The Quoted Companies Alliance

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22 October 2010

Dear Seamus,

ICSA Review of the Higgs Guidance on behalf of the FRC – Improving Board Effectiveness: A response to the second stage of consultation (the "Draft Guidance")

INTRODUCTION

The Quoted Companies Alliance (QCA) is a not-for-profit membership organisation working for small and mid-cap quoted companies. Their individual market capitalisations tend to be below £500m.

The QCA is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The QCA Corporate Governance Committee has examined your proposals and advised on this response. A list of committee members is at Appendix A.

We welcome the significant body of work you have undertaken in conjunction with the Financial Reporting Council on how good corporate governance can make the "next step" and become a truly powerful tool for effective leadership within businesses and for positive interaction with investors. Corporate governance issues should be the matter of constant debate and evolving best practice.

Before we address specific points on your paper, we set out what we have taken from the Draft Guidance to be the five key themes around which good governance should orbit:

1. **Role of Chairman**
2. **Creating a climate for constructive challenge**
3. **Management of relationships**
4. **Understanding respective roles**
5. **Bespoke skill development for each director**

We think that it would be useful if a statement of these key themes were to be set out in the preface to the final form of the guidance (the **"Final Guidance"**). The five identified principles are already stated in the text on page 4 of your paper, but such a powerful summary will be lost if not actually inserted into the Final Guidance.

RESPONSE

In direct response to your three questions:

Question 1: Do you agree with the purpose of the guidance as set out in the paper?

Yes, the QCA is fully supportive of the purpose of this guidance, subject to the concerns which we have already raised in our letter of 21 April 2010.

Since we wrote in April the UK Corporate Governance Code and the Stewardship Code have been published by the Financial Reporting Council and our own *Corporate Governance Guidelines for Smaller Quoted Companies* (September 2010) has been issued. All of these documents add significant colour and texture to the ongoing corporate governance debate.

Generally, as you will see in our other general comments there are certain areas where we think the Final Guidance could state positions in a more direct manner than currently set out in the Draft Guidance.

Question 2: Do you agree that the paper has identified the right areas where the existing guidance could be enhanced?

Yes, we agree that the right areas have been identified, but are of a view that in certain aspects this can be further developed, as set out below.

Question 3: Are there other areas which the guidance should look at?

We do not consider that there are any other areas to be reviewed at the present time.

OTHER GENERAL COMMENTS ON THE DRAFT GUIDANCE

<u>Other ICSA Guidance Notes</u>

On page 5 of your document you note that some of the detail which formed part of the original Higgs Guidance and was developed into more detailed Guidance Notes from ICSA have been removed from the Draft Guidance. In that we have received a regular flow of questions from our members in this regard, we think it would be very useful if the material were to be updated and maintained on the ICSA website and periodically refreshed.

We therefore suggest and request that the list at page 19 of the document is maintained possibly with hyperlinks to the relevant documents.

<u>A General Statement of Five Key Themes</u>

The Draft Guidance delivers practical assistance to boards. In this regard we think it would be very useful if the Final Guidance were to include a statement on its first page (possibly even by way of an insert box) of the five key themes, clearly set out as a series of numbered points. If directors and professionals do nothing more than read this key list, you will have at least delivered the guiding principles of effective governance to the reader.

As already stated, we consider the key themes to be as follows:

1. Role of Chairman

2. Creating a climate for constructive challenge

3. Management of relationships

4. Understanding respective roles

5. Bespoke skill development for each director

These five themes permeate the Draft Guidance but we consider a single statement would be very useful to board chairs, other board members, professional advisors and company secretaries.

Whilst not stated as such, there is possibly a sixth theme which is to **distil down the earlier principles into all levels of an organisation**.

<u>Specific comments on the text of the Draft Guidance</u>

Paragraph 5.1

The Draft Guidance contains a rather weak statement that the normal role of the senior independent director includes ensuring that the chair is passing the views of the shareholders to the full board. The role of the senior independent director includes forming his or her own opinion as to merits of the views of shareholders. The role of the senior independent director is not simply reactive.

We suggest that an additional concluding sentence could be added into paragraph 5.1 as follows:

"The senior independent director should be alive to sufficient investor feedback to fulfil these duties."

Paragraph 5.2

We consider that it would be useful if the Final Guidance were reworded to state that:

- the specific additional responsibilities placed on the senior independent director include at all times understanding the views of and the dynamic between the company chairman, executive management, other board members and shareholders; and

- at times when the board is undergoing a period of stress, the quality, strength and added value provided by the senior independent director is of particular importance.

The nature or prominence of the role of senior independent director does not change at times of board stress, but additional demands will be placed on such person.

We also think that it would be useful to include a statement in this paragraph that when a business is in difficulties its board must perform at its very best.

Paragraph 8.1

The discharge by the company secretary of his or her role is pivotal to the effectiveness of the board. We believe that in this paragraph the importance of the role of the secretary should be highlighted to a greater extent. The best company secretaries play an important role in advising, training and developing boards, not just presenting the legal position. Where appropriate, company secretaries often also encourage boards to seek professional external advice at an early stage when boards frequently try to leave this until late in the day.

