CIMA welcomes the opportunity to comment on the Government’s Green Paper on Corporate Governance Reform. We submitted a response to the Business, Innovation and Skills Parliamentary Committee Inquiry on Corporate Governance on 24 October 2016, and this response incorporates the points we made to that inquiry. The response is given in the sole context of the UK market and, as such, does not relate to any other jurisdiction.

Our response is written in four parts. Part one is the Executive Summary. Part two addresses our view of the role of business, the current regulatory landscape and how our thinking can help shape Government action. Part three is a detailed response to the consultation questions. Finally, part four outlines our view of a business model framework applicable to board governance.

PART ONE: EXECUTIVE SUMMARY

As stated by the Prime Minister in her introduction, business has the power to improve collective prosperity. The UK, and business specifically, is successful.

We recognise that the driver for reform lies in the declining trust that society places, not just in business organisations, but in all institutions, both global and national. Trust is at the heart of much in life, and the reputation of an organisation is critical to its long-term strategic success. Trust, or reputation, underpins whether investors want to invest in a company, whether customers want to do business with a company, whether individuals and suppliers want to work with a company, and whether society wants a company to continue to operate in their region.

The decline in public trust, which is once again highlighted through the Edelman 2017 global trust survey¹, is something that needs to be tackled.

UK corporate governance is widely admired around the world. Current legislation and regulation provides investors and other stakeholders with the powers to hold boards and directors to account. Nevertheless, improvements can always be made to the governance environment, and if done well, can provide opportunity for increased long-term success for business. This would make the UK an even more attractive place for businesses to be located.

¹ http://www.edelman.com/executive-summary/
Our recommendations are made in this context, and acknowledge the critical role business has in the well-being of society and the importance of putting the customer at the heart of strategic business decisions.

We address all the questions in the context of the external environment and their implications for business and encourage Government and business to work together to develop a sound corporate governance framework.

This environment gives rise to risks that will, from time to time, require businesses to change significantly, and some will fail. Government should recognise this reality, and continue to support the importance of business for the general well-being of UK life.

Central to all business is the creation of value for the customer and other stakeholders, in particular the investor. Our recommendations are underpinned by the use of a business model framework that assesses how an organisation defines, creates, delivers and captures value, with, and for, its stakeholders, in a consistent and coherent manner that connects with the wider eco-system.

The principal issues and our recommendations are

- The shareholders of a company at any point in time are diverse in their objectives, ranging from those looking to achieve an investment return in the very short-term through to the long-term. While short-term holdings do provide vital market liquidity, it is only those shareholders with longer-term objectives that are likely to exercise stewardship over a company and counter the tendency for executives to focus on near-term priorities. While recognising the complexity involved, we would welcome BEIS setting up a working group in respect of extending voting rights for strong stewardship. We would provisionally recommend that shareholders can only exercise their votes if they have held their shares for a minimum period; for instance, six months.

- S172 of the 2006 Companies Act requires directors to focus on the success of the company, having regard to the long-term and to their stakeholders, including investors. The relative success of companies with a long-term focus is highlighted in the latest report by Mckinsey on short-termism. The Financial Reporting Council's (FRC) Corporate Governance Code focuses upon the long-term success of the company. However, we would recommend that the Code is strengthened to require directors, within the chairman’s statement of the strategic report, to explain how they have addressed S172 in terms of all the companies' material stakeholders.

- Companies are required to prepare corporate reports, including the Strategic Report, a range of governance reports, and the financial accounts. There is, however, no

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requirement for them to be reported in an integrated manner. **We would recommend that their preparation on an integrated basis becomes a key principle of the Code so as to foster integrated thinking in business.**

- The FRC Financial Reporting Review Panel (FRRP) has the remit to review and require that companies prepare the Strategic Report and financial accounts on a fair, balanced and understandable basis. This remit excludes the annual report overall. **We would recommend that the remit of the FRRP is widened to cover the annual report in its entirety.**

- Companies are required to prepare a Viability Statement. To address the company’s viability, the directors need to consider both the opportunities and risks that the company faces to achieve success in the long-term. **We would recommend that the directors address the risks and opportunities in the context of a company’s business model. This should be focused upon how value is currently created, and the basis for the creation of value in the future for investors and those stakeholders material to the company. It should also include opportunities and threats that may affect the business model going forward,** although there is good reason to limit exposure regarding competitive opportunities. We set out the basis for a business model framework in part four.

- A significant factor in the long-term success of any company is its culture, and the quality and motivation of its employees. **We would recommend that within the Strategic Report, the directors include a section setting out how they have addressed these matters.**

- For all our recommendations, we believe that it is important that the directors’ address and report upon only those matters which they deem are material to the success of the company, while bearing in mind the need for concise reporting. **We would recommend that legislation, the Code and regulations allow directors to focus on material matters only. It is important that the basis of their decisions on what is material when subject to later consideration is based upon the values and culture prevalent across business and society at the time of the decisions.**

- To address these matters, and the value created for the stakeholders’ material to the company, it is necessary for the board members to comprise of the right skills, experience, independence and knowledge. Board members should also display the values adopted by the company. **We would recommend that the Governance Report sets out why the chairman believes that the board comprises those attributes.**

- The CFO should be seen as holding the business critical information for decisions and reporting in the business. This role underpins security, control and compliance within the business. The role should be founded on ethical principles that are widely-supported by professional bodies. Within CIMA, these are codified in our detailed management accounting principles³. **Because of its importance, we recommend the**

³ [http://www.cimaglobal.com/Members/The-Global-Management-Accounting-Principles/]
CFO role is reserved for professionally-qualified accountants within the Corporate Governance Code. This would be monitored on a comply-or-explain basis.

