's departure from the EU, including its impact on labour supply, and weak business investment.

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Globally, we also face challenges such as climate change and the transition to net zero, and the effects of fast-moving digitalisation and automation.[3] A McKinsey survey[4] of over 2,500 global business leaders found that only half feel their organisations are well prepared to anticipate and react to external shocks, while two-thirds view their organisation as overly complex and inefficient. Most of the top 10 challenges around organisational performance these leaders identify come down to people management, including hybrid working, closing skills gaps, talent attraction and retention, EDI and workforce mental health.

These challenges play to HR's strengths. Beyond the evident pressures facing businesses, the importance of getting people issues right has been emphatically illustrated recently by the following examples.

- **Incentive misalignment:** In 2022 alone, the Financial Conduct Authority issued nearly £240m in fines for failures to protect customers or investors, and inadequate implementation of risk and conduct management processes.[5]

- **Bullying and harassment:** Recent high-profile cases of sexual misconduct and bullying have highlighted that these can lead to serious financial and talent implications.

- **Industrial relations:** The number of working days lost to strikes across the UK in 2022 was the highest since 1989. This affected prominent companies, not just in formerly publicly owned industries but also in less traditional industries.

- **Pay and reward:** Investor activism over working practice has risen in recent years, including resolutions advocating wage increases for low-paid retail workers, or the election of worker directors to the boards of major US companies, including Starbucks and Alphabet.

- **Skills development:** Staff training, performance reviews and promotion are among the management practices most associated with higher organisation-level productivity, according to analysis from the ONS.[6] Zurich UK estimates that its long-term programme for upskilling homegrown talent will save the business £1m in recruitment and redundancy costs alone.[7]

- **Reconsidering workforce demographics:** B&Q has successfully experimented with how it manages, develops and retains older workers, having operated without a retirement age for more than 15 years. A pilot in one store found that having more older workers increased profits by 18% and led to a six-times reduction in staff turnover.

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## External and regulatory pressures

With the nature of work changing, businesses are finding themselves under increasing external pressure about how they treat their people. Investors are increasingly vocal about employment practices:

> *"I've only recently grasped the idea that the workforce* is *the company. The workforce is your asset – intellectual property, skills and capabilities. If moving in and out over time, it's a key indicator."* **(Investor, FRC Report[8])**

> *"Our clients still want us to make them money, but they are asking a lot more questions about* how *we make them money, and the impact of our investments on society and the environment."* **(Investor)**

This increased investor interest is reflected in the experience of chief people officers (CPOs), who noted they are getting more involved in investor conversations:

> *"Six years ago, we probably had about five investor calls. Last year we did 27 calls with investors wanting to have discussions about people – what we're doing with talent, the diversity piece... more and more of the investors want to see you linking rewards, long and short term, to ESG [environmental, social and corporate governance]."*
> **(FTSE-listed CPO)**

The role of people governance in companies' regulatory requirements has also increased, with a recognition by regulatory bodies of the criticality of workforce- and people-related issues like EDI, culture, behaviours and relationships among board members, succession planning and employee voice and engagement.

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### Box 1: The growing prominence of people governance

While financial governance has generally been the main concern for investors and regulators, aspects of people governance have become more important over the years:

- **1992** Cadbury Report: the prevention of one individual becoming dominant
- **1995** Greenbury Report: the creation of the remuneration committee with no personal financial interest
- **1998** Hampel Report: the promotion of management accountability to shareholders
- **2003** Higgs Report: the role of NEDs and the need for board evaluations, nomination committees and succession planning
- **2006** Companies Act 2006, s72: the duty to promote the success of the company; having regard to the interests of stakeholders
- **2011** Davies Report: increased gender diversity on boards
- **2016** FRC report on corporate culture and the role of boards[9]
- **2018** FRC guidance on board effectiveness[10]
- **2022** FCA listing rules on gender and ethnic diversity[11]

The Financial Reporting Council's (FRC) guidance on risk management and internal control requires boards to consider whether the company's leadership style and management structures, HR policies and reward systems support or undermine the risk management and internal control systems.

The FRC's board effectiveness guidance shows that the majority of questions to boards are concerned with the people aspects of corporate governance.

### Box 2: FRC board effectiveness guidance: Questions asked

| Topic for board debate | Addressed to | Strategy questions | Technology questions | Financial questions | People questions | Total number of questions |
|---|---|---|---|---|---|---|
| Strategy, leadership, behaviours | Whole board | 10 | 2 | 3 | 9 | 14 |
| Behaviours, reward | Senior management | 1 | 0 | 0 | 6 | 6 |
| Workforce and culture | Whole board | 3 | 1 | 0 | 14 | 16 |
| Relations with stakeholders | Whole board | 4 | 0 | 0 | 18 | 18 |
| Skills | Nomination committee | 0 | 1 | 0 | 4 | 4 |
| Length of service and diversity | Nomination committee/ whole board | 1 | 0 | 0 | 3 | 4 |
| Audit | Audit committee | 0 | 0 | 4 | 1 | 5 |
| Going concern | Audit committee/ whole board | 0 | 0 | 7 | 0 | 7 |
| Remuneration | Remuneration committee | 2 | 0 | 3 | 13 | 13 |
| | **TOTALS** | **21** | **4** | **17** | **68** | **87** |

*Note: Some questions fall into more than one category*

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In addition, the latest iteration of the Corporate Governance Code (published in 2018) contains several new people-related requirements:

- **Workforce and stakeholders:** Boards should describe how they have considered the interests of stakeholders when performing their duty under section 172 of the Companies Act 2006; three mechanisms for engaging with the workforce are recommended – a worker director, a workforce advisory panel or a NED with designated responsibility for workforce engagement.
- **Culture:** Boards are asked to create a culture which defines and aligns company values with strategy.
- **Succession and diversity:** The Code emphasises the need to refresh boards and undertake succession planning, with heightened emphasis on the role of the nomination committee on succession planning and establishing a diverse board.
- **Remuneration:** Remuneration committees should take into account workforce remuneration and related policies when setting director remuneration.

The Companies Act 2006 was amended in 2018, requiring company directors to have regard for stakeholders beyond their shareholders when carrying out their duties, and to publish a statement setting out how they had done so.

Corresponding objectives have been implemented along the investment chain. These include Principle 7 in the UK Stewardship Code:[12]

> *"Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities."*

This reflects growing interest in ESG issues, including workforce, supply chain and community practices, and heightened shareholder interest in these issues. It is worth noting that, despite the growing recognition of people issues at board level, none of the increased regulatory material in this area notes the role of the CPO or HR function in contributing to better governance or better boards. This is despite the fact that in many businesses – particularly larger listed companies – the people function is likely to be heavily involved in, if not responsible for, activities including preparing papers for the remuneration committee (RemCo), supporting the nomination committee (NomCo) with succession planning and facilitating board engagement with the wider workforce.

Throughout this report, we will explore why this is the case, and whether the role of the CPO in board governance needs to be more clearly recognised.

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# 3 How are boards dealing with people matters?

> *"I can't believe it's taken this long, but I think people have realised that, in terms of sustainable wealth creation, which is what boards are trying to achieve, the biggest value is going to come from people. You can have a great product. You can have some great tech. All those things are important, but what's going to make the biggest difference to realising wealth are the people."* **(CPO, private company)**

Unsurprisingly, the growing stakeholder interest in corporate employment practices, heightened regulation to ensure boards oversee corporate culture and workforce engagement, and the growing number of case studies providing evidence of the importance of good people management have increased the prominence of people matters in the boardroom. Every CPO we spoke with reflected that board engagement in people issues was higher than it had ever been and that their own profile, credibility and influence in the boardroom had grown. CPOs present on people issues regularly at board meetings and engage regularly with RemCos, NomCos and/or people and culture committees, but they also participate in, or run, ESG or responsible business committees.

