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17 February 2017

Dear Sirs,

Corporate Governance Reform: Green Paper

We welcome the opportunity to respond to the Department for Business, Energy and Industrial Strategy's (BEIS) consultation on its Green Paper on corporate governance reform.

As an overarching comment, we believe that effective corporate governance encourages sustainable long-term value creation, protects value and supports the interests of wider stakeholders.

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance Corporate Governance Expert Group, with contributions from our Financial Reporting and Shares Schemes Expert Groups, has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

Corporate governance codes

Corporate governance codes play an important role in assisting companies to put good governance into practice. Codes created by organisations independent of government act as the basis upon which companies comply with the requirements in a way most appropriate to their individual circumstance. The OECD encourages governments to ensure that appropriate frameworks exist for corporate governance codes to be put in place.

Growth companies should be aware that good governance guidance, which is tailored for their needs, exists. Government should play a leading role in highlighting this. Empowering companies to act in a more ethical way will enable smaller companies to both inspire trust from shareholders as well as grow and thrive.

The QCA Code

The QCA Corporate Governance Code for Small and Mid-Size Quoted Companies (the QCA Code[1]) has become a valuable reference for smaller companies that wish to follow good governance practice, whether or not on a public market. It is a practical, outcome-oriented approach to corporate governance for those quoted companies in the UK not obliged to apply the FRC's UK Corporate Governance Code ("the Code") using a mandatory comply or explain basis. The QCA Code focuses on companies on a public market, but also explains that adopting good governance principles is a helpful building block in any company's strategy for growth.

The QCA Code has been in place for over twenty years demonstrating that the small and mid-size quoted community takes governance seriously. The QCA Code is specifically designed to enable quoted companies at different stages of development and of different sizes to adopt good corporate governance practice. Its principle-based approach allows flexibility within a relevant structure.

Usually, the most complex corporate governance issues arise in relation to remuneration matters, audit and risk. Therefore, the QCA produces two further guides, which complement the QCA Code:

- Our Remuneration Committee Guide[2] supports members of remuneration committees, and those who advise them, to develop effective remuneration packages for executive directors and senior management which align with the interest of shareholders;
- Our Audit Committee Guide[3] assists audit committee chairpersons and members in being more effective in their roles, so that they are able to meet the expectations of investors and comply with good practice for small and mid-size quoted companies.

The QCA Code and guides are used by private companies of any size that wish to put good governance into practice and grow responsibly.

The role of shareholders in smaller companies

The shareholder base of the largest listed companies on the Main Market is very different to a small or mid-size company that is listed on the Official List, AIM or NEX Exchange. The former tends to have very few significant shareholders, who can influence management on their own whereas the latter often has a single significant shareholder who is able to hold management directly to account. This makes shareholder committees an appropriate initiative for large Main Market companies but redundant for small and mid-size companies.

The shareholding notification rules ensure that all shareholders and other stakeholders can recognise the shareholding structure of these companies and can determine the level of influence that can be brought to bear. These companies typically are those outside the FTSE 350. (The FRC's Code has already recognised the delineation between companies within and outside the FTSE 350, when setting requirements for the number of Non-Executive Directors on boards.)

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[1] http://www.theqca.com/shop/guides/86557/corporate-governance-code-for-small-and-midsize-quoted-companies-2013-downloadable-pdf.thtml

[2] http://www.theqca.com/shop/guides/118376/remuneration-committee-guide-for-small-and-midsize-quoted-companies-2016-downloadable-pdf.thtml

[3] http://www.theqca.com/shop/guides/92477/audit-committee-guide-for-small-and-midsize-quoted-companies-downloadable-pdf.thtml

Executive Pay

Q1 Do shareholders need stronger powers to improve their ability to hold companies to account on executive pay and performance? If so, which of the options mentioned in the Green Paper would you support? Are there other options that should be considered?

As the over-arching objective is to enhance trust, the options presented should be considered in the light of how effective they will be in achieving this objective.

We support shareholders of companies of all sizes using the powers they possess, including those given to them under the 2013 remuneration reporting regime, to scrutinise and, as appropriate, challenge executive pay and performance. In the event that the business community and the FRC believe that further specificity is required in the Code, or elsewhere, we would support such an initiative. We appreciate that other stakeholders will be particularly interested in how shareholders discharge this stewardship responsibility.