- The consultants that undertake board assessment reviews are not subject to any form of objective standards, despite the role of the assessment being, in effect, the audit of the board's effectiveness. This is therefore a critical component of sound governance. We would recommend that as part of their stewardship responsibilities long term investors, together with business leaders, develop a set of principle-based standards that consultants should apply. This should be referenced within the Stewardship Code.

- The issue of executive pay has attracted much negative attention with the media, politicians, and the public. There should be a robust connection between rewards and results. It is our view that this attention has undermined public trust in business and this needs to be addressed. Improved corporate reporting as addressed above is one way, but we would also recommend the following further actions -
  
  - Executive pay is clearly aligned to performance, with the Remuneration Report explaining how the executives have added value to material stakeholders over the long term.
  - The Remuneration Committee have oversight of, and report upon, the overall remuneration structure of the company's and its link to the company business model.
  - A table be included in the Remuneration Report setting out all those staff paid over, say, £1 million per annum, and reported in the context of the overall staff remuneration.

Finally, there are a number of privately held UK organisations that clearly operate in the public interest. Although this definition is subjective, we would recommend that any company whose size if listed would qualify it for entry to the FTSE 250 and where they meet a test which indicates an undoubted public interest, they should be subject to the reporting requirements of such companies. This additional reporting will drive accountability in these entities.
PART TWO: OVERVIEW

INTRODUCTION

CIMA is the world’s leading, and largest, professional body of management accountants, with over 100,000 members globally. We are incorporated by Royal Charter and headquartered in London. As a provider of world-class research and educational content to our profession, CIMA takes a keen interest in the development of corporate governance best practice, both in the UK and globally. CIMA welcomes the opportunity to contribute to this green paper solely within a UK context.

Together with the American Institute of CPAs (AICPA), CIMA has established the Chartered Global Management Accountant (CGMA) designation. CGMA is the global quality standard that further elevates the profession of management accounting. The designation recognises the most talented and committed management accountants with the discipline and skill to drive strong business performance.

The AICPA and CIMA also make up the Association of International Certified Professional Accountants (the Association), which represents over 600,000 management and public accountants globally, advocating on behalf of the public interest and advancing the quality, competency and employability of CGMAs, CPAs and other accounting and finance professionals worldwide.

BACKGROUND

CIMA agree that it is critical that the UK corporate governance framework is kept up-to-date, but also welcome the messages included in the green paper’s foreword by Secretary of State Greg Clark, regarding the current strength of UK corporate governance, and the possibility that further regulation may not be needed to secure necessary change.

We support the Government’s ambition “to make Britain one of the best places in the world to work, to invest and to do business,” and believe that professional bodies such as CIMA have a vital role to play in partnership with Government, when it comes to promoting the value of successful businesses to society.

It is very important to encourage understanding of good business practice and we believe that corporate governance should fundamentally support this outcome.

THE EXTERNAL ENVIRONMENT AND IMPLICATIONS FOR BUSINESS

Much has been written on the external environment and its implications for business. This is particularly relevant because of the current public mistrust of organisations. Below, we summarise, in no specific order, what we believe are the most significant issues, providing both opportunities and risks, to companies and organisations:
The shift of value from the Balance Sheet - Intangible assets such as intellectual property, customer base and brand now account for over 80 per cent of total corporate value, compared to under 20 per cent 40 years ago.

Operating in a global, interconnected environment, together with the risks of a return to nationalism in some countries

The impact of technology – automation, data, cybercrime

Business and Government working together to win public trust and promote value

Balancing the need to focus upon the short-term whilst focusing on long-term success

Demonstrating trust through a focus upon open and accountable, leadership and values

Diversity, and often conflicting regulation, including taxation

Addressing the challenges to the natural environment

Changing societal norms

Changing investor approaches

Infrastructure availability

Skills and talent shortage

Civil disruption

These opportunities and risks give rise to a complex environment, and can often overlap or conflict with each other. It is for this reason that policy and regulation should focus upon principles rather than rules.

Whilst aware of the public pressure for action on corporate governance, CIMA would caution against potentially politically-expedient measures. Any regulatory change should be founded on demonstrable evidence and should not unnecessarily impact on the attractiveness of the UK as a place to do business, or needlessly increase cost and bureaucracy.

It is also important to give recent changes to corporate governance codes and legislation time for Government to assess impact. This includes changes regarding executive pay, the viability statement, and the recent FRC report on culture.

The Government imperative in this area is well understood and we believe that a collaborative approach with UK business would be the best way of ensuring a positive policy outcome. We believe that additional regulation can undermine the genuine business desire to focus on the customer and this desire can best be harnessed through collaboration with business in a way that restores trust to society at large.

The incentive to survive in the long-term should be generally sufficient to incentivise sound business practice and we believe that the Government’s traditional focus on minimising regulation should be borne in mind throughout this review.
THE PURPOSE OF BUSINESS

In order to address the relationship between business and society it is helpful to remind ourselves what the purpose of the organisation actually is.

