



CMI RESPONSE: FRC CONSULTATION ON PROPOSED REVISIONS TO THE UK CORPORATE GOVERNANCE CODE

March 2018

Background

The Chartered Management Institute (CMI) and its CMI Women community are pleased to provide this brief response to the Financial Reporting Council's Proposed Reforms to the UK Corporate Governance Code.

As the professional body for management and leadership with a member community of 175,000 managers, CMI is responsible for standard-setting and raising standards in organisations across the economy.

CMI has been advocating gender balance since 1969 when we launched the Women in Management initiative. In 2016, we increased our focus on gender diversity and the benefits that it brings to business by launching this work under the new banner of CMI Women, a network within CMI. By 2024, the UK will need 1.5million more female managers and CMI Women is working to help plug this gap, focusing its strategy on building a world-class pipeline for women into management.

We recognise that good corporate governance is a crucially important part of good management and leadership. We therefore welcome the focus on this agenda to improve the quality of governance.

In this paper we offer some context and evidence from managers on the thrust of the proposed reforms, following on from our previous work with the FRC as part of the Culture Coalition, and our response to the Government's Green Paper (Feb 2017.) We respond in more detail to Questions 9-11 and 28 relating to diversity and inclusion.

Context: workforce representation and company culture

CMI is supportive of the policy direction set by the government and the FRC to encourage better company cultures, increase workforce voice in the boardroom, limit run-away executive pay, and drive less short-termist thinking and action in businesses.

As highlighted in our Green Paper response, CMI's members – managers across all sectors and sizes of organisation – are on the whole supportive of measures to provide for worker representation on boards. In a survey of 1,118 managers, a total of 63% were strongly or somewhat supportive.

Question: "Thinking about the wider political and business environment, how far do you support or oppose the following government measures?" - Responses for "Requiring large companies to have worker representation on boards"

<i>Strongly support</i>	<i>Somewhat support</i>	<i>Neither support nor oppose</i>	<i>Somewhat oppose</i>	<i>Strongly oppose</i>	<i>Don't know</i>
29%	34%	21%	9%	4%	3%

CMI's "Future Forecast" survey of 1,118 managers, November-December 2016

Executive pay

CMI's analysis of the National Management Salary Survey (NMSS) with XpertHR, the leading online HR resource providing pay benchmarking, has over many years pointed to a widespread disconnect between performance and pay in many UK organisations. Increases in earnings for senior leaders have outstripped those at other levels of organisations. While public debate is typically focused on the UK's largest businesses, this evidence suggests that similar patterns are to be found in many different businesses.

The NMSS 2016 incorporates data for 105,394 individuals submitted by 425 organisations. The survey captures performance data from those employers, where they have such ratings: the 2016 survey found that among managers who were deemed by their organisations to be under-performing, 23% still received bonuses. CMI is concerned that bonuses remain divorced from performance in too many organisations. We have argued that solutions require adoption of good management practice: clear targets, alignment of bonus criteria with performance, and preparedness to have difficult conversations with those who don't achieve criteria, whatever level that may be.

The wider perception that this is not done successfully across business may be why 74% of managers surveyed by CMI in December 2016 support the government in taking action to curb runaway executive pay.

Question: "Thinking about the wider political and business environment, how far do you support or oppose the following government measures?" - Responses for "measures to curb runaway executive pay"

<i>Strongly support</i>	<i>Somewhat support</i>	<i>Neither support nor oppose</i>	<i>Somewhat oppose</i>	<i>Strongly oppose</i>	<i>Don't know</i>
45%	29%	16%	6%	2%	3%

CMI's "Future Forecast" survey of 1,118 managers, November-December 2016

Moreover, support is strong at all levels of management seniority: 66% of respondents at Director or Partner level support such measures, indicating widespread recognition of the need to address this issue.

CMI therefore supports the bringing forward of measures to curb excessive and unearned pay – and specifically to strengthen transparency and support Remuneration Committees in achieving these ends.

