

Rt Hon Theresa May MP
Prime Minister, First Lord of the Treasury and Minister for the Civil Service
10 Downing Street
London SW1A 2AA

30th August 2016

A handwritten signature in blue ink that reads "Dear Prime Minister,".

CORPORATE GOVERNANCE REFORM

As the professional body for governance, ICSA: The Governance Institute strongly welcomes the emphasis you have placed on the need for companies to be governed in a way that is in the long-term benefit of both the company and society at large; and your willingness to make reforms that will ensure that the boards of companies do not lose sight of this important objective.

I would like to put forward two recommendations for your consideration as you develop your planned reforms. They relate specifically to the governance of larger private companies.

As the case of BHS has demonstrated, the fact that a large company may be privately owned does not reduce the public impact when it fails. Arguing that there should be different expectations on the board of directors simply because there is a different ownership structure is a red herring.

The Companies Act 2006 already recognises this to be the case, which is why the duties of directors set out in Part 10 of the Act – which include a requirement to consider the long-term consequences of their decisions and the impact on their employees and the community – apply to directors of all companies, not only publicly quoted ones.

In the same spirit, I believe that the boards of larger private companies should be expected to aspire to the same standards of governance as those in the listed sector.

My first recommendation therefore is that these companies – which for this purpose I would define as those required under the Companies Act to have audited accounts and to produce a directors' report – should be required to disclose in their annual report the extent to which they comply with the UK Corporate Governance Code, issued by the Financial Reporting Council.

I do not believe that it is necessary to introduce a separate code for larger private companies. The FRC's code is widely respected and emulated, and the "comply or explain" mechanism means that private companies would have the flexibility to deviate from its detailed provisions where they feel it is appropriate, as long as they disclose that they have done so.

If we are to expect the same standards of professionalism of the boards of larger private companies that we do of public companies, then we should also expect them to seek the same standard of professional advice. My second recommendation is therefore that the requirement in Part 12 of the Act for public companies to have a company secretary should be extended to these companies.

I would also like to comment briefly on your proposals relating to the remuneration of executive directors. While I entirely agree with you that the current system for setting and approving remuneration is not working, I am not persuaded that giving further voting rights to shareholders is necessarily the right answer.

Since 2002 we have been pursuing a regulatory approach based on a combination of transparency and voting rights. Despite both elements of the approach having been strengthened since then, it has done little or nothing to prevent an escalation of directors' fees and bonuses. It is not self-evident that further strengthening of the same basic approach would achieve that objective.

It seems to me that the issue is not that shareholders lack the rights that would enable them to hold companies properly to account, but that they are often reluctant to use them. For example, it is striking that, looking at the five largest shareholder revolts this AGM season, the average vote against the report was 54 per cent but the average vote against the chair of the remuneration committee was less than 1.5 per cent.

Unless investors become more willing to use the powers they already have, I believe it may be necessary to consider different – and possibly more radical – reforms.

I would welcome the opportunity to discuss these points and the recommendations on the governance of larger private companies with your officials, and with those at the Department of Business, Energy and Industrial Strategy.

I am copying this letter to the Secretary of State for Business, Energy and Industrial Strategy and to the Minister for Small Business, Consumers and Corporate Responsibility, and to the Chairman of the Financial Reporting Council.

A handwritten signature in blue ink, appearing to read 'Simon Osborne', with a stylized flourish at the end.

Simon Osborne FCIS
Chief Executive

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