A leading thinker in this area, Peter Drucker, defines the purpose of business as one that “...must lie outside the business itself. In fact, it must lie in society, since a business enterprise is an organ of society. There is only one valid business purpose, to create a customer”. To this we would add - over time. This addition is to address the importance of innovation and changes in the external environment.

The customer is a foundation of a business and keeps it in existence. The customer alone gives employment. And it is to supply the customer that society entrusts wealth-producing resources to the business enterprise.”

This definition focuses on the customer, employees and society, and the trust of society in business, together with the investor.

This issue of public trust has recently been developed extensively through the FRC report on culture in business, published in July 2016. The report emphasised the need to connect purpose and strategy to culture, align values / incentives and assess and measure outcomes. Those outcomes, the report suggests, should be assessed over the long-term, even at the expense of short-term financial gain. It stresses the widely-held view that incentives and behaviour within organisations can quickly come to define outcomes. While bringing short term benefits, unacceptable behaviour that undermines company values and erodes customer faith in the brand can quickly prove corrosive. The report emphasises that a demonstrable focus on values over time, and on how clear objectives are achieved bring the best outcomes for both business and society. We strongly support the work of the FRC on business culture and its inherent implications for changes to the Code.

Supported by this, our view is therefore that evolving best practice, as represented by leading companies should be welcomed but that, with improvements to the Code and reporting regulations Government can work with business to ensure maximum customer and stakeholder focus.

The changes that we advocate involve the promotion of the customer-focused business model into the heart of board decision making. This should be implemented as a principle-based change and should involve the comprehensive adoption of the principle of materiality. Below, we outline how our focus on the business model can support UK Government and businesses in its ambitions.

THE IMPORTANCE OF THE BUSINESS MODEL

It is our view that businesses themselves need to develop clarity around their business model, understand how value is created and shared with stakeholders, and the potential impact of
changes in the external environment, and how value can be created in future. At its heart is the value created for the customer. It also provides a framework for a company to address how it will address the risks, and opportunities, arising from the Sustainable Developments Goals (SDGs)\(^4\).

A well-described customer focused business model addresses, in an integrated manner, company objectives, values, opportunities and risks. It links remuneration to performance, and skills. It also provides a basis for strategic reporting and assurance, and helps put sound governance at the centre of corporate decision making. It ensures that metrics are the bedrock of the organisation and that they support all strategic decisions.

It is our contention that the board, senior managers, investors and wider stakeholders would benefit from a more integrated and common understanding of their business models. This would facilitate decision-makers in understanding when a company is deviating from value creation and help avoid decisions that lead to corporate failings, especially where this would be contrary to the public interest. In our view, Government could facilitate this understanding through codification of the business model concept. We would point to the work recently carried out by the FRC Lab as work on which to build\(^5\). More specifically, we would recommend that the Corporate Governance Code is updated to explicitly emphasise the need to consider all stakeholders that the company is dependent upon for its long-term success. This should include requiring companies to set out how value is currently created and preserved through their business model. In part four, we set out in further detail our business model framework. The framework anchors strategic decision-making, risk and viability statements into the heart of good governance. In addition to the widespread focus on the business model we would highlight a number of other important influences that can be strengthened to promote sound business.

**STEWARDSHIP**

The shareholders of a company at any point in time are diverse in their objectives, ranging from those looking to achieve an investment return in the very short-term through to the long-term. It is only those shareholders with longer-term objectives that are likely to exercise stewardship over a company. Following the 2008 financial crisis, the UK recognised, through the Walker Review\(^6\), that a dangerous disconnect was developing between company management and shareholders. In order to tackle this, the UK developed a Stewardship Code that aims to promote best practice amongst shareholders in terms of company engagement. The idea is to foster accountability through the value chain from the manager to the end beneficiary holding

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\(^4\) [https://sustainabledevelopment.un.org/?menu=1300](https://sustainabledevelopment.un.org/?menu=1300)


the share. Though not a legal requirement, compliance with the Code is strongly promoted amongst major asset owners and by the FRC. The Code has helped foster a sense amongst the investor community that they have a responsibility to promote the long-term interests of the system, as much as short-term gain. This community is typically made up of pension fund-holders, who rely on their investments performing over the long term. It follows, in our view, that such shareholders, who are demonstrating their interest and commitment to stewardship, should have a greater influence over the company. **We would therefore recommend that shareholders can only exercise their votes if they have held their shares for a minimum period, for instance six months subject to a more in-depth Government review of how this could be implemented.**

**CORPORATE GOVERNANCE FRAMEWORK**

The UK's Corporate Governance Framework (Code) is widely admired. For this reason, we fully support the continued promotion of the Code on a voluntary comply-or-explain basis. This promotes good practice but allows flexibility in a transparent manner. We fully support the continued improvement of best practice in line with UK reporting requirements.

The existing Code has been developed over the last 25 years to become a world-class and leading example of how corporate governance can be done successfully. The comply-or-explain regime, supported by the FRC allows companies to pursue best practice while, at the same time, deviating from this, where practical, and necessary for the benefit of the particular company.

The Code commences by stating “The purpose of corporate governance is to facilitate effective, entrepreneurial and prudential management that can deliver the long-term success of the company.” The Code also recognises the “providers of other capital”, but stating “While, in law the company is primarily accountable to its shareholders, and the relationship between the company and its shareholders is also the main focus of the Code, companies are encouraged to recognise the contribution made by other providers of capital.....”