Accordingly, option (v) – *strengthening the Code to provide specificity on how companies should engage with shareholders on pay, including where there is opposition to a remuneration report* – may enable shareholders to more effectively hold companies to account on executive pay and performance. However, care must be taken when changing the Code, in order to maintain an appropriate balance between addressing remuneration and other areas of corporate governance. The structure of the Code is already weighed down by the focus on remuneration matters.

We encourage BEIS to read our approach to remuneration in our 2016 Remuneration Committee Guide, which was written between 2015 and 2016 to specifically take into account the 2013 remuneration reporting regime. We particularly encourage you to read chapter four and appendix B on the voluntary application of the 2013 remuneration reporting regime by AIM companies. The 2013 remuneration reporting regime applies to listed companies only.

Remuneration arrangements for executive directors are an important factor in ensuring that their incentives are aligned to create value for shareholders. Companies of all sizes face many choices in tackling issues of remuneration; this is particularly true for small and mid-size quoted companies. Companies and their remuneration committees should therefore be able to exercise the necessary flexibility to use remuneration structures that are appropriate to alignment of management and shareholder interests.

Companies should approach matters of remuneration in a way that is proportionate, rational and measured. Equally, they should be clear and transparent when setting executive pay, in order to nurture the development of trust between companies and shareholders. Models of remuneration should support, in a clear manner, the sustained alignment of interests between directors and shareholders which should help to deliver long-term growth in shareholder value.

A significant proportion of an executive director's remuneration should be performance based. This can be done by linking pay to strategic milestones, key performance indicators (KPIs) and value drivers that incorporate challenging and transparent targets related to corporate and individual performance. Long-term incentives should be equity based and structured to reward long-term growth in shareholder value.

Q2 Does more need to be done to encourage institutional and retail investors to make full use of their existing and any new voting powers on pay? Do you support any of the options mentioned? Are there other ideas that should be considered?

The current voting and disclosure regime has been in place for a short time and has not yet completed its first three year cycle. In our view, the regime, to a certain extent, has had a positive influence on executive pay. In particular the new regime has resulted in companies taking into account the broader economic climate when considering executive remuneration, so that the pay awarded is more commensurate with the company's performance. Most importantly, it has focussed the minds of both companies and shareholders to actively address the issue.

Shareholders should be encouraged to take an active interest in every company they have shares in. Through their involvement they can encourage a company to improve its corporate governance measures which is likely to lead to better performance of the company. While there is a risk that too close involvement may lead to some shareholders receiving price-sensitive information, depriving them of the legal right to trade shares, we believe this is manageable through existing market structures and practices.

In a similar way, we encourage small and mid-size quoted companies on AIM and NEX to be aware of and adopt certain requirements for listed companies under the 2013 Directors' Remuneration Regulations.

A number of commentators have supported the shareholder committee approach. However, this concept is relatively underdeveloped in practice. If established, it would be necessary for the committee to have a well-defined remit and to ensure that management considers the views of all shareholders. Such an approach should only be progressed once a thorough examination of data, as to whether shareholder committees would add to shareholders' ability to maximise their stewardship powers, as well as enable companies to present information more effectively, has been carried out.

It should be noted that in comparison to the largest quoted companies, small and mid-size quoted companies tend to have a few large shareholders, who can have a direct impact on pay and other aspects of corporate governance. Committees to represent thousands of shareholders' interests are not necessary in this part of the market.

Shareholders should trust directors to do what is right and should not be taking responsibility for making decisions that should be taken by directors. This trust must be backed up with appropriate feedback mechanisms, so that shareholders can evaluate the directors' performance and indicate areas for improvement.

Q3 Do steps need to be taken to improve the effectiveness of remuneration committees, and their advisers, in particular to encourage them to engage more effectively with shareholder and employee views before developing pay policies? Do you support any of the options set out in the Green Paper? Are there any other options you want to suggest?

Our Remuneration Committee Guide assists in the effective operation of remuneration committees, supporting remuneration committee members and their advisers to develop effective remuneration packages for executive directors and senior management in a fair and reasonable manner. The effectiveness of remuneration committees will be best enhanced through more effective engagement and demonstrations of support by shareholders, whilst also holding directors to account as necessary.

The skills and experience of the Non-Executive Director (NED) is also a key factor that often gets overlooked in discussions on the effectiveness of remuneration committees. Boards need to ensure that the best people are sitting on this committee and should be checking both suitability and the need for ongoing training and education in what can be a very technical subject. This is linked to the drive for more diverse boards and promoting a new type of NED.

Q4 Should a new pay ratio reporting requirement be introduced? If so, what form of reporting would be most useful? How can misleading interpretations and inappropriate comparisons (for example, between companies in different sectors) be avoided? Would other measures be more effective? Please give reasons for your answer.

