FRC’s Review of the UK Corporate Governance Code
Interim submission from the Steering Group of The Purposeful Company
1. Submission objective and context

Central to the Government's agenda following the General Election is to “forge an economy that works for everyone in every part of this country” and at the same time to address the productivity shortfall in the UK economy. These aims were already clear before the Election, with the publication of Green Papers on Corporate Governance Reform and Industrial Strategy.

A theme running through the Green Papers and the Conservative Party Manifesto was that for the legitimacy of capitalism to be retained in the public’s mind, it must be seen to work more visibly for everyone. As such, the Government has committed to strengthening stakeholder, and in particular employee, voice into boardroom discussions as well as requiring further disclosure on executive pay, including pay ratios.

In light of these ambitions, and recognising that a large component of corporate governance reform will be delivered through the UK Corporate Governance Code, the FRC has announced a fundamental review of the Code. The FRC has commenced engagement with stakeholders across a number of dimensions of the Code and associated reporting requirements.

The purpose of this submission is to give the views of the Steering Group of the Purposeful Company Taskforce on how the Code should most effectively be redesigned and to suggest some revised core Principles around which the Code would be based.

The Purposeful Company Taskforce has brought together businesses, investors, academics, business consultants, and think tanks with the ambition of transforming British business with purposeful companies committed to creating long-term value through serving the needs of society.

This means our objective is to make good Britain's shortfall of purposeful, long-term companies so that the economy can rise to the challenge of lifting investment, productivity and living standards. To benefit all company stakeholders, including shareholders. And, by better serving customers, employees, supply chains and the wider community, to restore lost trust in the capacity of business to create human betterment.

Our approach is distinctive through bringing together participants from multiple perspectives while also being strongly founded upon rigorous evidence, wherever possible.

In summary, our research finds that there is no inherent conflict between a model that seeks to maximise value for shareholders and one that creates value for all stakeholders. However, the important caveat is that this focus on shareholder value must be long-term. There are several aspects of the UK governance environment that militate against this long-term focus. Addressing the issue requires joint action on how companies think about their purpose and associated governance, how value is identified and reported, and how investors fulfil their stewardship responsibilities. Our recommendations therefore cut across the FRC’s work on governance, reporting, and stewardship.

This submission focuses on the principles and overall structure of the UK Corporate Governance Code rather than its detailed content or implementation. We are ready to work with the FRC and other stakeholders to develop that more detailed thinking in due course.
2. Executive summary

- The Code should be simplified with a clear distinction between a shorter set of Principles, comply-or-explain Provisions, and Best Practice Guidance.
- While the Principles could apply to a wide range of types of organisation (including private companies if so desired) the comply-or-explain Provisions and Best Practice Guidance would be tailored for particular categories of entity (e.g. companies with a premium listing).
- The Code should aim to help companies create governance that supports their success as well as creating governance that seeks to mitigate agency and business risk.
- Therefore, the Code principles should provide a roadmap for companies to align governance with corporate purpose and business strategy, to support a long-term value orientation.
- This would be supported by clear reporting of how governance supports pursuit of the company’s purpose, with associated reporting on how the company’s section 172 Companies Act obligations have been fulfilled.
- The aim of the Code should be to support good governance in organisations in order to meet the needs of their ultimate owners – the Code should not be used to implement public policy that may be perceived as going against the interests of those owners.
- However, the Code can act as a catalyst towards encouraging a longer-term view of shareholder value than is currently the case, and thereby contribute to the wider policy objective of rebuilding trust in business.

The outcome of the review should be a shorter set of Principles that would help companies strongly align governance with purpose and long-term value creation. Companies should be required to explain how they have considered and implemented the Principles (“apply-and-explain”). The Principles would then be supported by comply-or-explain Provisions that could be tailored to types of company (for example premium listed companies), and Best Practice Guidance, which could help boards understand how to align with the Principles.

We have identified twelve principles, under three headings, to form the core of a simplified Code.

Figure 1: Draft Code Principles

<table>
<thead>
<tr>
<th>A. Putting purpose at the heart of governance</th>
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<td>Principle A.1: A company should identify and clearly communicate its purpose.</td>
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C. Corporate governance activity to support purpose

Principle C.1: Considering and Reporting on Purpose

(a) A company should consider and report on the extent to which the legal purposes of the company consist of or include purposes other than the benefit of its members, as provided for by section 172(2) of the Companies Act 2006.

(b) The company should consider and report on the extent to which it takes account of the factors listed in sub-sections (a)-(f) of section 172(1) of the Companies Act 2006 in making its decisions and in the structure of its corporate governance arrangements.

