Consultation by the Financial Reporting Council on Proposed Revisions to the UK Corporate Governance Code.

Submission in response by Relational Research.

Summary.

The Financial Reporting Council published Proposed Revisions to the UK Corporate Governance Code in December 2017. Appendices to this document comprise the Revised UK Corporate Governance Code, Revised Guidance on Board Effectiveness and a summary of changes from the 2016 version of the Code. Comments on the revised Code and Guidance have been invited, in particular on the specific questions set out in the consultation document. This submission sets out the comments of Relational Research.

We welcome the recognition of the value of the contribution of stakeholders to the success of companies and of engagement with them and their interests, as well as the wide-ranging impact of companies' activities on stakeholders and the importance for boards to consider how their companies interact with the workforce, customers, suppliers and wider stakeholders. We are also pleased to note the acceptance that companies can do more to recognise that the workforce and other stakeholders play a significant part in the long-term success of the company and that this is reflected in the revised Code by a requirement that boards should ensure effective engagement with, and encourage participation from, shareholders and other stakeholders. Significantly, the Introduction to the Code states that to succeed in the long-term, directors and the companies they lead need to build and maintain successful relationships with a wide range of stakeholders.

The Guidance which assists companies when applying the principles of the Code emphasises the value of alignment of the interests of all stakeholders with those of the company when it says "by promoting a more inclusive approach to stakeholder engagement and by encouraging boards to consider how the way in which decisions are taken might affect the quality of those decisions. By broadening boards' focus beyond the confines of the boardroom itself, opening boards up to different voices and influences, the Guidance supports openness and accountability in delivering the long-term success of the company". The Guidance also recognises that an effective board will have a clear understanding that long-term value for shareholders is dependent on relationships with stakeholders which will help to deliver the company's purpose.

The approach towards recognition of the value and importance of stakeholder interests and their contribution to the success of companies responds to the views increasingly expressed by business leaders, politicians, academics, opinion formers and many others, as well as the Green Paper on corporate governance reform published by the Department for Business, Energy and Industrial Strategy in November 2016. It is now generally understood that there is more to modern company structure, operation and success than the short-term drive for financial profit and return for shareholders, at the expense of investment in the company, employees, suppliers, customers and others who rely on the company for their livelihood and wellbeing. We also note the interesting and valuable report published by the FRC on Corporate culture and the role of boards published in 2016,

in which it is noted that a healthy corporate culture is a valuable asset, a source of competitive advantage and vital to the creation and protection of long-term value. We understand that much of its findings have been included in the revised Code and Guidance.

The approach taken in the Code and Guidance resonates with and reflects closely many of the views we have developed over the past 10 years as to how companies can flourish through an alignment of interests between the company and its stakeholders, recognising the value of engagement with them and support for their interests, based on understanding and nurturing their relationships with the company. By adopting this approach companies will be more successful and responsible to society, for the long-term benefit of all stakeholders, including shareholders, as well as society as a whole. In our view this will also encourage companies to invest in their workforce and the development of the business and take a long-term view of their operation.

However, as explained later in this submission, we suggest that the revised Code and Guidance should be clarified and expanded in a number of ways to help to understand and emphasise the value of an inclusive approach to stakeholder interests. An example of this, explained below, is that the board should have to disclose its policy towards stakeholder recognition and relationships and how the company has engaged with various groups of stakeholders and how their interests are met. Not only should the framework be explained but evidence shown that it has been applied in practice and action taken as a result. We suggest further that the approach to stakeholder relationships might be embedded in the company's constitution by including it in the company's Articles.

Further, whilst we recognise the benefit of the voice of the workforce in the boardroom through a panel or director appointed to represent their interests, we believe an executive director should be appointed to represent the interests of all stakeholders. This would emphasise the importance to the company of their interests in company policy, decision-making and operation. In addition, we suggest that the interests of the families of the workforce be addressed. We also suggest that company meetings be held on a quarterly basis (at different times of day and at different locations to encourage attendance) and that not only shareholders but also other stakeholders are invited to attend, for instance members of the workforce and some suppliers and customers.

We suggest that listed companies which follow the Code requirements and adopt the best practice set out in the Guidance, incorporating at least some of our suggestions, will lead the way to show that the corporate world can embrace the interests of the workforce, suppliers, customers, other stakeholders and society more broadly, whilst operating a successful and profitable business. The practice adopted will focus on the interests of all who have an interest in the success of the company and not just the short-term financially driven approach in the interests of shareholders. It should lead to a re-evaluation of the danger of ever-increasing pay differentials with the loss of recognition of the contribution of lower paid employees, as well as suppliers bring paid on time and within a reasonable period, customers receiving an efficient, speedy and personal service, and tax being paid where profits are earned.