> *"I have seen a move to boards really engaging in the cultural agenda (this may be linked to the regulatory agenda) and with greater external scrutiny for organisations (via investors and the press) on EDI [equality, diversity and inclusion]. This has increased the profile of this discussion on the board agenda. Clearly the health of succession is also a critical conversation for the board to engage in and I have seen an increasing move for this to be a topic of great interest."*
> **(FTSE-listed CPO)**

> *"I've been doing a plc job for 10 years and I've seen that interaction [between CPO and the board] change: the depth of it, the breadth of it… we have four board committees: audit, RemCo, NomCo and employee engagement – I'm driving three out of the four."* **(FTSE-listed CPO)**

## People challenges for boards

Despite this increased interest in people matters, there remain clear challenges when it comes to the board meaningfully engaging with people issues. As one former plc CPO-turned-NED put it:

> *"There is a strong interest in the people matters – increasingly so with the rise of employee activism. But board agendas too often get squeezed, data can be ignored in favour of anecdote, and short-term drivers can take precedence. The very best chairs know this and work hard in nomination and remuneration committees with the CPO to give the people agenda the airtime it needs for thoughtful scrutiny."*

Some people challenges that boards are facing on NomCos and RemCos include:

- succession planning in a global market, where, according to a former CEO of executive search firm Heidrick & Struggles, 40% of executives hired at senior level are pushed out, fail or quit within 18 months[13]
- balancing the need for a skills mix within the board covering areas as challenging and diverse as climate/sustainability expertise, emerging technologies, EDI expertise, as well as functional skills
- balancing conflicting stakeholder demands with the need to attract talent in a global marketplace during a cost-of-living crisis
- weaving targets on ESG, culture and EDI meaningfully into incentive plans
- managing increasing people-related regulation, for example around EDI, workforce reporting, employee engagement and remuneration.

## External workforce reporting

With the amount of external regulation on people matters increasing, so too is workforce reporting. When we analysed corporate reporting of workforce-related issues in 2022,[14] we found that the space afforded to these issues in annual reports had increased significantly.

Almost every report now contains a section dedicated to key stakeholders, with the workforce being the most prominent. Eighty-nine per cent of firms included employee-related risks, such as the failure to attract and retain key staff, the challenge of meeting future skills needs and the regulatory or reputational risks resulting from employees' conduct on their risk register. Eighty per cent included key performance indicators related to the workforce, including employee engagement and health and safety measures. Stimulated by regulatory requirements, reporting of issues like diversity and pay differentials also now features prominently in remuneration reports.

Research for the FRC has found that 68% of FTSE 350 companies have introduced a stakeholder NED, an employee advisory panel or a combination of the two since these mechanisms were promoted in the 2018 Corporate Governance Code.[15]

However, this analysis also found that, while the space dedicated to people-related matters in annual reports had increased, the balance between unsubstantiated narrative and concrete data was heavily weighted in preference of the former. For example, only a minority of FTSE 100 firms provided data on skills investment and training, on staff diversity or on the size of the contingent workforce. Furthermore, the content was almost always uncritical, presenting only positive information, rather than being based on more objective assessments.

While reporting and process are not as important as the outcomes that businesses deliver, the varied quality of reporting on people-related issues, training and skills, or employee engagement and wellbeing, is perhaps a sign of the limited expertise in these issues at board level. This could have serious implications for business and economic performance.

Implementing and measuring effective people management processes, reflecting critically on employment practices, or managing successful and productive mechanisms for workforce engagement are not easy tasks. They benefit greatly from professional training and experience.

In Section 4 we explore the current levels of people expertise on the boards of some of the UK's largest companies, and discuss some of the challenges that could come from not having an appropriate level of people expertise and professionalism providing oversight.

# 4 Is there enough people expertise at board level currently?

*"Everyone likes to think they dabble in the HR space, and they know all about culture... But in my experience, while other execs are great at handing out bonuses and giving people high grades on their appraisals, they are less good at delivering the more challenging aspects or thinking about some of those strategic aspects."* **(HRD-turned-NED)**

For our analysis, we examined the career histories of the boards of all FTSE 350 companies required to publish a pay ratio disclosure (meaning they have more than 250 UK employees and are thus categorised as a large business in the UK). We looked specifically for professional expertise and experience in people management roles prior to assuming both executive and non-executive board positions, as well as professional backgrounds in other fields, for comparative purposes.

For further details on our research, see the Methodology section.

## The composition of FTSE 350 boards

The analysis found that 25% of companies in the sample had at least one individual with HR experience at board level (see Table 1). In almost all cases, the HR professional was also represented on the remuneration committee.

**Table 1: Only a quarter of FTSE 350 companies have HR expertise on their boards**

*HR professionals on FTSE 350 boards and board committees (%)*

| | Proportion including HR professionals |
|---|---|
| Board | 25 |
| RemCo | 23 |
| NomCo | 20 |

These figures do not include workforce engagement directors appointed following the introduction of the provisions on stakeholder voice in the 2018 Corporate Governance Code. However, research for the FRC in 2021 suggested that 61% of FTSE 350 firms had appointed a workforce-related NED, but fewer than one in five had any formal HR or people management experience.[16]

These figures suggest that HR professional board-level representation has increased since 2019, when an analysis for the CIPD of FTSE 100 RemCos found that only 16% included someone with HR experience.[17] However, it also shows that three-quarters of companies have nobody with HR experience on their board or RemCo.

But does this make a difference? Given the increased technical complexity of remuneration, and the difficulties that companies and shareholders experience in managing executive compensation, might this development be related to whether a majority of RemCo members are financial rather than HR professionals?

There was no major difference between the proportion of FTSE 100 (23%) and FTSE 250 (27%) companies with a people management professional on their board.

Boards with a people management professional contained on average 10 people, the same as the average across the sample as a whole, suggesting that concerns about the size of the board and unwieldy decision-making processes are not the reason for the lack of people management expertise at board level – it's simply a case of other skills and experiences being prioritised.

Where people management professionals *are* present on boards, they overwhelmingly sit on RemCos, suggesting that their experience is seen as being directly relevant to remuneration issues. That isn't necessarily problematic, but it does raise the possibility that people management professionals are being pigeon-holed, and that hiring chairs may not be aware of the profession's potential to input into other strategic issues.

The UK Corporate Governance Code requires that at least one independent NED has recent and relevant financial experience, and that they sit on the audit committee. This means that all the companies in our sample included a senior finance professional on their board (see Table 2).

**Table 2: While all boards had financial expertise, levels of HR experience are much lower than other specialisms**

*Professional representation on FTSE 350 boards (%)*

| Professional background | Proportion of boards |
|---|---|
| Finance/accountancy | 100 |
| Banking | 65 |
| IT/tech/data/computing | 57 |
| Marketing/sales/advertising | 49 |
| Scientific/engineering | 43 |
| HR/people | 25 |

This perhaps reflects how finance, accounting and audit expertise are seen as specialist professional skills that are integral to a company and, without this representation at board level, the business cannot function effectively. People and HR skills appear not to merit the same esteem.

The importance placed on financial expertise and experience is understandable – if a company's finances are not properly managed, this represents a threat to the viability of the organisation and the livelihood of key stakeholders. Understanding financial information requires extensive specialist training. But these points are also true of people issues. For example, Grant Thornton analysis[18] found that cultural differences are a key barrier in 85% of failed merger and acquisition transactions. Are boards relying too heavily on financial expertise and insufficiently on people expertise?

Banking, tech, marketing and scientific backgrounds were also more commonly represented on boards than HR. There are again many valid reasons for companies to value expertise in these areas, but the contrast with HR is stark.

The emphasis on financial expertise is even more pronounced in relation to executive directors (see Table 3). While almost every company in the sample includes their chief financial officer on their board, there is no other executive role that is included on the board in more than 7% of cases. Only 16% of companies include an executive other than the CEO and CFO on the board.

**Table 3: Just 2% of boards include an HR director or a CPO as an executive director**

*Executive directors on FTSE 350 boards (%)*

| Position | Proportion of boards |
|---|---|
| Chief financial officer | 99 |
| Chief operating officer | 7 |
| Chief people or HR officer | 2 |
| Brand/regional head | 2 |
| Co-CEO | 1 |

This will be in part due to the Corporate Governance Code requirement that at least half the board (excluding the chair) should comprise independent NEDs. But the average size of boards with three or more executives was 10, the same as the average for the sample as a whole, showing that it is feasible to include more executive directors (who might be expected to possess a greater operational knowledge of the company) while maintaining independence and without requiring an unworkably large board.