Promoting Diversity and Inclusion in the Pipeline

We are pleased to respond below to the specific questions about the proposals relating to diversity and inclusion.

CMI has a long-standing track record of supporting gender balance in management, through its CMI Women network and campaigns (founded as Women in Management in 1968). We draw on this expertise and our long track record of research on good practice in this space, such as our January 2018 report, *A Blueprint for Balance*.¹ and also on the best practice identified through our 2017 report on black, Asian and minority ethnic (BAME) managers, *Delivering Diversity*, which focused on FTSE 100 companies in particular.

9. Do you agree that the overall changes proposed in Section 3 of the revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

We welcome the changes to the code proposed in Section 3 of the revised Code.

As CMI has long argued, it is vital that action on gender balance happens not only in selection for the boardroom, but in executive roles – and in the pipeline of management roles leading toward the top.

The latest CMI analysis with XpertHR (September 2017) highlights the critical importance of focusing on the pipeline at all levels. As the figure below shows, the proportion of management roles held by women declines from junior management roles through to senior and director level roles. As the left hand column indicates, women hold just 36% of senior management roles and 26% of director level roles. We have described this as a 'glass pyramid'.

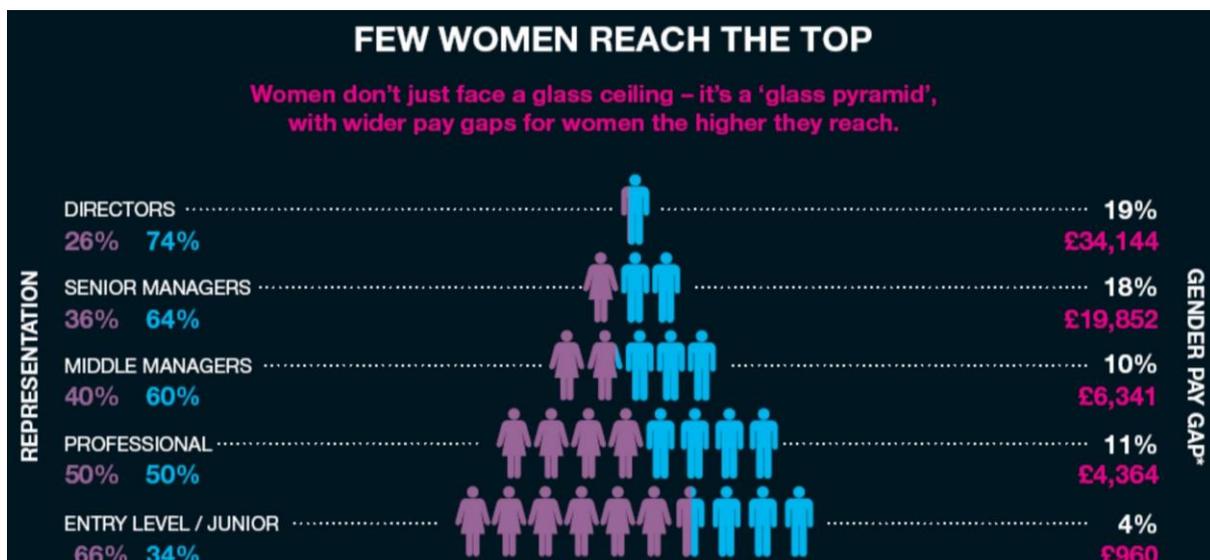


Figure 1: the decreasing representation of women in management and professional roles (and pay gaps at those grades, shown on the right)

¹ *A Blueprint for Balance: Time to fix the broken windows*, CMI (2018) via www.managers.org.uk/brokenwindows

The overall impact of these trends in progression are clear, as our analysis of the ‘missing middle’ has highlighted. There are approximately 3.3m managers in the UK, of whom just 34% are women – if we expected a 50/50 split, this represents 513,000 women ‘missing’ from management.