Principle C.2: Board Composition

A company should determine the board composition and appointment process that supports its purpose and corporate organisation, including: the make-up of the board in terms of mix between executive and non-executive members, the board committee structure, appointment processes, and approach to ensuring diversity of skills and experience. The board should consider how the structure ensures the views and interests of the company’s stakeholders are considered at board and senior management level. Particular attention should be paid to ensuring board governance interacts effectively with activity and governance at the executive level, to promote success of the company.

Principle C.3: Performance Measurement

The board should oversee how performance will be measured not just according to financial accounting standards, but identifying the KPIs that reflect how the company is delivering benefits to its shareholders and other stakeholders in pursuit of its purpose. The board should determine the assurance (external and internal) it needs over KPIs and should make the appropriate arrangements in order to provide stakeholder confidence. Boards should ensure that reporting of performance is fair, balanced, and understandable.

Principle C.4: Strategic Asset monitoring

The board should oversee establishment of KPIs and processes by which it monitors the health and development of the company’s strategic assets. These will include intangible as well as tangible assets, and boards should give particular attention to how intangible assets are measured and valued and their health monitored. The board should also identify the key risks to its strategic assets and achievement of its purpose. There should be a process for identifying, prioritising, and measuring key risks. This is likely to be defined in terms of material risks to key strategic assets. The company should ensure that appropriate governance and review procedures exist to support sound risk management.

Principle C.5: Human Capital

Boards should oversee establishment of principles for key aspects of the company’s people policies, including how employees are treated, rewarded and engaged, in order to foster and support the company’s desired culture in support of its purpose. This should include oversight of the company’s executive remuneration policy, but should also extend to providing governance to ensure the company has developed appropriate approaches in areas such as: pay fairness more broadly through the company, skills, training and development, feedback and evaluation, and employee voice.

Principle C.6: Stakeholder Reporting

Boards should consider the nature, frequency, and content of reporting that is most suitable for each of its stakeholder groups in order to demonstrate fulfilment of its responsibilities under section 172 of the Companies Act. Reporting should focus on how the company is serving the needs of all material stakeholders. Reporting should be clear, candid, and consistent, rather than focused on advocacy. Boards should constantly strive to develop objective and externally verifiable measurement approaches for the purposes of reporting.
3. Problem statements and implications

3.1 The Code as a critical part of the UK’s governance infrastructure

The Code is a critical part of the UK governance infrastructure, and has been pivotal in influencing board structure and practice. Adopting what was at the time a unique comply-or-explain approach, the original Code sought to establish a system of best practice oversight, controls, and incentives to protect company shareholders and to reduce the risk of management self-enrichment at shareholder expense. The innovation of comply-or-explain has encouraged a thoughtful approach to adoption by boards and has allowed a process of continuous improvement and development of the Code.

However, inevitably, developments are often suggested in response to perceived weaknesses in practice or corporate scandals. Therefore the Code has tended to expand over time as new provisions or safeguards are added. As the Code has grown, and taken on more components, the risk of it being interpreted in a tick-box manner, as a compliance check-list, has increased. Indeed too often governance reviews follow such a tick-box approach, and therefore may identify superficial rather than fundamental weaknesses in governance.

3.2. Who and what is the code for?

The Code developed as a mechanism to provide protection for investors in large listed UK companies. As a result the Code has arguably become focused on mechanisms that avoid corporate failures as opposed to those that support corporate success.

The current review creates the opportunity to design a code that helps companies to be great as well as helping them manage agency and business risks, consistent with the FRC’s mission to “promote high quality governance and reporting to foster investment”. The relationship between shareholders and the company should be one of supportive challenge as well as of control. This would be helped by a Code framework that encouraged companies to align governance to their purpose and strategy.

A simplified, principles-based Code, which balances orientation towards success against protection from failure, would also have broader applicability beyond listed companies, for example to large private companies, if so desired. Comply-or-explain Provisions or supporting Guidance would remain for specific circumstances, such as large listed companies, to deal with some of the more detailed matters relevant to those circumstances. But these should be separate from the key Principles of the Code.

Figure 2: Components of the new Code

<table>
<thead>
<tr>
<th>Code component</th>
<th>Applicability</th>
<th>Example</th>
<th>Reporting mechanism</th>
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<tbody>
<tr>
<td>Principles</td>
<td>Any organisation within scope of the Code</td>
<td>Identification of key stakeholders and stakeholder voice</td>
<td>Apply-and-explain: narrative explanation of how principle is applied</td>
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<tr>
<td>Provisions</td>
<td>Tailored schedules for different types of organisation (e.g. premium listed)</td>
<td>Independence of non-executive directors in premium listed companies</td>
<td>Comply-or-explain</td>
</tr>
<tr>
<td>Guidance</td>
<td>Some schedules applicable to all organisations, some</td>
<td>Guidance on mechanisms for employee voice</td>
<td>Supports practice and narrative reporting where relevant</td>
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So the Code should act as a guide for leadership on how to encourage the success of the company within an appropriate framework of control and risk assessment. The Code should give shareholders comfort that boards in compliance with the principles are appropriately promoting and protecting their long-term interests. Note that this paper sets out in detail only the proposed Principles for a new Code. The Provisions, Guidance, and associated Reporting Requirements would also be required.