The Code requires that “The board should present a fair, balanced and understandable assessment of the company’s position and prospects”. The current version of the Code has introduced the “Viability Statement” which requires the directors to “....explain in the annual report how they have assessed the prospects of the company....”

The Code states that “The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.”

The Code recognises that it “has been enduring, but it is not immutable. Its fitness for purpose in a permanently changing economic and social business environment requires its evaluation at appropriate intervals”.

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Chartered Institute of Management Accountants
The Helicon One South Place London EC2M 2RB United Kingdom
T +44 (0)20 7663 5441 F +44 (0)20 7663 5442
www.cimaglobal.com
These matters are all underpinned in law by the responsibilities of the director as set out in section 172 of the 2006 Companies Act:

A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.

We are of the view that the responsibilities set out in the Companies Act 2006 Section 172 are not sufficiently recognised as critical to business success. We believe that these duties are not always fully understood or acted upon by those who make corporate decisions. Purpose is often understood in narrow financial terms rather than broader societal ones, even though there is no legal reason that this should be the case. We therefore advocate the updating of the Code to require directors, within the chairman’s statement of the strategic report, to explain how they have addressed S172 in terms of all the companies’ material stakeholders. By disclosing this information, we believe that the board would inevitably need to focus on these duties in more depth than is currently the case.

CORPORATE REPORTING AND ACCOUNTING STANDARDS

Corporate Reporting in the UK has made considerable progress towards ensuring effective public protection against mismanagement, particularly with the introduction of The Strategic Report, including the viability statement; Corporate Governance, audit and remuneration committee reports; and the extended audit report.

The FRC’s Financial Reporting Review Panel (FRRP) considers issues raised in respect of the Conduct Committee’s reviews of company reports and accounts. Its scope is limited to the financial accounts and the strategic report. It must take this opportunity to reviews its skillset in line with modern business practice.
The Integrated Reporting Framework was issued, after a robust international consultation process, by the International Integrated Reporting Council in January 2015. The definition of an Integrated Report "is a concise communication about how an organisation's strategy, governance, performance, and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term." The Integrated Reporting Framework considers value in the context of a range of capitals: financial (including debt and equity), manufactured, intellectual, human, social and relationships, and natural. It also defines materiality as “a matter ... that could substantively affect the organisation’s ability to create value in the short, medium or long-term.”

The Corporate Reporting Dialogue (CRD), a group of eight major standard setters (including IIRC, IASB, FASB, GRI), has released a statement clarifying the common principles of materiality. It provides a comparison of the materiality definitions and approaches by CRD participants. Whilst not having a common definition, the CRD participants state “Their detailed promulgated requirements need not be applied if an item is not material to the reporting entity when viewed from the perspective of its primary stakeholders.”

Accounting standards have provided an effective framework to report financial information. However, the underlying intention that the standards should be principle based has occasionally tended towards a rules basis which we would recommend should be minimised.

REVIEWING CORPORATE REPORTING

The requirement to report and disclose on financial information can be an important tool in changing the behaviour of leading UK companies. ‘Joining the Dots’7, a major CGMA research report, published in January 2016, concludes that senior leaders are struggling to make the right decisions due to bureaucratic decision-making processes, siloed and short-term thinking, intra-organisational breakdowns in trust and collaboration, and difficulty translating ever-expanding volumes of information into relevant knowledge. The systems and cultures in which organisations are functioning are making it difficult to implement integrated thinking.

Furthermore, the same research shows that organisations that have advanced capability in the four principles to create and preserve Value on which the CGMA Global Management Accounting Principles (GMAP) focuses - Influence, Relevance, Analysis and Trust - enjoy a decision-making advantage: for example, in terms of better performance, improved strategic execution, and fewer failures of strategic initiatives due to delays in decision-making and reduced susceptibility to delivering flawed information to decision-makers.

In the current context, Integrated Reporting <IR>, underpinned by integrated thinking, provides the insight needed across a broader information set with a future orientation, drawing on the

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organisation’s business model within the context of its external environment, to meet this challenge.

However, the UK, in support of the aforementioned Companies Act S.172, currently has no requirement for the elements comprising the Annual Report to be integrated, or for the integration with the Corporate Sustainability Report when prepared. The effectiveness of the reporting information in these reports is often reduced by the inclusion of immaterial information due to regulation or otherwise. The requirements of the legislation, which gives directors responsibility to create successful businesses for the benefit of shareholders, whilst having regard to a range of other interests in our view are not reflected by current strategic reporting regulation or guidance. This could be remedied through a number of measures. Firstly, the FRC could issue clearer guidance on the link with statute. Secondly, the FRRP, which is responsible for the review of the overall integrated reporting requirements, should ensure reports provide a “fair, balanced, and understandable” assessment of the company’s prospects.

Additionally, reporting requirements should foster integration by strongly encouraging the effective narration of a concise communication about how an organisation’s strategy, governance, performance, and prospects, in the context of its external environment, lead to the creation of value over time. This means promoting the long term success, the interests of material stakeholders, and transparency of material matters. Any ex-post regulation should look to ensure that risks were considered in the context of the time.

A significant factor in the long-term success of any company is its culture, and the quality and motivation of its employees. We would recommend that within the strategic report the directors include a section setting out how they have addressed these matters.

Finally, reporting should be subject to the principle of materiality, so that only information material to the creation and preservation of value over time is included.