In the following part of this submission we explain in a little more detail our relational approach and, in the following section, address the questions in the consultation document including our suggestions for changes, clarification and additions. Given that there are 3 documents under consideration, the consultation document, the revised Code and revised Guidance, we ask that our comments be taken to apply to each where appropriate. In some areas it has led to some of our comments being repeated where they apply to different parts of the documents. We would ask that it be noted that we submitted comments on the Green Paper on corporate governance reform published by the Department for Business, Energy and Industrial Strategy in November 2016.

The Relational approach.

We are pleased that the approach taken in the consultation document, revised Code and Guidance with regard of engagement with interests of stakeholders (including shareholders) reflects quite closely the ideas and proposals we have developed for over a decade to put the interests of stakeholders at the heart of company decision-making and operations. We have written and lectured extensively on our ideas and how to bring them into practice in the corporate world and we have discussed them with business leaders, politicians, academics, professionals and opinion formers. We believe that there is an urgent need for a change of emphasis in the purpose of the corporate world from the relentless focus and demand on short-term and ever-increasing financial return for shareholders in listed companies, in the form of dividend payments and share price increase, often achieved through share buybacks, towards an approach which recognises and values the benefits of positive, nurtured and mature relationships with stakeholders and their interests. This reflects the value of the social and relational capital of a company and not just its financial capital, in which companies display commitment to their stakeholder community. We believe that companies whose interests are aligned with those of its stakeholders and which operate as a community of interests are likely to be more competitive, sustainable, productive, profitable and overall more successful, as well as attracting loyalty from employees, suppliers and customers.

The Green Paper acknowledged that many companies recognise the benefits of engagement with stakeholder interests in their business activities and that economic benefits are derived from bringing external perspectives to bear and in properly understanding and maintaining healthy relationships with interested groups. We suggest that engagement with stakeholders, including shareholders, having a continuing dialogue with them to understand their interests and values, listening to their views, treating them with respect, seeking shared goals and recognising issues over the running of their businesses (where relevant) and their contribution to the success of the company (whether they are employees, suppliers, customers, the local community, lenders or regulators), is essential for the operation of a successful and productive company. In other words, this engagement and recognition goes much beyond just a narrowly defined economic and financial goal.

One of our key proposals is that the measurement of the quality of relationships can be achieved by both parties being asked for their views on aspects of the relationship, for instance the closeness of communication, knowledge of the other party and their interests, whether each party is treated with respect and whether they have shared agreed goals. An analysis of the meaning of relationships and how they can be measured, improved and reported on can be found in The Relational Lens by John Ashcroft, Roy Childs, Alison Myers and Michael Schluter (published by Cambridge University Press 2017).

Properly paid employees with promotion prospects who are incentivised (through cash bonuses and share schemes), and are respected and their ideas and concerns listened to, will tend to be loyal to the company, more productive and less likely to leave or be absent from work through illness. Similarly, suppliers who are paid within a short timeframe and on the contractual due date, as well as being supported by the company, are more likely to give loyal commitment and service than if they are treated at arm's length and with late payment, with its damage to cash flow and the threat, for instance, of demands for more payments to display goods and early termination if price reductions are not forthcoming. Customers who are treated with concern and whose complaints are properly, promptly and personally handled will show loyalty and support for the business.

Further, in our view, individuals and other shareholders will be encouraged to invest for the longer-term if their concerns and interests are listened to and respected as investors, they have prompt access to directors and senior managers, and they are able to gain an understanding of the business and its plans. They will be more likely to feel a part of the company, show loyalty and take a longer-term view of their shareholding. They will also be in a position of knowledge and understanding to hold the directors to account if the company falls short of standards expected of a properly and responsibly run company. Incentives could be provided to encourage long-term investing (for instance, additional shares after 2 years).

Companies could consider ways to engage more closely with shareholders and other stakeholders on a regular basis. We suggest that companies could hold quarterly meetings with shareholders, possibly in different parts of the country and at convenient times of day to encourage attendance, and invite not only shareholders but employees and perhaps some suppliers and customers, as well as representatives of the pension fund trustees, banks and other lenders and regulators. There could be break-out groups for shareholders to meet individual directors to discuss different aspects of the business. Face-to-face meetings with directors would lead to greater openness, understanding and trust. Those investors in the company who are the main capital providers would be encouraged to hold shares directly in the company and to attend meetings with the company and other stakeholders.