The Higgs Report in 2003 recommended that there should be a significant number of executive directors on the board, contrasting the strength of the UK approach with the (then) different situation in the US:

> *"It is important to ensure that the board as a whole is well informed about the company. At present, most larger company boards have a significant executive representation on the board…* There is a greater risk of distortion or withholding of information, or lack of balance in the management contribution to the boardroom debate, when there is only one or a very small number of executive directors on the board. *For this reason, I recommend that the Code provides that there should be a strong executive representation on the board."*[19]

## Board committees

Board committees are another place where people issues might be overlooked. All companies operate audit, nomination and remuneration committees as mandated by the Corporate Governance Code, with 61% also operating at least one additional committee.

Our 2019 report on RemCos recommended that board committees should have a specific people-related remit, and this has now been adopted by 5% of the companies in the sample. Two per cent have incorporated 'people' into the remit of their RemCo, 2% into their NomCo, and 1% into an additional committee.

As this is the first time we have carried out this analysis, we lack comparable historic figures. However, there has undoubtedly been a large increase in committees relating to ESG, sustainability or corporate social responsibility (CSR) issues (see Table 4). This mirrors the increased regulatory interest in non-shareholder stakeholders and the rise of ESG as an investment concept. The 'S' of ESG or CSR typically covers workforce and employment practices, as well as the indirect workforce via supply chains and, in some cases, engagement with local communities and people as consumers, or end users. Therefore, many of the 41% of boards with an ESG, sustainability or CSR committee may engage with people-related matters through this mechanism. Risk and safety committees may also deal with people-related matters.

**Table 4: There has been a large increase in ESG, sustainability and corporate social responsibility committees**

*Board committees at FTSE 350 companies (%)*

| Board committee | Proportion of companies |
|---|---|
| ESG/sustainability/CSR | 41 |
| Risk | 20 |
| Safety | 10 |
| People | 5 |

A fifth of companies, overwhelmingly concentrated in the financial services sector, operate a risk committee separately from their audit committee (which is titled the 'audit and risk committee' at many companies). Ten per cent operate a safety committee, concentrated in sectors with higher risk of physical injury, including oil and gas or engineering. Seven per cent of the committees with safety in their title also served as a sustainability or environmental committee, while 3% had a more dedicated safety focus.

Companies do not automatically engage more with a particular issue or produce better outcomes because they establish a committee to focus on it. When the CIPD carried out stakeholder interviews ahead of the 2019 report, some participants argued that transferring an issue out to a committee might mean less exposure at full board meetings. The counterargument is that a dedicated committee ensures the issue is regularly and consistently reviewed by at least some board members and the papers are circulated to all board members. The committee should have high levels of awareness of the subject matter, so that members can act as an advocate for related issues in board meetings and understand how they interact with other items on the agenda.

In this context, we note that even the broadest definition of committees with a people-related remit (people specifically, plus ESG/sustainability, safety and risk) encompasses barely half the companies in our sample, which may indicate that this is an emerging area.

## People mistakes made by boards

> *"I call them HR hobbyists... they think because they've managed people that they 'do people'."* **(HRD, plc)**

We spoke to 40 CPOs, HR leaders and NEDs with HR backgrounds for this research. When asked about the errors they saw board members making around people, the most commonly reported were as follows:

- A lack of understanding of people issues
- A lack of emotional intelligence
- An overfocus on the financial skillset
- A lack of awareness/ discomfort around EDI.
- An 'overenthusiasm' around employee engagement, leading to interference with management

***Lack of understanding of people issues***
There was a common feeling – even a frustration – among some HR leaders that, because all senior managers and board members have experience leading teams, this can translate into a perception that they 'get' people, rather than seeing it as separate professional expertise.

> *"I'm shocked at the number of businesses that do not have a senior HR person in their executive team or on their board. I've been to a couple of companies with about half a billion turnover where you have a competent, capable team, but CPO minus two is where they stop. There's no one above that. So there's this whole wasteland around [strategic decision-making around people]."* **(CPO, private company)**

> *"Everybody thinks they can do HR because they've managed somebody or they've gone through a pay review... And yes, everybody has responsibility on culture, on engagement. But I worry greatly when I hear we're looking at doing skills assessments, perhaps onboarding, looking at the succession and looking at capability mapping our NEDs, and people say,*

*'Put me down for that.' … Actually, it's a much more involved assessment process. But the instinctive reaction is: 'I know how to do that.' It's always the people pieces, not risk- or finance-based specialisms. I think that's dangerous."*
**(HRD, plc)**

*"We come with that credibility and professionalism to be able to hold the mirror up and represent the people well… when decisions are being made, what are the implications on people? What are the OD [organisational development] implications?… Within our engagement survey there is feedback to the board: 'How well do you feel the company is being led?' Facilitating that conversation can be quite difficult. I suspect that if there wasn't anybody on the board with the people radar out, it might get overlooked. Deliberately."*
**(Group HRD, private company)**

*"How confident are you that your whistleblowing policy will protect the reputation of the organisation? What are the implications of not having everyone on the board having understood from the employee representative any engagement issues? What are the three biggest cultural or people risks the organisation has? Are they on your risk register, and when were they last discussed by the board? We would absolutely know the answers for finance."*
**(FTSE-listed CPO-turned-NED)**

***Overfocus on the financial skillset***
Linked to the above is the gulf in perceived credibility and desirability between financial and people experience. While the need for tight financial governance means financial skills will always need to be strongly represented on boards – in both executive and non-executive director roles – can this come at the expense of a more diverse skills mix, including people expertise?

*"People will have been invited to join the board because of their experience, but fundamentally it will be about governance, which will often sit around the financial, legal, audit area. There won't be necessarily as much depth of understanding of the people piece."* **(HRD, plc)**

*"[Audit chairs need] recent and relevant financial experience... I find it insulting and ridiculous that there's not an equally valid requirement for people that have got people, culture, diversity and inclusion, that it's not recognised as being recent and relevant experience to be able to be a valid board member... The [Corporate Governance] Code goes to the $n^{th}$ degree about what the businesses should be doing. It's not a big stretch to include something around people expertise being an important part of a board skillset."* **(HRD, plc)**

However, much comes down to the skills mix of the board overall – to ensure there is a good balance of skills, capabilities, values and beliefs across the board, rather than insisting on ticking the box of functional expertise.

***Overengagement and interference with management***
The increasing interest in people matters, particularly culture and engagement, on boards is welcome, but can prove something of a double-edged sword to HR leaders. Several noted there is something about engaging with people issues that can encourage some board members to overreach, crossing the line into management. Managing and effectively channelling this enthusiasm creates additional work for the CPO.

*"Their curiosity to really understand how the business works, that real driver to meet people at all levels is good. I think sometimes that tips into a blurring of roles in terms of what they should get involved in... They're starting to blur those lines between good governance and independence and immersion in the business."* **(HRD, plc)**

*"They wanted to go out and meet everybody. It needs to be controlled to a certain extent because otherwise it is death by anecdote. It comes from a good place, but roles and responsibilities need to be clear. It takes a lot of effort."*
**(HRD, public sector)**

***Lack of emotional intelligence***
High emotional intelligence should be a given for any senior leadership team – but this does not always translate into reality. CPOs are particularly alert to this, having seen the negative impact that a lack of awareness at board level can have on the organisation.

*"You cannot underestimate how much some people lack emotional intelligence, things that we would take for granted as human beings, let alone HR leaders. I challenge myself to ask the stupid question that seems obvious to me, but nobody else in the room seems to be thinking about... At least six or seven times out of 10 it opens a whole debate that needed to be had before we move things forward."* **(CPO, private company)**

*"Most humans, when they're talking about people, don't want to start with the data, they want to start with their opinion... but a [poorly] judged comment in a NomCo session, making throwaway comments about an individual and their capability, can literally ruin someone's career."* **(FTSE-listed CPO)**

***Lack of awareness around EDI***

Several CPOs flagged the need for board members to receive training to keep them up to date with shifting employee expectations, particularly around EDI. Board members can inadvertently use language that some employees might find offensive. Connected to this is the discomfort more traditional board members might feel around the shifting world of work, such as hybrid and flexible working. This is another area where CPOs can help support and educate board members.