3.3. **To what extent should the Code address wider public policy interests?**

There is currently a crisis of trust in business in the UK. Coupled with the urgent need to raise productivity, this is leading Government to look closely at aspects of Corporate Governance and Industrial Strategy. Given the influence and agility of the Code, it is a natural implementation mechanism for corporate governance reforms in a manner that is flexible, and easy to implement without complex and time-consuming legislation.

However, we are of the view that implementation of public policy initiatives via the Code that were seen to undermine company or shareholder interests would be fatal to its credibility. The great strength of the Code has been its ability gradually to cement shifts in opinion as to what constitutes good business practice. The comply-or-explain framework relies on policing by consent. If a majority of investors or companies felt that measures were being imposed through the Code that were damaging to their interests, then the Code would immediately lose credibility, and would risk being viewed as just another branch of regulation. A situation where it became normalised for companies not to comply with large number of Code provisions would undermine its legitimacy. This could be counterproductive. However, the Code can legitimately be used to lead corporate practice and opinion, and of course it remains comply-or-explain.

This would suggest that very specific quasi-regulatory provisions where there is neither evidence for their widespread efficacy nor business or investor support should be thought through very carefully before being implemented via the Code.

Therefore, in line with the FRC’s mission, the Code should remain fundamentally focused on measures that foster investment, and which therefore align with the interests of the ultimate owners of companies. However, our evidence gathering shows that the perceived conflict between stakeholder interests is in fact much less severe than commonly assumed. Indeed our research shows that over the long-term, increased shareholder value is well aligned with broader stakeholder interests.

Moreover, the current loss of trust has costs for all business, and so it makes sense for the Code to incorporate aspects of good business practice, where there is emerging consensus, as a catalyst to bringing standards in the market up to those of the best. We therefore believe that it is legitimate to broaden the Code’s scope from its current perceived focus on risk-mitigation for shareholders towards a wider positive agenda of good business practice. This should support shareholder interests both directly, through improving company performance over the long-term, and indirectly by helping rebuild trust in business.

This suggests two ways in which a revised Code could advance wider public policy interests while remaining true to its aim of fostering investment:

- Encouraging a greater focus by companies on organising governance in a way that supports their purpose, and therefore long-term value creation for shareholders and all stakeholders;
- Through encouraging improved consideration of long-term value and stakeholder issues, helping to repair the trust deficit that currently exists between business and society.
3.4. **What is purpose and why does it matter?**

The dictionary definition of purpose is: “the reason for which something is done or created or for which something exists”. In simple terms, then, a company’s purpose is its reason for existence, and every company has one.

The debate has raged for some decades over whether companies should exist to maximise value for their shareholders or to fulfil wider societal objectives. The increasingly complex stakeholder environment that business has to navigate, coupled with the breakdown of trust in business across the developed world, has led to a growing body of research into the nature and impact of purpose as a means of informing those complex trade-offs.

This debate has at times created a false dichotomy between the interests of shareholders and other stakeholders. Our research, set out in the Purposeful Company Interim Report, showed that, on the contrary, companies that focus on improved stakeholder outcomes also deliver superior shareholder returns over the long-term. The interests of shareholders and stakeholders are thus aligned. We are also starting to see evidence emerge that improved profit and performance follow the pursuit of purpose at a more profound level: the clearly articulated and self-conscious insistence, shared by owners, managers and customers alike that a company has a responsibility to contribute to human betterment as well as the creation of long-term value for all their stakeholders.

However this means being able to answer the question of why the company exists in a way that goes deeper than a mere description of products, services and financial returns and addresses how the company fulfils a broader social purpose. The mind-set is one of moving beyond thinking of business as a nexus of contracts to earn profit within the constraint only of what is legally permissible, but instead be about earning a mandate to be successful through the contribution made to society. Returns to shareholders, a crucial imperative of any business, are thus the outcome of delivering purpose – but not the purpose itself.

It is not realistic to expect all companies immediately to adopt the most profound interpretation of purpose, and so neither should a corporate governance code be designed with this as its presumption. In simplistic terms we can think of companies interpreting purpose at one of the three levels, set out below, and the Code should work for all of them. Note that these levels represent broad descriptors not formal categorisations, and companies may have aspects of the different levels in parts of the operations or in relation to certain issues. However, the spectrum is helpful in understanding how the Code could be designed to encourage companies to think about moving towards a form of purpose that is more than merely transactional.