The challenge for the future is particularly significant. The UK has been forecast to need 1.9m new managers over the decade to 2024, reflecting economic growth and replacement demands. On current trends the missing middle would only fall to 480,000 by that period: to fill the missing middle, 1.5m of the 1.9m would have to be women.²

We therefore welcome and support the proposed new requirement for companies to report on the gender diversity of executive committees and their immediate line reports. We also support the requirements for organisations to comment on the relevance of diversity to their business.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

CMI supports the proposal to extend the Hampton-Alexander recommendation beyond the FTSE 350.

CMI has been strongly supportive of initiatives to increase transparency about diversity, both relating to team composition, the creation of a diverse pipeline, and the closely related issues around gender pay gaps. Leading employers are increasingly embracing research as CMI’s research has shown.³ And the progress made in FTSE boardrooms towards the Davies targets is evidence of the power that transparency has to drive change. However, the need for change is not limited to those companies listed on the FTSE 350 at any given point of time – so the levers for change should not be limited.

We do not regard the costs or burdens as a barrier to action. CMI has convened a number of events during the development of the policy, partnering with the Government Equalities Office as part of the Business Reference Group to support the development of the proposals. Feedback at these events pointed towards limited costs in gathering and recording pay and progression data, as the data will be available in the vast majority of company payroll systems. The proposed requirement is very limited in the number of employees covered, so should be even more straightforward to report.

There is also an ever-increasing body of evidence of the business benefits of diverse leadership teams. The latest McKinsey data (January 2018) for example has shown that

² *The Missing Middle*, infographic, CMI (2016), available at <https://www.managers.org.uk/~media/Appius/Submissions/cmi-women-the-missing-middle-infographic.pdf>. Our analysis draws on *Working Futures 2014-2024*, UK Commission for Employment and Skills (2016)

³ *A Blueprint for Balance: Time to fix the broken windows*, CMI (2018) via www.managers.org.uk/brokenwindows

companies in the top quartile for gender diversity on their executive teams were 21% more likely to experience above-average profitability than companies in the fourth quartile⁴.

We therefore believe the benefits of addressing any gender imbalance would substantially outweigh any costs from this reporting requirement.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

We would support measures to encourage reporting on race and ethnicity. As with gender we believe that transparency and metrics will help shape behaviour and generate business commitment to achieving change.

CMI's *Delivering Diversity*⁵ report on race and ethnicity in the FTSE 100 (July 2017) examined current practice. It was clear that data collection, measurement and reporting on race and ethnicity – whether internally in the company or externally to stakeholders – lags far behind practices relating to gender. 83% of the HR/diversity and inclusion leaders that we surveyed said that they needed better data on ethnicity to drive progress. Many highlighted the lack of mechanisms in place for collecting such data.

We concluded that organisations needed to measure BAME diversity throughout their talent pipeline, including representation at management levels, establishing pipeline indicators that could be used to identify trends over time to manage progress.

We therefore believe that measures from FRC to encourage adoption would be valuable in supporting the momentum of businesses who are leading the way on this and encouraging others to engage on the issues.

We would support the FRC in requiring companies to report on the ethnicity of boardrooms and executive teams, aligned to the requirements of the new Section 3 regarding gender balance.

Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?

CMI supports the proposal that companies should be expected to discuss diversity as part of investor engagement. This engagement should draw specifically on the proposals identified in Section 3, Provision 23, regarding the importance of diversity to the business strategy, and identifying actions taken by the business to support diversity.

⁴ *Delivering through Diversity*, McKinsey & Company (2018), via <https://www.mckinsey.com/business-functions/organization/our-insights/delivering-through-diversity>

⁵ *Delivering Diversity*, CMI (2017) via <http://www.managers.org.uk/insights/research/current-research/2017/january/delivering-diversity>

Further Steps

We would be happy to support the FRC in further developing its response to the consultation or subsequent work streams, and helping to share developments through our communities. We would welcome further discussions.

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