EXECUTIVE PAY

In terms of remuneration we believe that many of the mechanisms needed to deal with the issue are already in place. The transparency of remuneration and the appointments process are successfully governed by the code and oversight of investors, such as fund managers, is promoted by the voluntary Stewardship Code. Furthermore powers allowing shareholders to vote on pay policy are still bedding in and we believe that it is still too early to assess the full impact of this additional measure.

In terms of developing this we think that business models which ensure that rewards and incentives are clearly linked to value adding performance over time should be encouraged and promoted. However, we would urge flexibility depending on the timeline of the specific company model.
Further regulation in this area may lead to perverse incentives and so we feel that the best approach is to work with business on appropriate methods of linking pay to performance. Executive pay should be clearly aligned to performance, with the Remuneration Report explaining why this is the case.

One mechanism for increasing transparency would be the use of a table of all remuneration within a refreshed FRC board effectiveness guidance publication. This could be provided to a certain level of materiality and provide a context to business operation but could be a useful tool in ensuring that wider society understands the company position. **Specifically, a table should be included in the Remuneration Report setting out all those staff paid over, say, £1 million per annum in the context of overall staff remuneration should be mandated.** Many companies already adopt claw back mechanisms where subsequent performance justifies this or there is a serious breach of legal duties. The timescale for claw back might be six years, in line with the statute of limitations.

In the context of the above we recommend that the Remuneration Committee have oversight of, and report upon, the overall remuneration structure of the company.

**BOARD SKILLS, EXPERIENCE, INDEPENDENCE AND KNOWLEDGE**

As stated above, the Code states that “The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.” **We would recommend that the Governance Report sets out why the chairman believes that the board comprises these attributes.** Additionally, we would highlight the importance of Non-Executive Directors, who lend independence of thought to a Board.

The consultants that undertake board assessment reviews are not subject to any form of objective standards, despite the role of the assessment to be, in effect, the audit of the board’s effectiveness. **We would recommend that as part of their stewardship responsibilities long term investors, together with business leaders, develop a set of principle based standards which consultants should apply. This should be referenced within the Stewardship Code.**

**THE PROFESSIONAL ROLE OF THE CFO**

The vast majority of chief financial -officers (finance directors or equivalents) of listed companies, and other large organisations are professionally-qualified accountants, subject to the professional standards requirements and continuing professional development requirements of their professional bodies.

Professional bodies provide the necessary independence and guidance that acts as a balance against short termism. The four key tasks of a CFO are financial security, compliance and control, strategic direction, and the implementation of the values of the business through...
ownership of the business model framework. Their skills include integrity and systemic thinking, including driving complexity out of the business.

We believe that it is important that the value of a professional qualification is recognised throughout the business community and promoted through Government education policy. The CFO should be seen as the guardian of the integrated business critical information for decisions and reporting in the business, providing to the board consistent information and insight on which sound critical judgments should be made. The CFO focusses upon business success, upholds integrity and provides a useful independent perspective to business decisions. It is therefore our view that the CFO should be a suitably trained professional. This can be achieved through reserving this role for professionally qualified accountants within the Corporate Governance Code. This would then be monitored on a comply-or-explain basis so that businesses have flexibility.

This measure would eliminate the anomaly whereby a director can withdraw or never hold professional qualifications but can hold the principal financial management role in the business. The integrity of the profession would be used against miscreants, including, as a last resort the use of existing professional sanction.

STRENGTHENING WIDER STAKEHOLDER RELATIONSHIP

With the increasing complexity in society we recognise that there can be a growing disconnection between the managers making decisions within companies and those who own shares. There is increasingly a concentration of shareholding in the hands of assets managers and arguably, as this is not their money, there is a lack of incentive to improve corporate oversight.

To address this we believe that companies need to ensure that their business model is developed with an appreciation of wider stakeholders including shareholders, and boards take decisions with the wider stakeholders in mind. To achieve this we believe that companies should be encouraged to appoint a diversity of members on to their board so that a plurality of skills, views and experience exists.

We believe that the business model framework can be useful in this context and should be promoted. In our view business success can only occur in the long term where a full range of stakeholder views are considered fully at board level. However, we do not believe that any Government measures are needed to mandate diverse shareholder engagement. We feel that this is best done through working with boards on a voluntary basis.

CORPORATE GOVERNANCE IN LARGE PRIVATELY HELD COMPANIES

At present the corporate governance Code applies to publically listed companies. However, as the green paper points out there has been a proliferation of company funding models in recent
years that has led to a growth in non-listed private firms. These firms often grow to substantial size and have a significant impact on their wider stakeholders and society.

While many of these companies acknowledge the importance of corporate governance we believe that Government should now seek to address the imbalance between these entities. **We would recommend that any company whose size if listed would qualify it for entry to the FTSE 250 and where they meet a test which indicates an undoubted public interest should be subject to the reporting requirements of such companies.**

This test could include significant employee numbers, material use of natural resources or public resources, public assets and operation of public services or call on public funds. This test should form the basis for coverage by a new, principles based Code aimed specifically at this sector. The basis for this would be that society grants limited liability to the owners of such companies and in return should expect a degree of due diligence.

**CONCLUSION**

We believe that based on this analysis our recommendations, would not only build on the successful best practice and regulatory framework that already exists, but would also address the issues around public trust that we agree are a concern. In particular, the additional reporting that we suggest would comprehensively demonstrate to stakeholders how corporates generate long term value.