- **Level 1: Shareholder Value Companies**

The company’s purpose is expressed solely or primarily in terms of creating value for shareholders. While, as shown above, there need not be a dichotomy between shareholder value and stakeholder value, a direct focus on shareholder value can create weaknesses in long-term performance:

- There is a risk of shareholder value becoming a short-term as well as long-term focus, with an emphasis on short-term profit and share price maximisation, at the expense of long-term shareholder value.
- Direct measures of shareholder value (such as revenue and cost) are easier to act upon than long-term intangible value. As such, a direct focus on shareholder value can discourage investment in intangible assets and can cause stakeholder considerations to be over-ridden in favour of short-term profit.
There is evidence that, especially when incentivised on a short-term basis, managers are prone to take actions that boost profitability or share price in the short-term, even if this is at the expense of long-term value. At worst, this short-term orientation can result in actions that are positively harmful to customers or other stakeholders as well as to shareholders.

- **Level 2: Enlightened Shareholder Value Companies**

The company's purpose is expressed in terms of creating long-term value for shareholders, and recognises that this requires a deep commitment to the benefit it seeks to provide to its customers and its impact on all stakeholders. This Enlightened Shareholder Value approach can improve long-term value orientation, although is by no means perfect:

- Build-up of intangible assets can take five years or more to feed through into share price so an explicit orientation to stakeholders can help managers to focus on these long-term value-creating investments.
- Recognition of the importance of customers, employees, and other stakeholders can help companies avoid mistakes that could have major reputational impacts, such as mis-selling to customers, poor product safety, exploitation of workers and so on.
- However, the approach is still instrumental: the focus on stakeholders is with the purpose of increasing profits, and so stakeholder activity is viewed as an investment like any other business activity. This can create the risk that “when push comes to shove” managers prioritise short-term profits over long-term value. Since it is difficult to calculate the bottom-line impact of many stakeholder investments, such an approach may lead to many investments not being undertaken.
- Alternatively, stakeholders may become viewed as constituencies to “manage” as profits are created. This can lead to development of corporate and social responsibility activity that is divorced from core business activity, instead becoming PR or advocacy.

- **Level 3: Purposeful Companies**

The company exists to provide a clear benefit to humanity, and from this flows value long-term value for shareholders and other stakeholders.

- In this case the business motivation is intrinsic – to make products that transform customers’ lives for the better, to provide employees with a healthy and enriching workplace, and to preserve the environment for future generations.
- There is not a direct attempt to calculate the bottom line impact, but a conviction that pursuit of purpose will lead to profits. Even though financial rewards are not the motivation for long-term responsible behaviour, they typically follow in any event.
- The intrinsic motivation of purpose can be hugely beneficial in unleashing human creativity, motivation, and innovation, and providing clarity to otherwise difficult trade-offs for managers. The commitment to a broader societal benefit helps rebuild trust.
- Intrinsic purpose typically leads to executives having even longer horizons than instrumental purpose, since it is hard to forecast profit implications beyond a few years. This in turn can lead to executives having horizons that outlast their tenure, which, as Jim Collins has highlighted, is critical in companies making the lead from “good” to “great”.
- There are two main risks with putting primacy on purpose defined in this way. One is that purpose is pursued without discipline, leading to suppressed returns to shareholders, and reduced flow of capital to such companies. The other is that purpose is defined as a beneficial by-product of the company’s activity rather than its reason for existence. This can lead to conflict between the company’s purpose and what it actually does, leading to inauthenticity.
It is this third category, Level 3, which justifies the description “Purposeful Company”. More discussion of what this means is provided in the Purposeful Company Policy Report. A company that is inspired by a clear role in the world, providing a clear benefit to humanity, which defines its reason for being. Purpose informs its existence, determines its goals, values, and strategy, and is embedded in culture and practice.

Enlightened shareholder value has perhaps focussed too much on CSR activities that are not embedded in core business practices, and therefore can be seen to be little more than PR or advocacy. Indeed the evidence that good CSR performance increases value is at best mixed. However, there is strong evidence of outperformance in companies that have a meaningful stakeholder orientation aligned to core business activity. For example, as Professor Alex Edmans from London Business School has shown, companies delivering measurable improvements in employee wellbeing or customer satisfaction perform markedly better over the long-term. Moreover, there is also emerging evidence that companies that have a purpose benefiting society that is beyond profit maximisation outperform. Purposeful Companies can, if purpose is implemented with clarity, be associated with outperformance as recent research by George Serafeim, Andrea Prat and Claudine Gartenberg has suggested.