It is encouraging that the Government, through the Green Paper and consultation, as well as the FRC, are helping to develop, through legislative and regulatory means supported by society as consumers and investors, a change in corporate culture to meet the expectation of employees, investors, suppliers, customers, regulators in the context of the responsibility of the corporate world to the society in which it operates and from which it benefits. We believe that companies which already adopt this approach will be recognised and encouraged and will lead others by example. The debate prompted by the suggestions in the Green Paper provide an ideal opportunity to start to reframe and refocus UK corporate culture in a distinctive and exciting way, based on commitment to stakeholder relationships, making the most of our enterprise, talents and resources, so that all will benefit and the litany of criticism of the corporate world will start to evaporate as faith and confidence is restored. There will be recognition of a more inclusive, responsible, constructive and successful form of capitalism. We consider that the revised Code and Guidance should play a significant role in helping to meet this goal with a change in corporate culture they will encourage.

A description of some of the problems with aspects of corporate behaviour, an analysis of the underlying causes (going back to company structures developed in Victorian times) and suggested ways to address the issues can be found in Transforming Capitalism from Within by Jonathan Rushworth and Michael Schluter athttp://relationalthinking.net/relational-research/ The approach is based on the framework of Relational Thinking which analyses the structure of relationships and suggests practical ways to put relationship priorities at the heart of society. This stands in contrast to a focus on the rights and interests of the individual within a narrowly materialistic world-view.

We believe that the adoption of the relational approach, supported by shareholders in companies, would transform the way in which business operates to serve the interests of, and create value for, all stakeholders (including shareholders) and society generally. It would also help to restore faith and confidence by society in the business world.

Against the background of our summary and description of the relational focussed approach, we now address the specific questions set out in the discussion document.

Questions addressed.

Question 1. Do you have any concerns in relation to the proposed Code application date?

We believe that the revised Code and Guidance should come into effect as soon as reasonably practicable but there must be sufficient time before they are finalised for full consideration of comments made and, where necessary, further discussion. Companies subject to the Code requirements (in particular company secretaries) will need time to absorb the revised requirements, if they involve a change of practice for them, and ensure that the board and others are ready to change their approach to decision-making and operation.

Question 2. Do you have any comments on the revised Guidance?

We have a number of comments on the revised Guidance, accepting that it is expressed not to be mandatory nor prescriptive. The Guidance is intended to assist companies in applying the principles of the Code and sets out good practice suggestions for meeting these requirements. It is valuable to stimulate boards' thinking on how they can carry out their role and encourage them to focus on continually improving their effectiveness. As a general observation we consider that there should be greater emphasis on the value to companies, shareholders and other stakeholders of following the practice set out in the Guidelines. Our comments on the Guidance are as follows:

a) Paragraph 10 of the revised Guidance states that at the heart of directors' duties (s172 Companies Act 2006) lies a focus on generating and preserving value for shareholders in the long-term, taking account of the interests of the company's workforce and "the impact on other stakeholders such as customers, suppliers, the community and the environment". We consider that it is not just a question of taking account of the impact on stakeholders, as s172 refers to "having regard...to...the need to foster the company's business relationships with suppliers, customers and others." This is a stronger statement, we suggest, than referring just to the impact on them and implies an understanding and appreciation of the interests of the stakeholders. It is helpful that paragraph 11 says that "An effective board will have a clear understanding of how that value is dependent on relationships with its stakeholders". It also refers to the importance of dialogue with shareholders, workforce and wider stakeholders and being pro-active in ensuring that such dialogue takes place. The questions for boards (on page 3) refer to the board considering the implementation, feasibility and impact on stakeholders as well as its impact on financial performance, and making sure that the voice of the workforce, customers and wider stakeholders is heard at board level and what impact this has had on board decisions.

We suggest that the need to value and foster the company's business relationships with stakeholders (and having regard to the interests of the company's employees) can be addressed in a rather more comprehensive way in the Principles and Guidance and embedded as part of the culture of the board and the company.

We believe that the directors should adopt a more deliberate policy towards stakeholder recognition and relationships, their approach to measuring the quality of these relationships, how the company has engaged with the various groups of stakeholders and how their legitimate interests are met, on the basis that this is in the best interests not only of the relevant stakeholders but also of the company and its shareholders. This would ensure not only that different stakeholder interests have been given consideration, but demonstrate the approach and action taken by the company to understand and measure the strength and quality of the relationship, the results of such an exercise, and how it can be developed for the benefit of both parties to a particular relationship and stakeholders generally. In other words, there must not only be a framework for engagement and measurement in place but evidence it has been applied in practice and actions taken as a result.