The success of a company is likely to derive from the activities of a wide team of people who should all share in the rewards of success. How such rewards are apportioned should be a matter for boards taking into account the particular circumstances of the company. This should be set out in the remuneration policy, and reported on by the remuneration committee.

Introducing a legislative requirement for companies to publish pay ratios would exert an administrative burden on small and mid-size quoted companies – both in terms of time and cost. There is no evidence of systemic high executive pay within the small and mid-size quoted company sector and we would therefore not wish to see a pay ratio reporting requirement introduced for small and mid-size companies on the Main Market of the London Stock Exchange.

If there is perceived to be a need for additional information to be published about the disparity between pay of directors and employees, this should be addressed directly by requiring additional disclosures about the amounts paid to the lowest paid employees, rather than indirectly through pay ratios. The introduction of such information (or any other requirement resulting from this consultation) should be subject to a transitional period of three years for smaller companies.

We note that the Pensions and Lifetime Savings Association's publication 'Understanding the worth of the workforce: A stewardship toolkit for pension funds', which outlines metrics that can be used by investors to engage directly with workforce-related issues, could help BEIS to understand how better narrative reporting and behaviours can be encouraged on a voluntary basis.

Q5 Should the existing, qualified requirements to disclose the performance targets that trigger annual bonus payments be strengthened? How could this be done without compromising commercial confidentiality? Do you support any of the options outlined in the Green Paper? Do you have any other suggestions?

Performance targets that trigger annual bonus payments should be challenging, yet achievable and serve as an effective incentive. Although there should be mechanisms in place for shareholders to challenge directors at appropriate times, they should not seek to forecast the commercial decisions of directors. A company's remuneration committee should ensure that a director's pay package is such that it rewards exceptional performance in a commensurate way.

Disclosure is increasing in this area and the Investment Association's stern pronouncements mean that disclosure is likely to increase rapidly over the next few years. This would make legislative action unnecessary.

Q6 How could long-term incentive plans be better aligned with the long-term interests of quoted companies and shareholders? Should holding periods be increased from a minimum of three to a minimum of five years for share options awarded to executives? Please give reasons for your answers.

A culture of long-term share ownership should be encouraged at all levels, through establishing share ownership schemes, share retention guidelines and other means. Long-term incentives should be equity based and structured to reward growth in sustainable shareholder value. However we do not support an increase of holding periods from a minimum of three years to five years for share options awarded to executives of small and mid-sized quoted companies.

Not all long-term incentive plan (LTIP) awards are made to senior executives. A five year holding period would be inappropriate for more junior employees as distinguishing between awards for different categories of staff may be difficult or discriminatory.

There is some doubt whether this creates an alignment with shareholders of small and mid-size quoted companies, which are growth companies. For instance, investor shareholders might not be able to retain their shareholding for more than three years and the business model could change radically over that time.

Furthermore, whilst there may be some willingness for small and mid-size quoted companies to require a post-acquisition retention requirement, the cost of acquiring the shares and the cost of the tax arising on the exercise of the option under an LTIP is likely to create hardship for the employee participant.

Extending holding periods to five years for share options would impose a disproportionate burden on smaller quoted companies with no clear benefit.

Strengthening the employee, customer and wider stakeholder voice

Q7 How can the way in which the interests of employees, customers and wider stakeholders are taken into account at board level in large UK companies be strengthened? Are there any existing examples of good practice that you would like to draw to our attention? Which, if any, of the options (or combination of options) described in the Green Paper would you support? Please explain your reasons.

There are many stakeholders who have an interest in the success of a company. Employees are critical to a business but should not be singled out as having preference over any other stakeholder group. Stakeholders will have different and often competing interests and the role of directors will be impossible if all competing demands need to be acted upon.

The current requirement is to promote the success of the company for the benefit of the members as a whole, whilst taking into account the competing demands of different stakeholder groups as currently set out in Part 10 of the Companies Act 2006 (as amended). Any business focussed on longer term growth will necessarily need to consider the interests of other stakeholders, including current and former employees, customers, suppliers and the local community. Sustainable long-term success can only be achieved by acknowledging the interests of stakeholders.

Companies should be more explicit as to how they go about considering the interests of stakeholders; we do not believe that additional legislation is necessary. Any further disclosure requirements (and any further legislation) should be restricted to companies with a market capitalisation commensurate with companies within the FTSE 350. This would protect smaller companies from additional burdens. The introduction of any requirements for smaller companies would not be welcomed and, if introduced, should be done on a phased and transitional basis.