At whichever level of purpose a company operates (recalling that, by definition, all companies must have a purpose), having governance that is strongly aligned with delivery of that purpose will help boards better fulfil their role as strategic partners in supporting company success, as well as providing control mechanisms to protect shareholders. At a minimalist level, a Code oriented around corporate purpose makes sense. However, the evidence in favour of the Enlightened Shareholder Value model is now very strong, and the emerging evidence in favour of Purposeful Companies ever strengthening. Encouraging more companies to progress to a more purposeful orientation (Level 2 or 3) also answers a growing call within British society for business to be more inclusive and to demonstrate the wider contribution it makes. It is therefore appropriate for the Code to be developed in a way that challenges boards to take on these broader questions relating to their purpose, whatever that may be, and in so-doing encourage them to reflect on that purpose, and commence the journey towards being Purposeful.
4. Proposal for reform of the UK Corporate Governance Code

In order for the Code to foster the economic development of companies within an appropriate risk and control framework, we suggest a model for Corporate Governance based on three principles:

1. Clear definition of the organisation’s **Purpose** must be the starting point from which the appropriate corporate governance model ultimately flows.

2. The model for **Corporate Organisation** should then follow from purpose. This will comprise an interconnected view of:
   a. Definition of the strategy, reviewed from time to time, by which the company seeks to achieve its purpose.
   b. Identification of the strategic assets, both tangible and intangible, that are critical to the delivery of the strategy in pursuit of the organisation’s purpose.
   c. Identification and prioritisation of the key stakeholders with which the organisation interacts.
   d. How owners can effectively support purpose.

3. The **Corporate Governance** structure is then designed optimally to support the corporate organisation in pursuit of its purpose. While not prescribed as a single model, the corporate governance structure will have a number of components and functions that can be defined.

**Figure 3: Model for Purpose-led Corporate Governance**

The UK Corporate Governance Code should therefore identify the **Principles** that describe each of these three components of purpose led governance, supported by comply-or-explain **Requirements** and best practice **Guidance**. This paper considers the Principles only.
5. Possible UK Corporate Governance Code Principles

To illustrate how the model of corporate governance outlined above would be implemented, we set out in this section a first draft of the Principles that could form the bedrock of the Code. As described above, these would be supported by comply-or-explain Provisions and best practice Guidance. These Principles remain subject to stakeholder review and testing by the Purposeful Company Taskforce.

A. Putting purpose at the heart of governance

Principle A.1: A company should identify and clearly communicate its purpose.

Principle A.2: A company’s corporate governance should be designed to help it meet its purpose, so as to create long-term value for, and protect the interests of, shareholders, while recognising the interests of other stakeholders.

A company's purpose is its reason for existence. We have discussed the definition and nature of purpose in Section 3 above. As a firm progresses from Level 1 to Level 2 or 3, its purpose should be expressed in terms of the benefits it aims to provide to the primary stakeholder that it serves, typically customers, and not just in terms of the value created to its ultimate owners. Whether a company is Level 1, Level 2, or a Purposeful Company, its purpose is critical because, from purpose, follows the fundamentals of the organisation, being the optimal ownership structure, strategy, its strategic assets, and identification of its key stakeholders. The effectiveness of a company's corporate governance therefore cannot be judged without a clear statement of that company's purpose.

B. Corporate organisation in support of purpose

Principle B.1: A company should set out and regularly review the strategy best suited to meeting its purpose.

Principle B.2: A company should have a clear view of its strategic assets: the strategic tangible and intangible assets that are most critical to meeting the company's strategy in pursuit of its purpose.

Principle B.3: A company should identify and prioritise the stakeholder groups that are most critical to its purpose over the long term and develop appropriate mechanisms for ensuring that the views of those stakeholders are reflected in board decision making.

Principle B.4: Companies should work with existing and potential investors to ensure that its owners understand and are supportive of the company's long-term corporate purpose and strategy, and have the information required to judge the company’s performance in the context of these.

Having defined its purpose, a company's corporate governance arrangements should flow from it. Rather than jumping straight to mechanistic debates about board committees and responsibilities, this discussion should start with fundamental questions of strategy, value, stakeholders, and ownership. A company's strategy will have a critical influence on the skills and experience required on the board. The strategy should be clearly linked to the company’s purpose to create a clear connection between that purpose and the actions the company will take to meet it.

Strategic assets are the key tangible and intangible assets that the company uses to create value. Identification of strategic assets is not possible without a clear articulation of how value is created for the company’s shareholders and stakeholders in line with its purpose. Identification of these assets therefore helps boards to retain focus on matters that are most important and material to the
business. Here materiality is defined as assets and matters having a significant impact on the ability of the organisation to deliver benefits to its shareholders and stakeholders in line with its purpose. Both the definition of strategic assets, and materiality, are therefore inevitably bespoke to each business, although the requirements to identify and nurture them are not.