We suggest that, in order that shareholders and others can see that these vital matters have been properly and fully addressed, the policy towards stakeholder recognition and relationships, the measurement of the quality of the relationships and how the company has engaged with stakeholders and their legitimate interests met, are disclosed in the annual report and accounts and perhaps also on a 6 monthly basis. Directors can therefore be questioned on their standards in recognising the value of stakeholder interests, engaging with them and taking their interests into account, and they can be held to account if necessary. These matters are also addressed in our comments on paragraphs 26-36 of the revised Guidance and under Questions 3 & 4 below.

b) Paragraphs 14-21 of the revised Guidance consider decision-making and how boards can best address the decision-making process. One matter which we think should be addressed is consideration of the relationships between board members. This is relevant in other parts of the Guidance, in particular Chapter 2: Division of Responsibilities. We believe that this is a critical matter for the chair to address because if the relationships between directors are not respectful, positive and understanding, this is likely to lead to difficulties and tensions and maybe a breakdown in board discussions and decision-making. This will not be in the interests of the company, its workforce, shareholders and other stakeholders. Their relationships can be measured, in a number of ways, for instance as to the way in which they communicate (for company purposes and personally), how well they know each other's background and personal circumstances, whether they respect each other's expertise and experience, and whether they have a focus on shared agreed goals so far as the company and its purpose are concerned.

We note that neither the revised Code nor Guidance seem to address issues concerning boards of companies where there is a group, for instance a parent holding company with operating subsidiaries. There are matters to address with such structures, not least the relationship between the directors of the parent and those of a wholly-owned subsidiary, where maybe a director of the parent is also a director of the subsidiary. There are obvious questions of conflict, in particular if there are group solvency concerns. We suggest that relationships between such boards should be regularly assessed to help to ensure they can work constructively and with respect and understanding, accepting their legal and other duties and that the parent company directors may have a different interest and perspective than those of the subsidiary.

c) We suggest that, in respect of general meetings of shareholders (paragraphs 22 and 23), other stakeholders should be invited to attend. This would be part of the general approach by companies not only to engage with particular stakeholders but for groups of stakeholders to meet each other, subject of course to confidentiality issues. We suggest, as described above, that members of the workforce, some major suppliers and customers, as well as representatives of the pension fund trustees, bank and other lenders and regulators could be invited to attend. Meetings could be held quarterly and at different times of day (to encourage attendance, for instance for those working by holding some meetings in the evening) and in different parts of the country. The meetings could have break-out sessions, for instance for those attending to meet the finance director, chair or non-executives, in order to raise specific issues.

d) Some aspects concerning relationships with the workforce and wider stakeholders (paragraphs 26-36) are addressed in our comments on paragraph 10 above. We agree that boards should identify the different sets of stakeholders. These are likely to include direct stakeholders such as the shareholders, workforce, suppliers and customers, and indirect stakeholders such as banks and other lenders, who share less of the risk of the business, pension fund trustees, regulators and of course wider society (for instance in respect of the company's responsibility to pay tax where profits are earned).

e) We agree that the views of the workforce should be sought and encouraged not only for the boardroom but throughout the company structure (paragraphs 31-36). This should be part of a culture to engage, encourage and incentivise the workforce. Our views with regard to the suggestion for a director appointed from the workforce, a workforce advisory panel and a designated non-executive director (paragraph 35) are set out below in our answers to Questions 3 & 4.

   A further suggestion is that the Guidance should be expanded to recognise that engagement with families of the workforce will lead to a greater understanding of the needs of the workforce and a more inclusive approach. This might involve time for families to meet senior management and other families at a hotel or retreat for weekends. Family life could be further encouraged by, for instance, the company giving 3 months paid shared parental leave after a child is born (now a statutory entitlement but we understand that only a few companies continue paying during this period). With regard to the examples of workforce engagement activities (paragraph 35), we suggest that activities in the company should be encouraged which lead to employees meeting others across departmental boundaries, mixing levels of seniority in the business. An example would be an office choir, which are popular. This helps to break down structural barriers within companies and encourages friendships, understanding of others' points of view and loyalty to the company.

f) We agree that surveys of views from employees alone are not sufficient for the workforce to be encouraged and supported and to give them a sense of value (paragraph 36). In our view, because all relationships involve at least two parties, there should be an assessment from both sides of the relationship between the workforce and management, with workshops to discuss the views for both parties to build trust and assess how relationships can be encouraged and enhanced, and issues of concern to either side addressed. These suggestions can be built into the Questions for boards set out at the foot in paragraph 36.

g) Aspects of company culture are set out in paragraphs 37-46. The development of a culture of good practice, professionalism, honesty, trust, openness and inclusivity can be anchored in good corporate governance to create the standard of behaviour expected of everyone in the company and to which all companies should aspire. This needs to be accepted and encouraged by shareholders. We believe that this is anchored in the relational approach we espouse and as described earlier in this submission. We suggest that this could be included in this part of the Guidance (and elsewhere) as an overarching approach of helping to understand and embrace the interests of each group of stakeholders with encouragement and incentives for the company to operate for the long-term benefit of all stakeholders, including shareholders and wider society.