As noted in Q3, boards should be populated with a diverse range of NEDs and their appointment should include knowledge and experience of the broader stakeholder base of the company. More focus should be placed on areas such as skill-set, age and geography in attracting the right NED who can provide a different perspective and understanding.

Q8 Which type of company do you think should be the focus for any steps to strengthen the stakeholder voice? Should there be an employee number or other size threshold?

Companies seeking to be successful over the longer term will strive to keep employees motivated and engaged through a number of mechanisms, which will vary according to the type of company and the stage of its development.

The degree of engagement with employees, and other stakeholders, is a measure of a board's concern about the potential impact of such relationships on the future success of the business. Disclosure about the steps taken to engage on a voluntary basis is more informative to stakeholders than any requirement to engage. Compulsory requirements to engage are likely to lead to meaningless conversations without substance, as well as boiler plate disclosures.

Any steps that strengthen the stakeholder voice should be proportionate with a company's size. Measures deemed appropriate for the largest companies will not necessarily be so for smaller companies and may lead to added administrative burden with no clear benefit.

We recommend that only companies with a market capitalisation commensurate with companies within the FTSE 350 should be included in any action taken. If an employee number test is applied, then only companies with no fewer than 750 employees should be included.

Q9 How should reform be taken forward? Should a legislative, code-based or voluntary approach be used to drive change? Please explain your reasons, including any evidence on likely costs and benefits.

It is not possible to answer this question fully because no evidence base has been produced to suggest that reform should be taken forward. In any event, a voluntary or code-based approach for listed companies with a market capitalisation commensurate with companies within the FTSE 350 should be used to drive change. As noted in Q8, a one-size-fits-all approach would leave smaller companies facing additional and disproportionate burdens without clear benefit.

Corporate governance in large, privately held businesses

Q10 What is your view of the case for strengthening the corporate governance framework for the UK's largest, privately-held businesses? What do you see as the benefits for doing so? What are the risks to be considered? Are there any existing examples of good practice in privately-held businesses that you would like to draw to our attention?

Different rules have evolved over time for public and private companies because of the differing nature of their shareholders and relationships between shareholders and directors. Many private companies are wholly owned and therefore can be operated in a very different manner to those where managers are behaving as fiduciaries for other people's money.

We represent small and mid-size quoted companies and therefore have limited our response to this question simply to remind you that the QCA Code and guides may be helpful to developing a voluntary, good practice code for privately held businesses. A one-size-fits-all approach will not serve as the best engine for growth for the UK and would have a disproportionate impact on growth companies.

Q11 If you think that the corporate governance framework should be strengthened for the largest privately-held businesses, which businesses should be in scope? Where should any size threshold be set?

We consider that a significant private company would have no fewer than 750 employees for these purposes. Companies in groups should be considered as a whole.

Please see our answer to Q8 and Q10.

Q12 If you think that strengthening is needed how should this be achieved? Should legislation be used or would a voluntary approach be preferable? How could compliance be monitored?

Voluntary codes should always be considered as the first step.

Please see our answer to Q9 and Q10.

Q13 Should non-financial reporting requirements in the future be applied on the basis of a size threshold rather than based on the legal form of a business?

Non-financial reporting requirements should be proportionate to the following:

- Stage of development;
- Size of business;
- Sphere of operations;
- Legal form; and
- The market upon which shares are traded (if any).

A proportionate approach ensures that small and mid-size quoted companies are sheltered from burdensome requirements that are targeted at larger companies. Furthermore, the scoping criteria relating to non-financial reporting requirements, such as those regarding modern slavery and the gender pay gap, are inconsistent. There is also a vast array of different scopes that apply to narrative reporting in the annual report.

These discrepancies can lead to situations where a smaller company is exempt from one non-financial reporting requirement, but not another. It can also make it difficult to determine the requirements that a company must follow, as it grows.

We encourage Government to reassess and align the criteria for non-financial reporting requirements. Our previous answers have provided the indicative thresholds that should be considered.

Other issues

Q14 Is the current corporate governance framework in the UK providing the right combination of high standards and low burdens? Apart from the issues addressed specifically in this Green Paper can you suggest any other improvements to the framework?

We have set out the difference between the shareholder bases of large and small companies on public markets. The current situation on AIM and NEX, where choice is encouraged between the Code and the QCA Code, should be sustained and actively encouraged so that companies can adopt a code that suits their size and stage of development. This is accepted by the small-cap fund managers we regularly talk to.