A weakness of the current corporate governance model is that, despite developments to Section 172 of the Companies Act, it has not encouraged enough companies to consider the role of other stakeholders within a model where shareholders have primacy. This can lead to companies making false or short-term trade-offs between shareholders and other stakeholder interests. There are organisations that manage these issues well, but we have also seen visible examples of how, when the goal becomes shareholder value alone, short-termism and, even worse, unethical behaviour can take root. This is not to say that other stakeholders should necessarily be ahead of, or even equal to, shareholders. But without a conscious orientation towards long-term stakeholder orientation, it is a risk that short-term, and potentially counter-productive, measures of shareholder value take hold. By contrast, we want companies to pursue the long-term alignment of shareholder and stakeholder interests that the evidence suggests exists for those companies willing to take a long enough view.

Identification of stakeholder groups in light of the company’s purpose leads to a richer analysis and prioritisation. This keeps board attention on how to generate value for all stakeholders over the long term, as opposed to a one-dimensional focus on short-term shareholder returns. As part of this it is important to consider how boards and management are to be kept alive to the views of different stakeholder groups in their decision making. The most appropriate mechanism depends upon the company’s circumstances and the Code principles should not be prescriptive. Supporting Provisions and Guidance could helpfully consider a range of models from formal employee representation on boards through to stakeholder panels or other authentic engagement mechanisms.

The question of ownership is relevant on two levels: first in terms of the corporate form that best aligns with a company’s purpose (joint stock company, private company, benefit corporation, mutual society, co-operative and so on); and second in terms of the types of investors it seeks to attract within that structure (for example index funds, long-term value investors, sovereign wealth or private equity funds, and so on) and the concentration of their holdings (blockholders, fully dispersed ownership). Other than in exceptional circumstances the corporate form will be a given for the board. However, boards do have a responsibility, within their ownership structure, to ensure investors understand the long-term purpose, and to seek investors that are supportive of it.

**C. Corporate governance activity to support purpose**

**Principle C.1: Considering and Reporting on Purpose**

(a) A company should consider and report on the extent to which the legal purposes of the company consist of or include purposes other than the benefit of its members, as provided for by section 172(2) of the Companies Act 2006

(b) The company should consider and report on the extent to which it takes account of the factors listed in sub-sections (a)-(f) of section 172(1) of the Companies Act 2006 in making its decisions and in the structure of its corporate governance arrangements.

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Principle C.6: Stakeholder Reporting

Boards should consider the nature, frequency, and content of reporting that is most suitable for each of its stakeholder groups in order to demonstrate fulfilment of its responsibilities under section 172 of the Companies Act. Reporting should focus on how the company is serving the needs of all material stakeholders. Reporting should be clear, candid, and consistent, rather than focused on advocacy. Boards should constantly strive to develop objective and externally verifiable measurement approaches for the purposes of reporting.

The corporate governance activities outlined above are in many ways familiar, and overlap with existing board and committee responsibilities under the UK Corporate Governance Code. However, there are two important differences:

- At each point the governing principle is that corporate governance activity should exist to support the company in achieving its purpose. This of course includes adequate control mechanisms in relation to performance measurement, risk, and remuneration, backed up by high quality reporting. However, shifting the emphasis of the activity from control to creating value in line with purpose will help to make corporate governance an enabler for business success, and will lessen the risk of corporate misbehaviour that results from a company losing touch with its stakeholder needs.
- By starting with purpose, the principles above do not presuppose a specific governance or board committee model. A principles-based approach helps to ensure that board structures and processes are aligned to purpose and creation of stakeholder value, rather than being adopted as a checking mechanism in a one-size-fits-all model.

While many existing board committees and activities would, therefore, persist under these
governance principles, there may also be important differences, which are explored below.

6. Implications for Board and Committee structures

Overall we would suggest that aspects of Purpose and Corporate Organisation would be for the full board to review and determine. Operation of the Corporate Governance activity would, as now, be delegated to board committees. However, committee structures may look different from today.

Current board committee structures are determined by a model of governance aimed towards minimising agency risks arising from the separation of ownership and control. From this has emerged:

- Nomination committees, designed to ensure a fair and unbiased approach for appointing directors to act in shareholders' interests and ensure succession is appropriately managed;
- Audit committees, to oversee the review and reporting of financial results internal and external assurance, to provide a true and fair view to shareholders and to prevent fraud and misrepresentation;
- Remuneration committees, to ensure that executive incentives are aligned with shareholders' interests, in order to prevent rent-seeking by management;
- Risk committees (particularly in financial services) that aim to monitor and minimise risks to the business and to ensure compliance with the requirements of financial regulators.