   A positive culture can be developed through recognising the value of the workforce, for instance, and measuring the quality of the relationships between management and other parts of the workforce from the perspective both of the management as well as the workforce, rather than only from the perspective of the workforce in typical employee attitude surveys and, where necessary, the quality of the relationship can be improved. As part of valuing and encouraging the workforce, employees would be paid generously (with no unfair zero hours contracts), they would be incentivised by financial rewards (cash bonuses and an interest in the company through shares), their views sought, listened to and acted upon, and their family interests respected. At the same time, management would have an opportunity to address concerns such as low productivity, excessive absenteeism and other matters within a constructive dialogue. It would be expected that this would lead to lower levels of sickness and absenteeism and lower staff turnover.

   In a company with a positive culture, suppliers would always paid by the contractual dates (we suggest this should be no more than 30 days), good business relationships developed and help given to develop the supplier's business (for instance helping with their IT). Customers would be treated personally with rapid handling of complaints and acknowledgement of fault. We believe that a culture of valuing the contribution of all stakeholders would lead to a reduction in pay differentials and companies relying less on debt. Further, we believe that such a culture would lead to companies recognising that they should pay tax in the country where profits are made, and not devising schemes to minimise tax liability through, for instance, intra-group licensing or other arrangements.

   These are just a few examples of how good relationships with stakeholders could be evidenced and an inclusive culture developed. One way to encourage a company to adopt such a standard with the backing of shareholders would be to adopt by shareholder resolution a provision in the company's Articles that the interests of all stakeholders would be valued, the quality of relationships with stakeholders measured, and their interests would be central to the company's decision-making and operations as this is most likely to promote the success of the company for the benefit of members. The company would of course expect that other companies it deals with would adhere to the same or equivalent standards.

We believe that the adoption of this approach and a set of values by the board and throughout the company as suggested in the Guidance (paragraphs 41-42) would encourage people to want to work for the company, it would attract customers and suppliers, and would greatly enhance the reputation of the company in the eyes of investors and society.

h) Responsibilities of members of the company board are explained in paragraphs 47-68 and the company secretary role in paragraph 69-74. We suggest, as mentioned above, that the relationships between board members are key to the successful operation of the board. Directors should be trained in how to develop and practise positive working and social relationships so they work together to promote the success of the company, in accordance with their duties, and ensure that the company's standing in the investment community and wider society is constantly reviewed and enhanced. It is important, in our view, to emphasise the relational aspect in these paragraphs. This would also embrace the relationships and understanding between particular directors and other stakeholders, for instance shareholders, key suppliers and customers. It is important, for instance, that non-executive directors do not just operate within the confines of the boardroom but have a good understanding of the business and its relationships with major stakeholders, in particular the workforce, suppliers and customers. The company secretary is rightly recognised as having a key role for the smooth and proper operation of the board and the individual roles of the directors. The quality of the relationship between the company secretary and individual board members should be assessed to support the suggestions in paragraph 74.

i) Paragraphs 75-95 address the role of the nomination committee, succession planning, and evaluation of the performance of the board. Our main suggestion is that an important factor in all these aspects is how the board works together and the relationships between individual directors and groups of them (for instance executive and non-executive), as well as overall as a working unit. This aspect is acknowledged in paragraphs 82 and 95. In addition, as suggested in paragraph 94, we consider that it would be appropriate and helpful for comments from the workforce and other stakeholders to be sought as part of the evaluation process.

j) Paragraphs 96-101 address audit, risk and internal control matters. One suggestion we make in connection with risk management is that companies cannot have effective risk management unless stakeholder relationships have been understood, analysed and properly managed. This applies not only to external relationships with suppliers, customers, shareholders and regulators, but also with regard to relationships with employees, internal audit and partnerships, and relationships with other group companies where there is a holding company and subsidiary companies. The risks may be generated by the actions of external parties, inadequate engagement by the company's own management team, or a weak relationship between senior management and those holding the client or other stakeholder relationship. In every case, sound relationship management practice will reduce the risks faced by the company.

k) Issues concerning remuneration are addressed in paragraphs 102-113. Our comments on this are set out in respect of section 5 of the revised Code (questions 14-16 below), but should be read as also applying to this part of the Guidance.

Questions 3 & 4. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement and should there be reference to certain other principles?