The adoption of a business model approach, centred on the customer should allow Boards to effectively consider the long term sustainability of their decisions. This would address many corporate failings, which often result from a change in the external environment impacting the business model that is designed to take advantage of short term market fluctuations at the expense of the sustained addition of value over time. We believe that by ensuring board decision-making goes through the robust and rigorous thought processes that a revised corporate governance framework would ensure, the erosion of public trust that exists can be reversed.
PART THREE: CIMA RESPONSE TO CONSULTATION QUESTIONS

1. 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?

The shareholders of a company at any point in time are diverse in their objectives, ranging from those looking to achieve an investment return in the very short term through to the long term. It is only those shareholders with longer term objectives that are likely to exercise stewardship over a company.

Following the 2008 financial crisis, the UK recognised through the Walker Review that a dangerous disconnect was developing between company management and shareholders. In order to tackle this the UK developed a Stewardship Code which aims to promote best practice amongst shareholders in terms of company engagement. The idea is to foster accountability through the value chain from the manager to the end beneficiary holding the share.

Though not a legal requirement, compliance with the Code is strongly promoted amongst major asset owners and by the FRC. The Code has helped foster a sense amongst the investor community that they have a responsibility to promote the long term interests of the system as much as short term gain. This community is typically made up of pension fund holders who rely on their investments performing over the long term. It follows, in our view, that such shareholders, who are demonstrating their interest and commitment to stewardship, should have a greater influence over the company. We would therefore recommend that shareholders can only exercise their votes if they have held their shares for a minimum period, for instance six months subject to a more in depth Government review of how this could be implemented.

2. 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?

See Answer to Question 1

3. 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?

In the context of the issues that we identify around executive pay in part one of this paper we recommend that the Remuneration Committee have oversight of, and report upon, the overall remuneration structure of the company.
4. 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.

We do not feel that pay-ratio reporting requirements would be a sensible measure to take. The figures attained would be misleading and the figure would depend vastly on the sector it applied to. Transparency in pay can be achieved through other mechanisms.

One mechanism for increasing transparency would be the use of a table of all remuneration within a refreshed FRC board effectiveness guidance publication. This could be provided to a certain level of materiality and provide a context to business operation but could be a useful tool in ensuring that wider society understands the company position. Specifically, a table should be included in the Remuneration Report setting out all those staff paid over, say, £1 million per annum in the context of overall staff remuneration should be mandated. Many companies already adopt claw back mechanisms where subsequent performance justifies this or there is a serious breach of legal duties. The timescale for claw back might be six years, in line with the statute of limitations.

5. 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?

See answer to question four above.

6. 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.

In terms of developing this we think that business models which ensure that rewards and incentives are clearly linked to value adding performance over time should be encouraged and promoted. However, we would urge flexibility depending on the timeline of the specific company model. Our detailed view of how a business model framework can work to address long term incentives is given in part four of our response. See part four.

7. 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.

If companies were to adopt the business model approach that we outline in Part four of this paper then this issue would be addressed through the defining value element. This is an...
iterative process involving four steps. Firstly firms identify relevant stakeholders that will include customers, shareholders, employees and suppliers. Second, they prioritise and rank the stakeholders (in most cases the customer is ranked the highest). Third, they identify the needs of all high priority stakeholders and finally they formulate value propositions that meet the needs of the high priority stakeholders.

8. 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?

All large companies should be targeted, regardless of being listed, as we believe that the importance of understanding stakeholder voice is instrumental to the long term success of any company and its business model.

9. 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.

In part one of this paper we outline a mixed approach to this question in detail. Generally, changes to primary legislation can be avoided in our view, through incremental revision to the Corporate Governance Code. We also think that there is merit in bringing business and Government together to work up the detail of our recommendations of shareholder voting and external board consultants.

10. 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?

At present the corporate governance Code applies to publically listed companies. However, as the green paper points out there has been a proliferation of company funding models in recent years that has led to a growth in non-listed private firms. These firms often grow to substantial size and have a significant impact on their wider stakeholders and society. While many of these companies acknowledge the importance of corporate governance we believe that Government should now seek to address the imbalance between these entities. We believe that the justification for this is that the granting of limited liability confers both rights but also responsibilities on private companies to wider society.

11. 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 would recommend that any company whose size if listed would qualify it for entry to the FTSE 250 and where they meet a test which indicates an undoubted public interest should be subject to the reporting requirements of such companies.
This test could include significant employee numbers, material use of natural resources or public resources, public assets and operation of public services or call on public funds. This test should form the basis for coverage by a new, principles based Code aimed specifically at this sector. The basis for this would be that society grants limited liability to the owners of such companies and in return should expect a degree of due diligence.

12. **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?**

This can be achieved through a revised governance Code that would be explicitly targeted at these companies. It could operate on a *comply-or-explain* basis though would be written for wider stakeholders rather than for investors as is the case in the listed companies code.

13. **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?**

Yes. This would level the playing field in terms of reporting requirements and address public interest concerns as outlined above. We suggest a size threshold equivalent to a FTSE 250 entity as referred to in question 11.