The control orientation of these committees can result in a “tick-box” to review and governance, and also diminishes the role of the board and its committees as strategic partners in the business enterprise of the company. The principles we suggest would not discard the monitoring and control role of boards, but would seek to frame it much more in terms of a positive agenda of helping companies align with their purpose.

The diversity of business purposes should result in a greater diversity of detailed mechanisms for supporting that purpose. As a result, adoption of the principles above will require boards potentially to rethink the role and function of their committees. There have been elements of this thinking with the development of Sustainability or Sustainable Business committees. However, too often these are framed in terms of the impact of business activity on stakeholders as opposed to the delivery of core business benefits to stakeholders in line with the company’s purpose. Moreover, development of multiple committees can lead to the segmentation of activity that militates against joined-up board thinking and overview.

Without wishing to impose a one-size-fits all model on all corporations, it is likely that most purposeful companies could seek to organise their corporate governance around four committees:

- **The Board Operation Committee**, which would oversee board structure, appointments and effectiveness;
- **The Performance Committee**, tasked with identifying, monitoring, and assuring key performance KPIs for the business in line with its purpose;
- **The Strategic Assets Committee**, tasked with monitoring the health of strategic assets, stakeholder relations, and key risks thereto, and plans for long-term innovation and investment;
- **The Human Capital Committee**, covering employee terms and conditions, including executive remuneration, investment in skills and training, culture, employee engagement.

Other committees may be appropriate. It could be argued that the role of technology and innovation is so important for most companies that an Innovation Committee could be required. However, there is
an argument that this cannot be considered in isolation outside of consideration of a company’s Strategic Assets.

It could be argued that there is no need for a Human Capital Committee, as employees are just one stakeholder, who could come under the remit of the Strategic Assets Committee. However, there are good reasons for a separate Human Capital Committee. First, companies are social entities and as such employees will always be a critical stakeholder. Second, the current focus on employees as stakeholders emphasises the importance to social cohesion of building strong awareness of people matters within the board. Third, the area of executive remuneration will remain high profile and important, demanding detailed oversight as part of a separate committee.

The volume of detailed regulatory risk work may require formation of a Risk Committee within regulated financial services firms. However, a criticism of such Committees is the focus on narrow technical issues as opposed to broader risks. Incorporation of the Risk Committee’s current work into a broader Strategic Assets committee helps boards to focus on the more material risks, and also to identify non-financial or strategic risks that are pertinent to the company’s purpose.

Overall, there should not be a single committee structure that all must adopt, but boards should consider the most appropriate way to establish a structure that covers the required span of activity, and then to explain how that is achieved.

In all of these areas, and others, there will be a need to consider carefully the interaction between board oversight committees, the work of the full board itself, and management committees and governance. The separation between non-executive and executive must remain, and the purpose of these illustrative committee structures is to indicate how boards may consider providing governance oversight of matters that are properly within the preserve of the executive. In general, in each of these areas, the role of the relevant committee is to:

- Play a role in challenging management as philosophy and principles are shaped
- Satisfy itself that appropriate governance exists to ensure those principles are enacted through the organisation
- Receive appropriate information from executive management to judge achievements and progress and to provide appropriate challenge
- Ensure stakeholder views are appropriately sought
- Oversee appropriate assurance and reporting

The table below shows how the work of these committees cover the key governance activities within our model, and also shows how they subsume the work of existing committee structures.
### Figure 4: Map of board committees and activities

<table>
<thead>
<tr>
<th>New Board Committee</th>
<th>Activity</th>
<th>Current Board Committee activity subsumed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board Operation</td>
<td>Composition of the board&lt;br&gt;  - board committee structure&lt;br&gt;  - role and appointment of board members&lt;br&gt;  - skills, experience, and diversity of board&lt;br&gt;  - board succession and effectiveness</td>
<td>Nominations Committee</td>
</tr>
<tr>
<td>Performance</td>
<td>Performance measurement&lt;br&gt;  - definition of stakeholder value and KPIs&lt;br&gt;  - audit and other assurance&lt;br&gt;  - reporting of performance</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>Strategic Assets</td>
<td>Strategic asset monitoring&lt;br&gt;  - identification of strategic assets&lt;br&gt;  - monitoring of strategic assets&lt;br&gt;  - reporting on strategic assets&lt;br&gt;  - innovation and investment&lt;br&gt;  - identification and monitoring of key risks&lt;br&gt;  - assurance to regulators (if applicable)</td>
<td>Audit Committee&lt;br&gt;  Risk Committee&lt;br&gt;  Sustainability Committee</td>
</tr>
<tr>
<td>Human Capital</td>
<td>Human Capital implications&lt;br&gt;  - executive remuneration&lt;br&gt;  - fair pay report&lt;br&gt;  - training and development (both on-the-job and external), evaluation and feedback, performance criteria&lt;br&gt;  - wider people policies and conditions&lt;br&gt;  - employee voice&lt;br&gt;  - culture</td>
<td>Remuneration Committee&lt;br&gt;  Sustainability Committee</td>
</tr>
</tbody>
</table>