Question3 relates to engagement with the workforce and suggests 3 options: a director appointed from the workforce, a formal workforce advisory board or a designated non-executive director. Our concern with the second of these is whether the views of the advisory board will be taken into account properly at board meetings. It would be better, in our view, to have someone representing their interests who attends board meetings. Our suggestion in response to the Green Paper was that the interests of a number of groups of stakeholders should be represented by an executive director. Non-executive directors are not intended to be engaged in detailed operational matters and they only devote part of their time to the non-executive role. The practical aspects of engaging with the workforce and, as we suggest, other stakeholders and understanding and promoting their interests in a balanced but effective way, with the time which would be expected to carry this out effectively, seem to be more in the remit of an executive director. A detailed knowledge and understanding of the business and how stakeholders engage with and contribute to the success of the business would be required to carry out the relationship role.

To give this responsibility to an executive director would recognise the significance of stakeholder interests in corporate decision-making and planning at the board level and throughout the business. Creating a post of Stakeholder Relationships Director, for instance, would send a clear message to the corporate world and society in general that companies will move to a more stakeholder-inclusive approach and away from a narrow finance-driven shareholder focus. Such a director would therefore have similar status at board level as, say, the finance director. The Stakeholder Relationships Director and the board would need to keep under review the dynamics of the workforce and other stakeholder groups and relationships, and those whose interests are represented by third parties such as trade unions and trade associations.

Although certain non-executive directors may have the interest, personality, character and time to understand and represent the interests of stakeholders at board meetings, this is unlikely to be as effective as a director employed by the company with a full-time role to work with the other directors and employees to understand and promote the interests of those stakeholders who have a close financial or wider interest in working with the company. The appointment of a director with responsibility for stakeholder relationships would avoid an election or other choice for a workforce or other stakeholder representative. Further, the director should have a degree of longevity in the post, whereas an advisory board or a director elected by the workforce may change quite frequently.

Although it is important for the voice of the workforce to be heard, there is a strong argument, we believe, that the interests of other stakeholders should also be represented by a specific director. The director would take time and commitment to meet the main stakeholders, including the workforce, and represent their views and interests at board level (bearing in mind that a director's duty is to the company, as with the other directors, under the Companies Act). If this is not acceptable, then we suggest that there should be one director to represent the interests of the workforce and another appointed to represent the interests of other stakeholders.

We suggest therefore that the Code and Guidance should include a requirement for the company to appoint an executive director to represent the interests of all major stakeholders. Companies could, of course, make such an appointment without a Code requirement but including it in the Code would give the proposal authority and encouragement (albeit on a comply or explain basis). It should in any event help to give practical effect to Principle C by encouraging the company to meet its responsibility to shareholders and other stakeholders and ensure effective engagement with, and encourage participation from, stakeholders.

We have other comments on Section1 of the revised Code not least that, in our view, the wording in the consultation document and the Introduction to the Code concerning the interests of stakeholders is not fully reflected in the wording of the Code. The Introduction to the Code states, amongst other things, that "To succeed in the long-term, directors and the companies they lead need to build and maintain successful relationships with a wide range of stakeholders". We do not consider that the wording of Principle C reflects this requirement and, in any event, we believe it is too limited. We suggest that this Principle be amended (or perhaps an additional Provision added) to reflect what we say above, that directors would adopt a policy towards stakeholder recognition and relationships, their approach to measuring the quality of these relationships, how the company engages with the various groups of stakeholders and how their legitimate interests are considered and met, on the basis that this is in the best interests not only of relevant stakeholders but also of the company and its shareholders. This would not only provide clarity that different stakeholder groups have engaged with the company, but they have been encouraged to participate and their interests have been given proper consideration. It would also demonstrate the approach and action taken by the company to understand and measure the strength and quality of the relationship, the results of such an exercise, and how it can be developed for the benefit of both parties to a particular relationship and stakeholders generally. As stated above, there must not only be a framework for engagement and measurement in place but also evidence that it has been applied in practice and actions taken as a result.

As explained above, we suggest that, in order that shareholders and others can see that these matters have been properly and fully addressed, they are disclosed in the annual report and accounts and perhaps also on a 6 monthly basis. Directors can therefore be questioned on their standards in recognising the value of stakeholder interests, engaging with them and taking their interests into account, and the directors can be held to account if necessary. Certain disclosure is required in Provision 4 but our suggestion, as summarised above, would provide details of the company's policy towards stakeholder recognition and relationships, measurement of the quality of the relationships, engagement with stakeholder groups and how their legitimate interests are considered and met.

Disclosure could also be required as to how the company engages with the interests of employees beyond current disclosure requirements, for instance how much weekend and overtime work is required, confirmation that share schemes for all employees funded by the company are provided, minimum pay scales and disclosure in bands of remuneration for all employees and details of any discussion forum with different seniority levels of employees.