*"One of the biggest challenges is that most of the people in those [chair] roles have been out of industry for quite some time. And [it] has changed the most in the last three years – employee expectations turned on their head and the whole EDI agenda ... I see them trying, but they don't really get it. They're a bit like my dad, you know? A lot of them have been so senior for so long, they're quite far removed from reality."* **(CPO-turned-NED)**

*"People understand diversity and inclusion much better if they're currently in a workplace. That's where most people get their insight and learning about it. If you've been out of the workplace for a while, you might not know some of the language that is okay and not okay to use. And the impact of a non-executive director saying something that is offensive, totally unintended, is pretty big. [We can] help them to understand the latest thinking in areas like inclusion."* **(FTSE-listed CPO)**

*"We do have to do a bit of education... our chair has done some EDI training with the board, particularly around some of the terminology that people might be using."* **(FTSE-listed CPO)**

Our findings suggest that encouraging greater access to, and representation on, boards for people management professionals could improve business strategy and oversight in many organisations. We examine this further in Section 5.

# 5 How can people professionals add value to boards?

*"The CPO background gives us an ability to listen, coach and support, which should almost be second nature, and a political astuteness from supporting CEOs and boards that comes in handy for any board or team setting."*
**(Former FTSE-listed CPO, now NED)**

**People professionals as board members**
The data analysed through this research suggests an increasing openness to people professionals when making NED appointments, although HR skills remain behind other functional and specialist areas, including finance, marketing and IT. As previously discussed, boards need a mix of skills and experiences, meaning HR expertise may not always be the most attractive and essential. As a partner in one executive search firm said:

*"There are more routes from exec to non-exec, and more diversity on boards, than ever before. We saw interest in having a people expert on the board spike after the 2018 Corporate Governance Code update. But now we need more tech skills, more sustainability skills, and so on. The people dynamic is there, but it's not the only one hiring chairs are looking for."*

However, as this headhunter implies, and the increasing proportion of NEDs with HR backgrounds shows, the people dynamic is seen as a valuable angle for hiring chairs. What is it that senior HR leaders can bring to the boardroom, and what aspects of the skillset are most appealing?

1 **Understanding remuneration:** Where HR leaders are on boards, they are almost always on the RemCo, and often chairing it. This reflects their experience of managing pay awards and understanding the sensitivities around remuneration, the psychology of incentives, and the impact of reward on employee motivation and engagement. However, limiting CPOs to overseeing remuneration is short-sighted.

2 **Succession planning:** The work done by HR leaders around the recruitment and retention of people at all levels but particularly at senior leadership, including ExCo positions, is deeply relevant at board level. This requires knowledge of team dynamics, skills and diversity, and the impact those factors can have on culture and performance.

3 **Understanding people data:** Senior HR professionals have considerable experience in identifying and gathering people-related data, ensuring that companies are able to effectively measure and monitor their performance as an employer, but also in interpreting this data and linking it to organisational performance. Understanding data across areas like employee engagement, wellbeing, turnover, absenteeism or diversity indicators ensures decisions are evidence-based, helping avoid the risk of making poor decisions based on subjective instincts or anecdotes.

4 **Expertise in EDI:** Managing diverse workforces, different employee needs and expectations sensitively and professionally is increasingly critical. There exists a growing body of case studies of what not to do. People professionals have considerable training and experience in how to get it right.

5 **Expertise in organisational change:** With fast-paced technological change and the shift to a net zero economy, HR leaders' experience in leading OD transformation is much needed.

6 **Expertise in team dynamics:** Insights into effective teamwork are crucial at board level. Boards oversee the work of the key management teams and must also operate as a team themselves. We found examples of CPOs getting involved in board effectiveness work and evaluation.

7 **General leadership and strategic accountability:** CPOs are accountable for major strategic decisions. They handle significant budgets, work across multiple markets and business cultures, and engage with multiple stakeholders, both internally and externally. They are not just HR leaders but business leaders with commercial understanding and strategic accountability.

1 2 3 4 5 6 7 8

*"I noticed in the early years [of being a NED] that the board didn't understand the strategic importance of the people agenda. And the HR profession suffered because of that. Now there is more recognition about the importance of the people agenda… I'm beginning to hear people say: 'I need somebody who understands how I move my people, this large, monolithic global organisation, from where it was to where I need it to be.'"* **(HRD-turned-NED)**

*"You can provide the organisational antenna as you know what to watch out for in terms of the culture and the impact the culture is having on the performance of the business. In recent years with the focus of boards moving to culture, EDI and skills, having CPO experience at the board is invaluable… limiting the focus to remuneration is cutting off advantageous insights."* **(FTSE-listed CPO)**

*"[The CPO] is one of the few roles where you work across the organisation, but rarely have control… you rarely own the budgets. You rarely own the people. But you're trying to influence all levels. And it is one of the few roles where you're expected to work out how to help influence individuals behind the scenes, rather than leading the charge. Both of those lend themselves as skills and styles to being a good non-exec."* **(Former FTSE-listed CPO, now NED)**

However, it's important for HR leaders on boards to show the breadth as well as the depth of their expertise, to avoid being pigeon-holed:

*"As a non-exec, it's hard being around the table when you're the only one trying to get them to think about the people aspects. It can feel that anything relating to people they look at you, whereas when it comes to finance, everyone has to debate… So, the flipside is you get on there and you're trying to drive the business side of things, but they only ever want you to focus on the people bit."* **(HR leader/NED)**

While it is unnecessarily prescriptive to suggest every business should be required to include a people management professional on their board, our analysis suggests a strong basis for thinking that the practice should be more widespread than it currently is.

In Section 6, we discuss changes to business regulation and practice that might bring this change about.

**People professionals advising boards as part of the senior leadership team**

> *"Historically the CEO had one partner which was the CFO. Going forward, CEOs need two key people: the CFO and the CPO."*
> **(Non-executive chair)**

> *"I've got a voice on [commercial] issues too. I don't just sit there regarding the people things. As CPO, you've got that broad business accountability. I would say that comes first and then the people aspects and strategies come as part of that."*
> **(FTSE-listed CPO and NED)**

CPOs are increasingly engaging with boards (making the step to board level is a logical progression for many). Some of this interaction is formal (for example, through the preparation of papers for committees, particularly RemCos and NomCos, or supporting the chair or company secretary on new board appointments and training) and some more informal (such as navigating the CEO/chair relationship or being attuned to interpersonal dynamics around the board table). Other duties may include facilitating board engagement with the wider workforce, or collaborating with the company secretary and/or investor relations director on reporting ESG activities to investors, particularly related to workforce aspects of the 'S'.

> *"Like the company secretary, the CPO role is crucial. It helps to oil the wheels of the board. A top-notch CPO will understand the mood of the board, the things they worry about and the challenges the company faces. They help to bring the voice of the workforce and of the customer into the boardroom. Formally the CPO often leads on talent, succession, culture and remuneration – but they facilitate and support with objectivity and total confidentiality – the board needs to take collective ownership and set the tone from the top and a good CPO can support them to do this."* **(Former FTSE-listed CPO, now NED)**

Several interviewees reflected that the relationship between the chair and CPO requires careful nuance to manage effectively, given a CPO may be required to comment objectively on CEO performance, help manage the relationship between the CEO and chair, and even be involved in CEO exit and replacement. As one CPO (and NED) put it:

*"You have to be able to navigate politics, not play politics. There's no rulebook for that. Sometimes you put your foot in it and you learn never to do that again!"* **(CPO and NED)**

The company secretary has the main responsibility for ensuring that the board receives the right agenda and papers and the right induction and training, so the CPO must work collaboratively with the company secretary. Practice varied considerably among the companies we spoke to. Some CPOs were very engaged in planning and supporting board training, while others left it to the company secretary. In some companies, the relationship works smoothly; in some others, there appears to be slight rivalry for the board's attention. In smaller companies, the company secretary and HR director may well be the same person.

*"I need to have a relationship with the chairman and the board, but my number-one role is to make sure that the senior leadership team can deliver the strategy."* **(FTSE-listed CPO)**

In many cases, despite not having much formal involvement in board induction and training, the CPO still provides valuable input into ensuring that new and current board members develop a good understanding of company culture and sensitive and evolving areas like EDI and wellbeing.

*"One of the [sessions] that I put forward last year was on wellbeing and mental health. We got our CMO (chief medical officer) in to help them understand what it is and what it isn't, what the science is saying. So, what you get is informed conversations on the topics that might be hot as opposed to 'I read something'. Having a better informed and better trained board helps us not to have to train in board meetings but have good conversations, but there's a limited amount of time."*
**(FTSE-listed CPO)**

# 6 Conclusion and recommendations

The insight in this report suggests that there is often a significant mismatch between the skills and knowledge of boards and those needed to understand the main people-related risks facing organisations.