Note that in practice, depending on the nature and sector of the organisation, the remit of the Strategic Assets Committee as set out may become too broad, and require formation of, for example, a separate Risk Committee (as would almost certainly be the case for a bank, for example).
7. Provisions, Guidance, and Reporting

This paper has focussed purely on the Principles that could form the core of a new UK Corporate Governance Code. The Principles have been designed to focus on areas of core business practice with broad applicability, including into, for example, large private companies. Therefore, while the principles cover the main areas of board activity covered by the UK Corporate Governance Code, they do not cover many of the detailed comply-or-explain Provisions. Many of these Provisions, which largely pertain to listed companies, have developed over many years and have widespread support amongst investors. Moreover, they have become so embedded into corporate practice that they cannot be said to be a great burden.

We therefore see the principles that we have proposed as sitting within an overall structure for the Code as set out at Figure 2, repeated below.

Figure 2 (repeated): Components of the new Code

<table>
<thead>
<tr>
<th>Code component</th>
<th>Applicability</th>
<th>Example</th>
<th>Reporting mechanism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principles</td>
<td>Any organisation within scope of the Code</td>
<td>Identification of key stakeholders and stakeholder voice</td>
<td>Apply-and-explain: narrative explanation of how principle is applied</td>
</tr>
<tr>
<td>Provisions</td>
<td>Tailored schedules for different types of organisation (e.g. premium listed)</td>
<td>Independence of non-executive directors in premium listed companies</td>
<td>Comply-or-explain</td>
</tr>
<tr>
<td>Guidance</td>
<td>Some schedules applicable to all organisations, some tailored to segments</td>
<td>Guidance on mechanisms for employee voice</td>
<td>Supports practice and narrative reporting where relevant</td>
</tr>
</tbody>
</table>

The application of the Principles is not amenable to a “yes-no” comply-or-explain basis. Therefore, they would be operated on an “apply-and-explain” basis, so that companies would be expected to provide narrative reporting on how the Principles had been applied.

Extensive comply-or-explain Provisions would remain. Initial review suggests that the schedule for listed companies, for example, would retain many of the comply-or-explain provisions that currently exist, as investors would expect their retention. There will be an opportunity for some shortening, but also for clear separation of, and alignment between, comply-or-explain Provisions and associated Reporting Requirements.

Guidance would be useful in a number of areas, for example stakeholder voice, remuneration, best practice in interaction between boards and management, to name but three. However, this would clearly be separated from strict comply-or-explain Provisions.

Overall, therefore, ambitions for a dramatically shorter Code may be difficult to meet. However, a Code that is rooted in a brief statement of some universal Principles, as set out in the paper, supported by a re-organised set of comply-or-explain Provisions and Guidance schedules would give greater clarity and therefore simplicity.
8. Next steps

This paper outlines the views of the Steering Committee of the Purposeful Company taskforce in relation to the principles on which a revised UK Corporate Governance Code could be based. Next steps would include:

- **Stakeholder testing** – we would be happy to help the FRC convene a review constituency drawing on the Purposeful Company Taskforce members, with particular emphasis on getting feedback from corporates on the practicalities of the new framework and its potential impact on corporate behaviour, in order to get buy-in from the corporate sector.
- **Review of existing Code comply-or-explain Provisions**: which of these should be retained as shortened comply-or-explain Provisions for different types of company (e.g. listed versus private companies), which can be removed, and how they should be organised against the new Principles. The aim should be where possible to reduce the number of comply-or-explain Provisions.
- **Review of which elements of current Best Practice Guidance require refreshing** (e.g. executive pay).
- **Development of guidance on reporting against the Principles, the comply or explain Provisions, and the Best Practice Guidance.**

We would welcome feedback from the FRC to help refine the next phase of development and to understand what support the FRC requires.

The Purposeful Company Steering Group
July, 2017
Launched in September 2011, Big Innovation Centre is a hub of innovative companies and organisations, thought leaders, universities and 'what works' open innovators. Together we test and realise our commercial and public-purpose ideas to promote company and national innovative capabilities in a non-competitive and neutral environment. We act as catalysts in co-shaping innovation and business model strategies that are both practical and intellectually grounded. Our vision is to help make the UK a Global Open Innovation and Investment Hub by 2025, and to build similar initiatives internationally. For further details, please visit www.biginnovationcentre.com

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