With regard to suppliers, disclosures could be made, for instance, showing evidence of building close and understanding relationships, with payment on time or earlier (with no more than a 30-day payment period), help with IT and no penalties or requirements for additional payments for displaying goods. Disclosure would be required of incentives to encourage long-term holdings of shares by investors and engagement with individual as well as institutional shareholders. Clarity would be needed of tax paid and rates in countries where the company's and group profits are earned, with full disclosure of any schemes or mitigating factors for lower taxes being paid.

If detailed guidance is given as to the disclosure requirements on a variety of aspects affecting companies' operations, examples of which are given above, this would enable there to be greater scrutiny of the directors' approach to stakeholder groups and their regard to the society in which the company operates and from which it benefits. It would also be possible to compare the attitude and performance of companies in the same or similar sectors or across sectors, recognising that businesses may need to approach stakeholder engagement and support in different ways, depending on the nature of the business and which stakeholders have a significant interest. Shareholders, analysts and the wider public would then be able to judge the level of responsibility of companies and their legitimacy in the context of their role and responsibility in society. The disclosure exercise would help to set a new standard for acceptable business practice and help to redefine the identity of the corporate world with values of fairness, inclusiveness and transparency. Companies which meet the standards of acceptable business practice, of which there will be many, will be recognised and encouraged, by attracting goodwill, investors and customers or clients, and this will lead others by example to improve their practices.

We also await with interest the Government's proposals for secondary legislation with regard to directors' reporting on how they comply with the requirements of s172, although there are already statutory requirements in respect of this. We note in paragraph 30 of the consultation document that Provision 4 and the Guidance may need to be amended to reflect any new requirements.

Question 5. Do you agree that 20 percent is 'significant' and that an update should be published no later than 6 months after the vote?

20 per cent may be a reasonable threshold, but we believe there should be greater consultation before remuneration packages are proposed to shareholders. Increasing levels of remuneration packages for senior executives which lead to greater pay differentials between highest and lowest paid does not reflect well on the company's image in society and can be seen as not showing recognition of the value to the company of those paid very much less, nor respect for their commitment, hard work and contribution to the success of the company. Executives and remuneration committees must consider levels of remuneration and differentials very carefully so as not to demotivate the workforce, damage the image of the company in society and undermine the legitimacy of a market-based economy. We expand on this below.

Questions 6-13.

For the purpose of brevity and to focus on the relationship principle, we only comment on these matters concerning boards and their responsibilities as set out in h) and i) above.

Questions 14-16.

We consider the suggested provisions overall are sensible and reasonable. Statements such as those in paragraphs 80 and 81 of the consultation document ring true. However, as mentioned above, we are concerned over the continually growing pay differentials in some companies. We think there is a danger of remuneration committees taking the approach in setting remuneration packages by aligning the interests of the directors with those of shareholders. This can lead to a focus on short-term financial return to drive up profits and the share price to meet thresholds. We consider the remuneration committee should assess the level of executive remuneration in the context of pay throughout the company (or group). If there are incentive schemes (by shares or cash) for senior executives, an equivalent should be put in place for all employees. This could be a John Lewis type bonus based on the results for the year (accepting that this is not a listed company), or a contributory or non-contributory share reward scheme. This should encourage employees to feel engaged with the company and its long-term success, with a belief that they can share in that success when so often they see that success bypassing them and reflected only in higher rewards for senior executives and increased dividends for shareholders.

The remuneration committee with an expanded remit (or perhaps working with other committees) should scrutinise closely pay levels within the company (from the highest to the lowest), listen to and take into account the views of a range of shareholders, institutional and individual, as well as a range of employees and possibly other stakeholders. In some companies remuneration levels cause an annual battle with significant voting against pay packages at AGM's. Directors should strive to avoid this as it reflects badly on the company and its image and does not demonstrate to shareholders, employees and wider society that a consistent and fair approach is being taken to the way in which the business is managed and remuneration levels set. In addition, there should be clear reporting annually on the nature, scope and details of executive remuneration, its justification and a summary of discussions between the remuneration committee, employees and the shareholders.

Further, we suggest that the committees could report each year how they have approached their role and summarise the consultation they have undertaken and why they consider their recommendations to the board as to the level of remuneration for executives are reasonable and proper and in the interests of the company, not just in terms of a comparison with other companies of similar size in the sector but also in the context of all remuneration levels within the company (or group).