14. **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 considered the UK Corporate Governance framework in the context of the external environment in part two of this paper and set out specific recommendations in part one. In addition to the point raised in our answers above, we would also highlight the importance of company culture and values in ensuring long term success as well as materiality, the role of the CFO, diversity of board skills and standards for board consultants.
PART FOUR – BUSINESS MODEL FRAMEWORK

INTRODUCTION

This paper summarises a framework, the CGMA Value Generator, to help company boards plan the allocation of resources in their business, and to oversee the delivery of value from the operations. It is based upon the CIMA report “Rethinking the Business Model”.

The framework is based upon the creation of value for the customer and other stakeholders, in particular the investor. It assesses how an organisation defines, creates, delivers and captures value, with its stakeholders and for its stakeholders in a consistent and coherent manner that connects with the wider ‘ecosystem’.

The basis for the CGMA Value Generator uses the company’s business model to establish how value is created today, and how value can be created through addressing the opportunities and risks arising from the changing external environment.

In the UK, the framework underpins the directors’ responsibilities under S172 CA 2006, and the preparation and publication of a listed company’s Viability Statement and Strategic Report. It also underpins the preparation of an Integrated Report.

DIRECTORS RESPONSIBILITIES

The responsibilities of a director set out in the UK Companies Act, section 172 require them to promote the success of the company, and in addition to investors have regard for the long term; employees, suppliers, customers and others; community and the environment; and reputation. See Appendix 1

For listed companies, the UK Corporate Governance Code amplifies these responsibilities, focused upon the long term success of the company, and requires companies to issue a Strategic Report, including a Viability Statement. This report should be fair, balanced and understandable, enabling an assessment of the company’s position and performance, business model and strategy, together with the principal risks facing the company. See Appendix 1

These are substantial responsibilities, and in today’s increasingly complex business environment require a robust and integrated approach to discharging them. To support boards in undertaking these corporate governance responsibilities, CIMA has worked with an influential group of experts to develop a business model framework centred upon the creation of value, the CGMA Value Generator.
THE CHALLENGE

According to ‘The 2017 Edelman Trust Barometer’, trust in business is low and reducing, 45% in the UK. This is driven by a range of factors including high profile corporate failures, the perception that executive pay is not aligned to performance, and misselling to customers.

The challenge for boards is to create and communicate the value of their organization for all material stakeholders in an integrated manner. The focus for all organisations should be achieving success over time, a longer term focus.

To achieve this the organisation must meet the needs of their customers and other stakeholders including of society, also over time. A critical stakeholder is the investor but their return is dependent upon meeting customer needs in return for a fair consideration.

In order for an organisation to meet the needs of the customer and other stakeholders over time, it needs to understand:

- how value is created today
- the potential impact of changes in the external environment, and how value can be created in future.

This will enable the board to consider the potential changes in the external environment driven by technology and its implications for the delivery of products and services, and for the expectations of society.

We believe that, as spelt out in the recent Mckinsey report⁹, entitled ‘The impact of Short-Termism, the effective allocation of resources is critical to long term business success. Specifically, the board needs to ensure that the allocation is a holistic process addressing all the organisation’s material stakeholders, and how the value derived from customers will be shared between investors, employees, investment in the business, and society mainly through taxation and regulation.

THE CGMA VALUE GENERATOR (CGMA VG)

To support this challenge, led by the board, we have developed a business model framework, The CGMA VG). The purpose of the CGMA VG is to provide the board and management with a tool to consider the business through a series of lenses. This provides a basis for board discussion of those aspects of the business which are subject to change at any point in time.

The CGMA Value Generator provides:

• an uncluttered approach to ensure the difference between strategy and operations is clearly defined in a model where value is at the core. Defining a strategy to capture value is the strategic element, whereas creating and delivering value is the operational element. It is crucial that these two phases are not dislocated.

• a basis to view the business through a series of lenses, for instance values and behaviours, risk and risk appetite, and of course value creation for the investor and other stakeholders

• a business model framework, and a series of questions that boards should be able to answer to ensure they have a fair and balanced understanding of how value is currently created and the opportunities and risks to creation of value in future.

• a basis for reporting on an integrated basis to investors and other stakeholders

THE STRUCTURE OF THE CGMA VG FRAMEWORK

Central to CIMA’s Business Model Framework is the creation of Value. Value is about people. It is about how their needs are met. Value goes beyond shareholder value to creating shared value for the organisation’s stakeholders. Value can be financial or non-financial and both tangible or intangible. The move from an industrial economy to a knowledge- and information-based economy increased the importance of non-financial and intangible value to organisations.

The CGMA VG Framework, centres upon value creation (see appendix 2 for definitions):

• Defines the objectives and values of the organisation; the stakeholders and their needs, and in particular the products or services to meet a customer need(s).

• Identifies how the products or services are created

• Identifies how the products and services are delivered

• Addresses how the value captured is shared between the stakeholders

Value is not limited to the past and present as recognised in traditional financial statements. It also extends to the future. Value covers both the short-term and the long term. The short term is important because firms must survive for them to have any long-term prospects. However, short-term value must not undermine long-term value. The CGMA VG Framework (diagram 1) addresses potential change in the external environment arising from (see appendix two for definitions):

• Technology

• The market place

• Society
QUESTIONS FOR THE BOARD TO ADDRESS

Defining

- Is there clarity between those areas where the board is proactive – defining objectives and values, and allocation of resources – and where it seeks assurance – creation and delivery?

- Are the objectives of the organization focused upon the creation of long term value?

- Who are the principal stakeholders – Financial, human, social, natural, manufactured, intellectual?

- Do the organisation’s values and culture support the creation of long term value?