These include issues such as sexual harassment and other forms of discrimination, bullying and poor working practices, which can lead to serious reputational damage if not recognised by senior leaders. Companies that don't take EDI matters seriously are also likely to fall behind in the war for talent.

This 'people insight' deficit also means that many organisations fail to fully recognise the value-creation potential of their workforces, reflected by falling levels of investment in workforce training and disappointing levels of productivity growth in the UK. Meanwhile the need for organisational change is growing.

The challenges facing UK boards have changed, with greater expectations for competence around people issues. Several of the main challenges around organisational performance come down to people management, including closing skills gaps, talent attraction and retention, EDI and workforce mental health.

At the same time, the majority of UK boards lack directors with a professional background in HR and people development, which would not be seen as acceptable for financial expertise – indeed the UK Corporate Governance Code has required recent and relevant financial experience on audit committees. The end result, as the evidence in this report shows, is that, while 100% of FTSE 350 company boards have members with finance or accounting backgrounds, only a quarter have a member with professional HR experience. Many chairs, senior independent directors, and nomination and remuneration committee chairs also have financial backgrounds. There is even a lack of HR representation on remuneration committees (23%) and nomination committees (20%), despite these both being focused on the key people issues of reward and talent.

This picture is emphasised when looking at the professional backgrounds of executive directors on FTSE 350 boards. In all, 99% of boards have a chief financial officer or finance director among their executive directors, compared with just 2% that have an HR director at executive director level.

Addressing this does not necessarily mean that an HRD or a CPO should always be a main board member. However, it should require boards to have formal processes for accessing the professional expertise of senior-level HR practitioners who know the business, on all matters or committees where in-depth insight on workforce matters is required. And it should lead to investors asking questions about the overall balance of skills and experience on the board.

Consequently, the CIPD believes there is a strong case for some key refinements to the UK Corporate Governance Code and accompanying guidance to signal to boards the need for input, support and advice from senior-level HR practitioners on critical workforce issues.

### Recommendations

1 CPOs should have the right of access to the remuneration and nomination committees, in the same way that the Cadbury Report recommended that finance directors do to audit committees. In listed companies this tends to be the case already, but in the public sector or smaller organisations, it may not be.

2 The chair of the remuneration committee or the NED responsible for employee voice should have recent and relevant people experience, so that there is the same expectation of professionalism as for the audit committee. This should not necessarily mean that only those with professional qualifications can apply, but it does mean that people expertise needs to be taken as seriously as financial expertise.

3 The board, supported by the HRD (if not represented on the board), should ensure that it has the necessary knowledge of workforce policies, practices, behaviours and data to inform its understanding of people risks, in the same way that the board is expected to have sufficient understanding of the financial risks. Investors and the FRC may wish to consider whether disclosures around the skills of the board as a whole, as well as the individual directors, are sufficient.

4 The FRC should consider whether the current structure of UK boards is imbalanced, with too few executive directors. The current UK Corporate Governance Code wording states:

> *"The board should include an appropriate combination of executive and non-executive (and, in particular, independent non-executive) directors, such that no one individual or small group of individuals dominates the board's decision-making."*
> **(Part 2: Division of Responsibilities, paragraph G)**

This is clear, but, in practice, the number of executive directors is mostly reduced down to the CEO and CFO.

Boards need to match the balance of skills and experience of the whole team on the board, including both executive and non-executive directors, to the challenges faced by the organisation. At present, the balance of experience on UK boards is weighted towards financial expertise almost by default. Boards need to consider and explain how their composition matches the challenges faced by the company.

If you are an HR leader with aspirations of building a portfolio career of NED roles, our guide to advancing your career and moving from an HRD to a NED role offers key considerations and headhunter tips on:

- preparing for a role
- finding a role
- beginning a role.

Our case studies give practical advice from senior leaders who have successfully made this move.

# 7 Methodology

For our analysis, we examined the career histories of the boards of all the FTSE 350 companies required to publish a pay ratio disclosure (meaning they have more than 250 UK employees and are thus categorised as a large business in the UK). We looked specifically for professional expertise and experience in people management roles prior to assuming board positions, as well as professional backgrounds in other fields, for comparative purposes.

As we only viewed the profiles of individual board members on company websites, it may be that the analysis slightly underestimates the extent of board-level representation of the HR profession; for example, board members may have people management experience that isn't mentioned in their profile. However, it is unlikely that meaningful HR experience would not be mentioned in a paragraph summarising the significant parts of an individual's career history and, if it was omitted, that would be somewhat revealing of the skills the company considers relevant at board level.

**Employers beyond the FTSE 350**

The research was limited to the FTSE 350, because the process of identifying the companies was comparatively uncomplicated and the career histories of their board members are disclosed in a relatively consistent fashion. However, there are good grounds to think that it is illustrative (even if not entirely representative) of major employers more generally.

The research seminars and interviews found that the issue of the low profile or lack of expertise relating to people management at board level spanned different organisations regardless of ownership structure. It is just as important to non-listed businesses, subsidiaries of foreign-owned organisations and major employers beyond the private sector that their long-term strategy accounts for their people needs and how they will fulfil them as it is to companies on the FTSE 350.

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CIPD

Championing better work and working lives

# CIPD response to FRC Corporate Governance Code consultation 2023
# 13 September 2023

codereview@frc.org.uk

**About us**
We are the professional body for HR and people development. We've been championing better work and working lives for over 100 years.
We help organisations thrive by focusing on their people, supporting our economies and societies. We're the professional body for human resources, learning and development, organisation development and all people professionals – experts in people, work and change.
With 160,000 members globally – and a growing community using our research, insights and learning – we give trusted advice and offer independent thought leadership. And we are a leading voice in the call for good work that creates value for everyone.

**Summary**
We welcome the FRC Code consultation and wish to comment on some key areas relevant to the HR profession. We appreciate that the focus of the FRC and its mandate from government was to focus more on the audit and financial aspects of governance; however, we focus more on the people aspects. Our response is based on individual interviews and group calls with our senior members over several months.

- Overall, we welcome the suggested changes and believe that they will help boards to better understand and manage their responsibilities.

- We believe that there are wider issues around board composition and succession planning which should be considered: Specifically, the board needs to consider the balance of skills and experience of the board as a team in addition to the skills of the individual directors, and to consider non-financial, as well as financial, expertise. There is usually too much focus on the latter and not enough on the former in both cases. This is an area where HR professionals can add valuable expertise, as highlighted in the CIPD report: The value of people Expertise on corporate boards (2023)[i]. We make some more detailed recommendations in our report.

- Equality, diversity and inclusion (EDI): We agree that a more joined-up approach would be useful in principle, and that a focus on outcomes would be useful, but further changes are needed, especially around merit and objective criteria, and all directors should receive some basic training on EDI.

- Sustainability reporting: We are unconvinced that giving additional powers to audit committees is the right way forward. We believe that there is too much focus on financial experience and not

enough on other areas such as HR experience, which also leads to a greater danger of group-think.

We comment in more detail on our report and some of the individual questions below.

## The value of people expertise on corporate boards

The CIPD published a report in July 2023 based on group calls and individual interviews with our chief people officers (CPO) members, and on statistical analysis of FTSE 250 boards.

**Key findings of the report:**

- Many of the key challenges facing companies relate to people issues; however, there is often a significant mismatch between the skills and knowledge of UK boards and those needed to understand the main people-related risks facing organisations. The focus is too often on the skills and performance of individual directors rather than the overall skills and knowledge of the board as a whole.

- This 'people insight' deficit also means that many organisations fail to fully recognise the value creation potential of their workforces, reflected by falling levels of investment in workforce training and disappointing levels of productivity growth in the UK.
    - Several of the main challenges around organisational performance come down to people management, including closing skills gaps, talent attraction and retention, EDI and workforce mental health. Indeed, a recent Gartner survey found that workforce issues rated alongside digital technology initiatives as the top strategic business priorities for boards in 2023-24.
    - Corporate failings, such as sexual harassment and other forms of discrimination, bullying, and poor working practices, can lead to serious reputational damage if not recognised by senior leaders.
    - Companies that don't take equality, diversity and inclusion (EDI) matters seriously are also likely to fall behind in the war for talent.