On the Main Market of the London Stock Exchange the largest company in the FTSE All-Share index[4] (HSBC) has a market capitalisation of £135,636 million; the smallest company in the index has a market capitalisation of £34 million, 0.025% of the size. The top 10 companies in the index account for 34% of the market capitalisation of the index, which comprises 635 companies in total. Clearly, there is a vast difference between largest and smallest.

These companies need to be treated differently and disclosure requirements need to be carefully crafted if policymakers want growth companies on the Main Market to continue to grow and create jobs. **Achieving the aim of better behaviour in the largest companies should not be to the detriment of growth companies and the UK economy.**

As the over-arching comply and explain system of the Code gets ever more detailed this tends towards many companies having to explain why a requirement is not yet appropriate. This is a negative approach rather than a differentiated system that encourages companies to show their progress and the positive action taken.

If the Government does decide to adopt a one-size fits all approach and extend requirements regarding executive pay and / or strengthening the employee, customer and wider stakeholder voice to all companies on the Main Market then we believe that small and mid-size quoted companies should be granted a transitional period of between three and five years so that they have adequate time to make the changes necessary to meet any new requirements.

However, we repeat that **we do not think that a one-size fits all approach is conducive to encouraging growth in the UK economy.**

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

[4] http://www.ftse.com/Analytics/FactSheets/temp/8ff36385-594c-4054-ab67-5aa3bc8f8457.pdf

APPENDIX A

Quoted Companies Alliance Corporate Governance Expert Group

Edward Craft (Chairman)	**Wedlake Bell LLP**
Colin Jones (Deputy Chairman)	UHY Hacker Young
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Kalina Lazarova	BMO Global Asset Management (EMEA)
Nick Graves	Burges Salmon
David Hicks	Charles Russell Speechlys LLP
David Fuller	CLS Holdings PLC
Nicholas Stretch	CMS Cameron McKenna LLP
Nick Gibbon	DAC Beachcroft LLP
Tracy Gordon	Deloitte LLP
Melanie Wadsworth	Faegre Baker Daniels LLP
Rob Burdett	FIT Remuneration Consultants
Richie Clark	Fox Williams LLP
Michael Brown	Henderson Global Investors
Will Pomroy	Hermes Investment Management Limited
Alexandra Hockenhull	Hockenhull Investor Relations
Julie Stanbrook Bernard Wall	Hogan Lovells International LLP
Darshan Patel Niall Pearson	Hybridan LLP
Peter Swabey	ICSA
Jayne Meacham Carmen Stevens	Jordans Limited
Darius Lewington	LexisNexis
Peter Fitzwilliam	Mission Marketing Group (The) PLC
Cliff Weight	MM & K Limited
Caroline Newsholme	Nabarro LLP
Louis Cooper	Non-Executive Directors Association (NEDA)
Julie Keefe	Norton Rose Fulbright LLP
Amanda Cantwell	Practical Law Company Limited
Philip Patterson	PricewaterhouseCoopers LLP
Marc Marrero	Stifel
Edward Beale	Western Selection Plc

Quoted Companies Alliance Financial Reporting Expert Group

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Matthew Howells (Deputy Chairman)	Smith & Williamson LLP
Jonathan Compton	BDO LLP
Amy Shepheard	Deloitte LLP
Neil Armstrong	Frontier Developments PLC
Gary Jones	Grant Thornton UK LLP
Anthony Carey	Mazars LLP
Joseph Archer	PKF Littlejohn LLP
Andrew Westbrook	RSM
Donna Caira	Saffery Champness
Edward Beale	Western Selection Plc

Quoted Companies Alliance Share Schemes Expert Group

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Emma Bailey (Deputy Chairman)	Fox Williams LLP
Philip Fisher Andy Goodman	BDO LLP
David Daws	Blake Morgan
Caroline Harwood	Burges Salmon
Nicholas Stretch	CMS Cameron McKenna LLP
Juliet Halfhead	Deloitte LLP
Danny Blum	Eversheds Sutherland
Rory Cray	FIT Remuneration Consultants
Shofiq Miah	Fox Williams LLP
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Sara Cohen	Lewis Silkin
Liz Hunter	Mazars LLP
Stephen Diosi	Mishcon De Reya
Stuart James	MM & K Limited
Graham Muir	Nabarro LLP
Andrew Quayle	Olswang
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Dave Bareham	Smith & Williamson LLP
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