- How does the Business Model create value for each of the stakeholders? Do the stakeholders have a consistent view to that of the organization as to the value created for them? Is the value creation for all stakeholders sustainable?

- Does the board have a clear and robust view as to the potential changes in the external environment and the opportunities and risks that may arise?

- Does the organisation’s strategy and plans address how these opportunities and risks will be respectively embraced and mitigated?

- Are all activities of the organisation addressed on an integrated basis?
Assurance

- Are the values applied throughout the creation of the products and services, including staff, supply chain, partners?
- Are the values applied throughout the delivery processes to customers focused upon meeting their needs over time?
- Are the organisation’s KPIs aligned to create value consistent with the objectives and values defined by the board?
- Is the stress testing process of the plans robust?

Capture – Allocation of resources

- Is the allocation of resources undertaken based upon the value created by the organisation?
- Does the information provided to the board clearly differentiate between current income and costs, and investment for the future, providing how the organisation creates value over time?
- Is the allocation a holistic process addressing all the organisation’s material stakeholders – Reinvestment in business, executive pay, return to investors, payments to society (taxation, regulatory costs, other)?
PART FOUR - APPENDIX ONE

UK Companies Act and UK Corporate Governance Code requirements

The responsibilities of a director of a UK company are set out in Section 172 of the UK Companies Act 2006.

“UK Companies Act 2006, Section 172. (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to – (a) the likely consequences of any decision in the long-term, (b) the interests of the company’s employees, (c) the need to foster the company’s business relationships with suppliers, customers and others, (d) the impact of the company’s operations on the community and the environment, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and (f) the need to act fairly as between members of the company.”

For listed companies the UK Corporate Governance Code states “Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.”

The Code includes the requirements to prepare a Strategic Report, and within that a Viability Statement:

“The board should present a fair, balanced and understandable assessment of the company’s position and prospects.

C.1.1. The directors should explain in the annual report their responsibility for preparing the annual report and accounts, and state that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company’s position and performance, business model and strategy. There should be a statement by the auditor about their reporting responsibilities.

C.1.2. The directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company. 11

The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

C2.1. The directors should confirm in the annual report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. The directors should describe those risks and explain how they are being managed or mitigated.
C.2.2. Taking account of the company’s current position and principal risks, the directors should explain in the annual report how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.

C.2.3. The board should monitor the company’s risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls.

PART FOUR - APPENDIX TWO

VG FRAMEWORK DEFINITIONS

The VG Framework shows Value Creation at its heart operating within the business ecosystem. The business ecosystem comprises markets, society, technology and risk and opportunity.

Markets: The market is the space in which firms interact with their customers, suppliers, partners and competitors. Its defining characteristics are exchange, competition and profit. Within markets there are interlinked interactions among different players around collaborations, coordination and competition. These markets evolve continuously as different players and interactions enter or exit the space.

Society: Society regulates the conduct, activities and operations of firms through laws, customs, moral norms and social action. It comprises Governments, regulators, local communities and civil society organisations. It transcends national boundaries and in a digital world it has both local and global dimensions. Society provides the social, economic and legal infrastructure that enable business activities to take place. It can give or withhold the permission to operate in its jurisdiction. It can also prescribe or proscribe various activities of the firm.

Technology: Technology is the application of scientific knowledge to solve problems and tackle issues that people and society face. It is the means by which firms and their partners make things happen and is embodied in tools, techniques, methods and processes. The impact of technology on society and markets is immense. Its impact on society is shown in demographic shifts, new forms of interaction and organising, new expectations and experiences. Technology impacts markets through its effect on productivity, efficiency and the production and delivery of new types of goods and services. In recent times, technology (especially digitalization) has been the single most important source of disruptions in the firms’ environment.

Risk and opportunity: Risk and opportunity are two sides of the same coin – it depends on how you are positioned to tackle the issue. Opportunity encompasses new possibilities for firms to
collaborate, coordinate and compete with others. Risks refer to the chance that events will occur that will prevent the firm from achieving its value objectives. Risks do not operate in isolation and are often linked to each other. Risk are managed according to the risk appetite, capacity and tolerance of the firm.

At the heart of the CIMA Business Model Framework is Value and in particular how it is Defined, Created, Delivered and Captured

Defined: Defining value is an iterative process involving four steps. Firstly firms identify relevant stakeholders that will include customers, shareholders, employees and suppliers. Second, they prioritise and rank the stakeholders (in most cases the customer is ranked the highest). Third, they identify the needs of all high priority stakeholders and finally they formulate value propositions that meet the needs of the high priority stakeholders.

Created: To create value, firms must put in place the infrastructure, capability and relationships that enable them to convert inputs to outputs that meet the needs of their customers at an appropriate cost both to the firm and at a price that the customer is willing to pay.

Delivered: Firms deliver value to customers by making available to them goods and services that meet their needs. Customers have become increasingly discerning and demanding and expect to receive a good customer experience.

Captured: Value is captured when revenue earned from delivering value exceeds the cost of creating value. This difference is then shared with stakeholders who have been part of the value creation and delivery process, such as employee remuneration, taxes, dividends and earnings retained for re-investment.

Should you require any further information or need us to attend your office in person please do not hesitate to contact us.

Charles Tilley
Executive Chairman
CGMA Research Foundation

Andrew Harding
Chief Executive – Management Accounting
Association of International Certified Professional Accountants