- However, the majority of UK boards lack directors with a professional background in HR and people development, which would not be seen as acceptable for financial expertise – indeed the UK Corporate Governance Code has required recent and relevant financial experience on audit committees. While 100% of FTSE 350 company boards have members with finance or accounting backgrounds, only a quarter have a member with professional HR experience. Many chairs, senior independent directors, nomination and remuneration committee chairs also have financial backgrounds. There is even a lack of HR representation on remuneration committees (23%) and nomination committees (20%), despite these both being focused on the key people issues of reward and talent.

- This picture is emphasised when looking at the professional backgrounds of executive directors on FTSE 350 boards. In all, 99% of boards have a chief financial officer (CFO) or finance director among their executive directors, compared to just 2% that have an HR director at executive director level.

- The report highlights common errors that CPOs see board members making, which include:

- an over-confidence/a lack of understanding of people issues
- an over-focus on the financial skillset
- an 'over-enthusiasm' around employee engagement
- a lack of emotional intelligence
- a lack of awareness/discomfort around EDI.

**Recommendations:**

1. Investors should ask questions about the overall balance of skills and experience on the board. An HR director (HRD) or a chief people officer (CPO) should not necessarily be a main board member. However, boards should have formal processes for accessing the professional expertise of senior-level HR practitioners who know the business, on all matters or committees where in-depth insight on workforce matters is required.

2. The CIPD believes there is a strong case for some key refinements to the UK Corporate Governance Code and accompanying guidance to signal to boards the need for input, support and advice from senior-level HR practitioners on critical workforce issues.

3. CPOs should have the right of access to remuneration and nomination committees, in the same way that the Cadbury Report recommended that finance directors do to audit committees. In listed companies this tends to be the case already, but in the public sector or smaller organisations, it may not be.

4. The chair of the remuneration committee or the NED responsible for employee voice should have recent and relevant people experience, so that there is the same expectation of professionalism as in the audit committee. This should not necessarily mean that only those with professional qualifications can apply, but it does mean that people expertise needs to be taken as seriously as financial expertise.

5. The board, supported by the HRD (if not represented on the board), should ensure that it has the necessary knowledge of workforce policies, practices, behaviours and data to inform its understanding of people risks, in the same way that the board is expected to have sufficient understanding of the financial risks. Investors and the FRC may wish to consider whether disclosures around the skills of the board as a whole, as well as the individual directors, are sufficient.

6. The Financial Reporting Council (FRC) should consider whether the current structure of UK boards is imbalanced, with too few executive directors. The current Code wording states:

   *"The board should include an appropriate combination of executive and non-executive (and, in particular, independent non-executive) directors, such that no one individual or small group of individuals dominates the board's decision-making"* (Part 2: Division of Responsibilities, paragraph G).

   This is clear but, in practice, the number of executive directors is mostly reduced down to CEO and CFO.

7. Boards need to match the balance of skills and experience of the whole team on the board, including both executive and non-executive directors, to the challenges faced by the organisation. At present, the balance of experience on UK boards is weighted towards financial expertise almost by default. Boards need to consider and explain how their make-up matches the challenges faced by the company. We do not believe that this is currently the case and we suggest that the FRC's Financial Reporting Lab explores this further.

We comment further on these issues in the relevant questions below.

## Consultation questions

## Board leadership and company purpose

**Q1: Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?** *(When reporting on its governance activity the board should focus on outcomes in order to demonstrate the impact of governance practices and how the Code has been applied. Where the Board reports on departures from the Code's provisions, it should provide a clear explanation.)*

The changes themselves will not deliver more outcomes-based reporting. It is only the company's reporting that can do that. However, the changes should be helpful in communicating the desired behaviours.

However, there is a constant tension which is not really articulated here: it is not possible to achieve both:

- The more that investors seek comparability, the more focus on detail there will be, leading to more boilerplate reporting.
- The more that companies have freedom to choose what to say, the simpler and clearer the content is likely to be, but with the risk that companies may omit information that investors would like to see.

If you want boards to focus more on the key issues, you may need to reduce some other disclosures. If you want to include the maximum disclosures in order to achieve comparability, you may need to sacrifice effectiveness of communication. This is an example of a polarity[ii] whereby opposing forces pull at each other to keep things balanced.

There is a wider question as to whether and where companies are generally expected to comply and where there is more room for experimentation and explanation. In order to achieve compliance, you may need more of a performance culture. In order to achieve explanations, you may need more of a learning culture. Many companies which are at an early stage of reporting are more likely to only be able to report on inputs as a starting point; with reporting on outputs at a more mature stage.

The CIPD has conducted research into Creating learning cultures: assessing the evidence[iii]; with further information available here: Creating and developing positive organisational cultures for learning and inclusion[iv].

Questions which perhaps align more with the Department for Business & Trade Non-Financial Reporting call for evidence (see our submission in response[v]) might be:

- Would it be possible to reduce some of the disclosures around inputs, in order to achieve better reporting on outputs? An example might be to reduce the disclosures around board attendance and individual qualifications, and to focus more disclosures around the skills of the board as a whole.

- Would it be possible to disclose some of the information on the company website rather than in the annual report?

**Q2: Do you think the board should report on the company's climate ambitions and transition planning, in the context of its strategy, as well as the surrounding governance?**

Yes, while recognising how hard some companies are finding the reporting as it may involve wider changes internally. The board should also ask itself whether it has the necessary skills and experience to know which questions to ask and seek to upskill the existing directors/seek new ones as appropriate. The FRC should encourage companies to report on key aspects of HR strategy and practice on areas such as change management, organisational design, strategic workforce planning, upskilling the workforce and supply chains; not just how it will use hard skills around carbon, hydrogen, construction, extraction, etc.

See the CIPD report on net zero for people professionals Putting people professionals on the road to net zero[vi] and examples of case studies from CIPD members: Embedding environmental sustainability initiatives in your organisation: Case studies[vii]

The need for organisations to recognise that investing in workforce skills is central to sustainability was articulated earlier this year by Microsoft President Brad Smith, who said that, as firms moved to transition to net zero, they are "*confronting a huge sustainability skills gap. This gap encompasses three categories. First, some employees need deep and specialized sustainability knowledge and skills in areas like carbon accounting, carbon removal and ecosystem services valuation. This includes the skills needed to address these issues through new climate-specific digital tools. Second, broader business teams need readier access to more limited but sometimes deep knowledge in specific sustainability subject areas, such as climate-related issues that have become important for procurement and supply chain management. Third, a great many employees need basic and broader fluency in sustainability issues and climate science fields that impact a wide variety of business operations and processes."*[viii]

## Division of responsibilities

***Q4: Do you agree with the proposed change to Code Principle K (in Section 3 of the Code), which makes the issue of significant external commitments (overboarding) an explicit part of board performance reviews?***

**Q5: Do you agree with the proposed change to Code Provision 15, which is designed to encourage greater transparency on directors' commitments to other organisations?**

Our perception is that there is too much focus on the skills and performance of the individual directors rather than the board as a team, and whether the board has the skills and experience that it needs in order to meet the external challenges, and whether it is performing as a team.

Clearly shareholders need to know sufficient detail about the individual directors in order to make an informed decision as to whether or not to vote for them. However, the key questions that shareholders should be asking themselves are:

- What are the key challenges facing this board?
- Does the board as a team have the key skills and experience that it needs to meet these challenges? See the CIPD report: The value of people expertise on corporate boards, which suggests that they may not. **We recommend that all directors receive training on EDI.**

Many boards already provide an overview of the skills of the board as a whole in the annual report, but they provide much more detail about the individual directors. We also hear fewer concerns about the team rather than the individual from shareholders, but we wonder whether this is because of a focus on the disclosures made, rather than those which are most important.

We wonder whether the annual report or the company website would be the best place to include detailed biographies, the latter with a link from the annual report, or perhaps the annual report should only include biographies for new directors. The report could then focus on the skills of the team rather than the individuals.

## Composition, succession and evaluation

**Q6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?**

Yes (aim to avoid duplication of the FCA listing rules).