We believe the overall approach should be to recognise the contribution made by employees to the success of the business. Lower paid employees may have a stressful or physically tiring job, including long hours. Higher paid executives may carry greater responsibility for the management and development of the business, often involving more interesting and challenging opportunities than are available to those lower down in the business structure, so there should be recognition of the commitment and contribution to the success of the business by the workforce at all levels. There should be a sense of corporate and shared endeavour.

To demonstrate that directors and remuneration committees have properly and fairly addressed pay levels throughout a company (or group of companies), it would be helpful for different levels of pay to be disclosed, with an explanation justifying them, alongside the report of the remuneration committee as suggested above. The disclosure of pay bands would follow the practice of a number of companies, so that the number of employees within different pay bands would be disclosed, from the lowest to the highest paid. The report would explain the appropriateness of the differentials for the business of the company in the context of the sector in which it operates. The company would explain its policy and approach to remuneration at all levels and why, for instance, limited or no increases are given at some levels but increases are proposed at other levels. If the company outsources a significant amount of its business or has self-employed workers, consideration should be given to equivalent disclosures for the third-party contractor and self-employed workers, to encourage transparency.

These disclosures would help to ensure that companies have considered remuneration levels carefully and sensitively throughout the business, and require them to justify their approach. It would also enable comparison to be made between businesses in the same and similar sectors. The requirement for disclosure should be such that a consistent approach is encouraged by all companies in particular sectors.

We consider that the interests of the company and its shareholders would be best served by incentive share schemes (or cash bonuses) being established for all levels of the company's employees. Simple long-term schemes could be devised for all employees in the form of exercisable options or the issue of shares assuming various targets are met. Such targets would include investment in and expansion of the business by organic growth. Tax relief should be given if options are exercised or shares awarded if they are held for a set period of time.

Initial consultation on the further direction of the Stewardship Code (Questions 17-31).

We do not propose to comment on the detailed questions on the Stewardship Code but we hope that matters such as the level of responsibility through the investment chain (from capital provider through intermediaries such as fund and investment managers), the recognition of the value of long- term engaged investment and encouragement for investment in the business of the company will be addressed, as well as recognition by shareholders of the value of stakeholder (employees, suppliers, customers etc) involvement and engagement.

Conclusion.

Whether people are employees, customers, suppliers, investors, or small business owners, whether they are parents, patients or simply voters, we live at a time when they feel increasingly disempowered. The corporate world has been regarded as part of the problem rather than as part of the solution. Investors, whether directly or indirectly through their pension funds, are frequently discontented about levels of pay at the top level of the companies where their money is invested, employees almost universally feel disengaged from their places of employment, consumers are suspicious and frustrated in their dealings with large companies where they feel the balance of power is heavily weighted to their disadvantage, small suppliers are alienated by changes in payment terms in times of financial crisis, and are frequently unable to negotiate fair terms due to size difference with their customer.

A change in the Code and Guidance to recognise the legitimate interests and contribution that all stakeholders make to the profitability and growth of companies would start to spread the different ethos across all areas of society. The private sector can once again lead the public sector in terms of bringing about changes in corporate governance and awareness of the best interests of society at large. By companies taking into account the importance of stakeholder recognition and engagement, the application of stakeholder interests is likely to be applied to public sector institutions such as schools, hospitals, primary healthcare, and larger charitable enterprises. Long-term national cohesion and well-being depends on trust, and development of that trust depends on relationships being fostered not just between individuals, but between the organisations and groups which make up the activities of our daily lives.

At the time of change in our relationships with our European neighbours, there is special need to foster and build relationships across all parts of society within the UK itself. Indeed, the UK has the opportunity once again to provide leadership in the international corporate world by showing the way in terms of building strong effective relationships across the stakeholder networks which enable and support productivity and performance at the highest levels. When the UK leads with these changes, there is little doubt that others will follow, and the UK's contribution to better global corporate governance will be widely recognised. In addition, faith and confidence by society in the corporate world will over time be restored, whilst at present there is concern over many aspects of corporate behaviour.

Thus, we are encouraged and excited by the possibilities arising from the shift of focus reflected in the revised Code and the Guidance towards recognition of the value and importance of stakeholder interests and their contribution to the success of companies. We hope that the opportunity to embed this in the working practices of all major companies will be taken to the full. Our comments above in response to the FRC proposals in the context of the wider national picture reflect these aspirations.

We hope that the comments and suggestions in our submission are helpful and make a constructive contribution towards finalising the revised Code and Guidance, as well as adding to the continuing debate about the purpose and future operation of listed and other companies and their role and contribution to society. We would be pleased to discuss our submission with the FRC and, if thought helpful given our research and writing on stakeholder value and engagement and what this means in practice, work with the FRC on issues of principle, as well as detailed matters and drafting, as the revised Code and Guidance are finalised.

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