**Q7: Do you support the changes to Principle I moving away from a list of diversity characteristics (gender, ethnicity) to the proposed approach which aims to capture wider characteristics of diversity?**
Proposed wording: *"Both appointments and succession plans should be based on merit and objective criteria. They should promote equal opportunity, and diversity and inclusion of protected characteristics and non-protected characteristics including cognitive and personal strengths."*

Yes, we support the move away from a list in the Code; whereby companies report where they have set targets, or explain where they choose not to report. We also support a focus on outputs (success in application) rather than inputs (policies), while recognising that newly listed companies may need to start from inputs. In addition:

- we support mandatory company reporting on gender and ethnicity, including narrative reporting, but we believe that this should be in primacy legislation or in sustainability reporting standards rather than the Code

- we support voluntary reporting on disability as proposed by the DWP
- we have commented on social reporting in more detail in our response to the call for evidence on non-financial reporting from the Department for Business and Trade
- we have produced a guide to inclusive recruitment,[ix] which is aimed at managers rather than boards, but the principles are the same.

However, we have some reservations regarding the language in Principle I as set out below. As drafted, the Code states that: "*Both appointments and succession plans should be based on merit and objective criteria*."

The wording implies that merit is separate from/does not need to meet objective criteria, which we believe is not the intention, and is no longer in line with good practice. Indeed, the London Business School/SQW/FRC 2021 report on Board Diversity and Effectiveness[x] noted that *"it is now clearly a small minority of directors who use such language as 'meritocracy' in the diversity conversation to avoid appointing a diverse board"*.

All boards want to appoint based on merit if, by that, we mean ability to add value to the company. However, it would be better to define what they *do* mean rather than rely on a vague term: whether that be in-depth sectoral experience, or competencies such as intellectual acumen, the ability to challenge, etc, to define what outcomes they are seeking from the person and how that person will add value to the board as a team as well as his/her individual qualities. Otherwise, different committee members may all have different understandings of what the word means.

**We would therefore suggest that the FRC delete the word "merit" and rely solely on "objective criteria".**

Our members tell us that board members need training on EDI: "*People understand diversity and inclusion much better if they're currently in a workplace. That's where most people get their insight and learning about it. If you've been out of the workplace for a while, you might not know some of the language that is okay and not okay to use. And the impact of a non-executive director saying something that is offensive, totally unintended, is pretty big. [We can] help them to understand the latest thinking in areas like inclusion.*" (FTSE-listed CPO)

**Q8: Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?**
Revised version: *"The annual report should describe the work of the nomination committee, including:*
*• succession planning for both board and senior management positions, in order to deliver the company's strategy, including an explanation of how the committee has overseen the development of a diverse pipeline for succession;*
*• the appointments for the board and senior management, including the search and nomination procedures and promotion of diversity;*
*• the effectiveness of the diversity and inclusion policy, including progress towards company objectives and adherence to established initiatives;*
*• the gender balance of those in the senior management and their direct reports; and*
*• how the board performance review has been conducted, the nature and extent of an external evaluator's contact with the board and individual directors, the outcomes and actions taken, and how it has or will influence future board composition.*

Yes. It will be interesting to see how boards report on the effectiveness or otherwise of their diversity and inclusion policies and progress. The CIPD has conducted an analysis of company reporting on the gender pay gap[xi] and we found that:

- in the first year of reporting on the gender pay gap, 74% of employers that had submitted their gender pay gap data also gave a weblink to a narrative explaining their figures and any plans they might have to create a more equal workplace
- by 2022/23 however, this proportion had slumped to 56%, possibly indicating that some employers no longer feel the need to justify their figures or actions.

**Board performance reviews**

**Q9: Do you support the proposed adoption of the CGI recommendations as set out above, and are there particular areas you would like to see covered in guidance in addition to those set out by CGI?**
*15 Recommendations: https://www.cgi.org.uk/assets/files/pdfs/Publications/reporting-on-board-performance-reviews.pdf*

Yes, we support the recommendations, which are aimed at better communication.

The CIPD has reviewed the academic evidence on what works in performance management[xii] by and for managers, rather than boards, but the principles are likely to be similar. The findings include that:

- feedback is important
- developmental conversations should be kept separate from those looking at assessments and reward
- discussions about what employees have learned and how they can improve are very different from those about accountability for past performance.

Given that annual reports are generally focused on past performance and reward, they are not likely to be the appropriate place to disclose developmental needs. See Performance management: Could do better?

## Audit, risk and internal control

***Sustainability reporting***

**Q12: Do you agree that the remit of audit committees should be expanded to include narrative reporting, including sustainability reporting and, where appropriate, ESG metrics, where such matters are not reserved for the board?**

No. On balance we do not support an expanded role for the audit committee.

The FRC consultation states that: *"The audit committee has experience in setting policies and frameworks which could be adapted to ESG metrics, and as such it is best positioned to oversee ESG disclosures, controls, processes, and assurance."*

Currently there is too much focus by government, the FRC and by boards on financial expertise; see our report on the value of people expertise on corporate boards. This may lead boards to focus too much on money and risk, rather than people and opportunity. We are not convinced that the audit committee will have the relevant skills or capacity to oversee more work as many audit committees are already overstretched and their membership may not be sufficiently broad.

For example, effective ESG reporting is likely to require insights on key areas of human resource management which are critical to an effective transition to net zero operations, including workforce planning, change management (including consultation with employees) and training and development.

Many of the risks that could derail firms' transition to net zero are people-related rather than purely financial and so reporting on ESG matters requires expertise that lies outside that of most audit committees.

Our members tell us that:

*"I've been doing a plc job for 10 years and I've seen that interaction [between CPO and the board] change: the depth of it, the breadth of it… we have four board committees: audit, RemCo, NomCo and employee engagement – I'm driving three out of the four." (FTSE-listed CPO)*

*"Six years ago, we probably had about five investor calls. Last year we did 27 calls with investors wanting to have discussions about people – what we're doing with talent, the diversity piece… more and more of the investors want to see you linking rewards, long and short term, to ESG [environmental, social and corporate governance]." (FTSE-listed CPO)*

We note that the FRC has interviewed audit committee chairs regarding ESG, but has not interviewed the chairs of other committees to obtain their views. (Audit Committee Chairs' views on, and approach to (ESG) June 2023 (frc.org.uk)) We would suggest that the FRC also interviews the chairs of ESG committees and others such as people and culture committees as regards non-financial reporting.

Given that some 41% of FTSE 250 boards now have an ESG/sustainability/CSR committee, we are unconvinced of the need to expand the remit of the audit committee. We believe that individual companies are best placed to decide which committees should have oversight around disclosures. It may be more appropriate for the whole board to oversee ESG, or for environmental metrics to sit with a sustainability committee, or for the people and culture committee or the ESG committee or the nomination committee or the employee engagement committee to have oversight of the relevant sections of the social part of non-financial reporting.

***Risk management and internal controls***

**Q15: Where controls are referenced in the Code, should 'financial' be changed to 'reporting' to capture controls on narrative as well as financial reporting, or should reporting be limited to controls over financial reporting?**

Yes, controls should refer to both financial and non-financial reporting as this should improve the quality of data and thus the quality of reporting over the longer term. The wording should read:

*"…establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of financial, non-financial and narrative statements."*

One of the requirements in the Code on the board is to consider:

***The skills, knowledge and experience of the board and management.*** *The board should consider whether it, and any committee or management group to which it delegates activities, has the necessary skills, knowledge, experience, authority and support to enable it to assess the risks the company faces and exercise its responsibilities effectively. Boards should consider specifically assessing this as part of their regular evaluations of their effectiveness.*

Given the findings of our report on the value of people expertise on corporate boards, which found a lack of HR expertise among board members among 75% of major listed companies, we question whether UK boards have the necessary skills, knowledge, experience, authority and support to enable them to fully assess people risks.

We also question whether nomination and remuneration committees have all the necessary skills and experience, given that 80% of nomination committees dealing with succession planning and senior talent and 77% of remuneration committees dealing with motivation and reward lack HR expertise, depending on whether they have the necessary support from HR teams.

In the internal controls guidance, boards are responsible for:

- *ensuring that appropriate culture and reward systems have been embedded throughout the organisation;*

and

***Exercising responsibilities***
*…in deciding what arrangements are appropriate the board should consider, amongst other things: • The culture it wishes to embed in the company, and whether this has been achieved.*
*As with all aspects of good governance, the effectiveness of risk management and internal control ultimately depend on the individuals responsible for operating the systems that are put in place. In order to ensure the appropriate culture is in place it is not sufficient for the board simply to set the desired values. It also needs to ensure they are communicated by management, incentivise the desired behaviours and sanction inappropriate behaviour, and assess whether the desired values and behaviours have become embedded at all levels. This should include consideration of whether the company's leadership style and management structures, human resource policies and reward systems support or undermine the risk management and internal control systems.*
*…In addition to the board, committee and management's own monitoring activities, sources of assurance might include reports on relevant matters from any compliance, risk management, internal control and internal audit functions within the company*

Given the role of HR in promoting culture, agreed behaviours, leadership and management training, talent succession planning and reward, other possible sources for non-financial reporting could be HR and/or sustainability reports within the company.

**Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?**

We note that the quality of people data is less reliable than financial data due to under-investment over many years[xiii]. Companies have not prioritised investment in non-financial data systems, which means that they will not have received non-financial reports of the same quality as financial reports[xiv], and may not have truly understood these risks or known to ask the right questions about people risk management due to their lack of HR/other non-financial expertise.

## Remuneration

**Q22-23:**

- **Do the proposed revisions strengthen the links between remuneration policy and corporate performance?**
- **Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?**

Yes. We support reference to employee pay and conditions being taken into account in remuneration outcomes for directors. Listed companies already report their pay ratios.

**Q24: Do you agree with the proposed changes to Provisions 40 and 41?** *(Aim to reduce reliance on templates, cross-refer to gender pay gap reports)*

Yes. There has been an improvement in reporting with companies talking about the impact that their engagement with employees has had, in addition to their engagement with shareholders.

**Q25: Should the reference to pay gaps and pay ratios be removed, or strengthened?**

Companies do not currently communicate well on the gender or ethnicity pay gap. We support greater use of narrative reporting in addition to the figures, although we believe that this should be in legislation rather than in the Code. It should be reported annually, but not all of the detail need be included in the annual report. However, if this is to happen, there should be a reference or link to the relevant information.

The CIPD has championed the need for employers to produce narratives explaining their pay ratios and gaps, so we would support companies reporting the measures that they have taken to reduce those gaps and the impact of those measures.

What boards and remuneration committees should focus on in the context of the Corporate Governance Code is not so much the detail, but more the key risks to their business, given the economic and social context: many companies face talent shortages, and with 57% of undergraduates now female[xv], and up to 80% of consumer decisions taken by women[xvi], boards need to consider how they will be able to compete with the potential loss of talent and customers if their competitors' pay gap is much smaller, such that they have first choice of talent, as well as the risks to employee motivation where there are huge pay disparities (60% of respondents in a CIPD survey[xvii] agreed that CEO pay levels in the UK demotivate employees) at the same time as a cost-of-living crisis, and the impact on the culture created when the pay gap effectively tells some employees that their work has less value than others, with a corresponding impact that this may have on the company's ability to deliver its plans. Investors will have an interest in understanding the environment in which the company is operating, and how boards are managing these tensions.

If boards need additional information, we have produced guidance for companies on how to report here:

- Gender pay gap reporting guide[xviii]
- Ethnicity pay gap reporting guide[xix]

We support the DWP guidance on disability reporting[xx].

And we have looked at the impact of the cost-of-living crisis on employees[xxi]:

## Artificial intelligence

**Q26: Are there any areas of the Code which you consider require amendment or additional guidance, in support of the Government's White Paper on artificial intelligence?**

We do not believe that there is a need for additional guidance in the Code. It may be useful, however, to consider whether to include some content in the board effectiveness guidance in the future. For example, highlighting the need for boards to ensure they have met the five principles for the responsible use of AI set out in the Government's white paper if these are adopted:

- Safety, security and robustness
- Appropriate transparency and explainability
- Fairness
- Accountability and governance
- Contestability and redress.

An area of people risk which boards may need to be particularly wary of is EDI, where the data used to train the AI may or may not have been diverse, which may affect the outcomes proposed by the AI. Boards may want to ask whether the AI has been subject to a diversity audit to guard against these risks.

The CIPD recommends that organisations draw up an AI policy to:

- ***Consider your organisational culture:*** *If you have values or behaviours that encourage initiative, curiosity and experimentation, then your AI policy should reflect these. If the environment is more tightly controlled or regulated, then your policy may need to reflect that.*
- ***Determine why you want an AI policy:*** *Consider the areas of risk management for the organisation, particularly regarding data security (e.g. ensuring the organisation's data is not inadvertently placed into the public sphere), accuracy and quality assurance (e.g. ensuring employees don't solely rely on outputs from AI tools, but validate the generated information), control*

*(agreeing what is and isn't reasonable use), and fairness (e.g. ensuring that use of tools guards against bias).*

- ***Articulate the benefits that you want to achieve**: Is the aim to increase productivity, improve quality, reduce time spent on activities, or possibly to accelerate learning? Articulating desired benefits guides usage and reduces fear about elimination of jobs.*
- ***Understand current use in your organisation**: This may be difficult if there is low trust at present. People who are already using AI may worry they will get into trouble. But it is important to get at least some sense of where, when and how people are using the tools.*
- ***Consider where AI may be deployed in different roles**: Some of this will be driven by the approach of senior leaders but will also be influenced by the nature of the role. AI tools can support research, planning documents, writing business papers and policies, assessing data for errors, writing code and beyond.*
- ***Maintain compliance with obligations and requirements**: These can include aspects such as data security and GDPR obligations, local legislation or requirements from industry regulators. It is also critical to identify how the organisation will guard against algorithm bias. Determine whether there are new legal requirements driven by AI, or whether your existing policies already cover them sufficiently or should be revised. The new policy may need to articulate the connection to the ones already in place, reminding employees of their existing responsibilities.*

*In the round, these elements of the organisational culture, structure, current usage, along with matters such as legislative requirements, will guide the development of your policy.*

For more on people and technology risks, please see our reports and guidance below:

- Automation, AI and technology | CIPD[xxii]
- Impact of artificial intelligence, robotics and automation technologies on work | CIPD[xxiii]
- Responsible investment in technology | CIPD[xxiv]
- Preparing your organisation for AI use | CIPD[xxv]

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[i] www.cipd.org/uk/knowledge/reports/people-expertise
[ii] www.harvardbusiness.org/navigating-complexity-managing-polarities
[iii] www.cipd.org/globalassets/media/knowledge/knowledge-hub/reports/creating-learning-cultures-1_tcm18-75606.pdf
[iv] www.cipd.org/uk/views-and-insights/thought-leadership/the-world-of-work/positive-organisational-culture-inclusion
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[vi] https://www.cipd.org/uk/knowledge/reports/people-professionals-net-zero/
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[x] www.london.edu/-/media/images/leadership-institute-refresh/frc-board-diversity-and-effectiveness-in-ftse-350-companies.pdf
[xi] www.cipd.org/uk/views-and-insights/thought-leadership/cipd-voice/gender-pay-gap
[xii] https://prod.cipd.co.uk/en/knowledge/reports/what-works-in-performance-management-report/ and www.cipd.org/en/topics/recruitment
[xiii] www.cipd.org/uk/views-and-insights/cipd-viewpoint/people-analytics
[xiv] www.cipd.org/uk/knowledge/reports/improving-people-data
[xv] Education and training statistics for the UK, Reporting year 2022 – Explore education statistics – GOV.UK (explore-education-statistics.service.gov.uk)
[xvi] Avivah Wittenberg Cox 20-First Interview Final Cut on Vimeo

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[xvii] www.cipd.org/uk/knowledge/reports/ceo-pay-report
[xviii] https://prod.cipd.co.uk/en/knowledge/guides/gender-pay-gap-reporting-guide
[xix] https://www.cipd.org/uk/knowledge/guides/ethnicity-pay-reporting-guide
[xx] www.gov.uk/government/publications/voluntary-reporting-on-disability-mental-health-and-wellbeing
[xxixxi] www.cipd.org/uk/views-and-insights/thought-leadership/cipd-voice/cost-of-living-workplace
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[xxiv] www.cipd.org/uk/knowledge/guides/responsible-investment-technology
[xxv] www.cipd.org/en/knowledge/guides/preparing-organisation-ai-use