We would draw your attention to page 34 of our own *Corporate Governance Guidelines for Smaller Quoted Companies* (September 2010) which refers to the secretary acting as a sounding board to the directors. We have made the point that difficulties arise if the company secretary is also a director. Conflicts may arise between those offices and, particularly where the finance director is requested to also perform the function of company secretary, there is a risk that the office of company secretary is devalued.

We would support a statement that contracting the company secretary role out to a service company focused on regulatory compliance or otherwise diminishing its significance should be actively discouraged. Outsourcing to a part time company secretary can be more effective than adding to the burdens already placed on the finance director.

Paragraph 9.4

We think it would be useful if the penultimate sentence of the second bullet point of this paragraph be amended to make the drafting more direct; amend "some chairs favour" to "it is often useful to…". We think that the three stage process suggested should form part of the guidance rather than simply being an observation: often it is a very good idea and it does serve to make governance a decision making process rather than a single decision.

Paragraph 11.2

We fully agree with the sentiments expressed in the first sentence of this paragraph. We feel that the sentiment should be expanded to make clear that although cooperation is certainly required between the chair, the new director and the company secretary in order to devise an effective induction programme:

- directors themselves are responsible to ensure that they are provided with a satisfactory induction;
- directors themselves are responsible to ensuring that they receive ongoing training; and
- if a director considers that he or she is not receiving appropriate development and training to carry out his or her role it is incumbent on that individual to highlight and escalate the matter to ensure that appropriate development and training is received.

Paragraph 12.4

We believe that a clear statement should be included in this paragraph to the effect that if directors do not possess the skills required or are unable to devote the appropriate time to a directorship, they should resign. Alongside this, there should be a realisation by chairs that not everyone is suited to take on the role of a director and there shouldn't always be a natural progression in terms of promotional stages which results in individuals holding this office if it is not suited to their personality and/or abilities.

Paragraph 14.2

We think that it would be useful to include some links to additional useful articles for boards to consider in the Final Guidance such as the following:

ICSA general guidance on directors' duties:

http://www.icsasoftware.com/dl/ICSA_Guidance%20Note%20Directors'%20General%20Duties%20Final.pdf

The very persuasive GC 100 paper on how the stakeholder factors set out in Companies Act 2006 should be distilled into corporate decision making:

http://www.practicallaw.com/cs/Satellite?blobcol=urldata&blobheader=application%2Fmsword&blobkey=id&blobtable=MungoBlobs&blobwhere=1247246565487&ssbinary=true

The constant evolution of corporate governance

We think it would be useful to include some wording in the Final Guidance which recognises the fact that companies are constantly evolving and, as a result of this, the needs of each company should be continually re-evaluated.

The Final Guidance needs to emphasise the dynamic nature of corporate governance issues. As a company evolves, so too should its governance.

Value creation

We note that the Draft Guidance does not say a great deal about entrepreneurial attitudes and value creation.

As a representative body of the small and mid-cap quoted sector which is an important driver of the UK economy and source of new jobs and wealth we would support the inclusion of a statement that good governance processes are about value creation and long term preservation of shareholder value. Good governance should ultimately lead to greater job stability and economic stability within the country. This is obviously pertinent as we all work to grow out of the contraction of the last three years. We have noted an increasing number of takeovers of UK quoted companies coming from overseas in recent times. One of the cited reasons for this is that strong corporate governance in the UK, when combined with a good access to capital and a skilled workforce makes for attractive investments. However, we do not have any supporting statistical analysis for this perceived trend. We often hear people agreeing that corporate governance should not just be a box-ticking exercise but companies are more likely to take an active interest in the subject if they can see value-accretion may result.

We do hope that these comments are useful. If you would like to discuss any of these issues further, we would be happy to attend a meeting.

Yours sincerely,

Tim Ward
Chief Executive

APPENDIX A

QCA CORPORATE GOVERNANCE COMMITTEE

Tim Goodman* (Chairman)	-	Hermes Equity Ownership Services Ltd
Mirza Baig	-	F & C Asset Management
Edward Beale	-	City Group plc
Tim Bird/Edward Craft*	-	Wedlake Bell LLP
Nigel Burton	-	Advanced Power
Anthony Carey	-	Mazars LLP
Louis Cooper	-	Crowe Clark Whitehill LLP
Clive Garston	-	Davies Arnold Cooper LLP
Nick Graves	-	Burges Salmon LLP
Dalia Joseph	-	Oriel Securities
Michael Landon/Cliff Weight	-	MM & K Ltd
Andrew Viner	-	BDO LLP
Melanie Wadsworth	-	Faegre & Benson LLP
Tim Ward	-	The Quoted Companies Alliance
Kate Jalbert	-	The Quoted Companies Alliance

*Main Author(s)

APPENDIX B

THE QUOTED COMPANIES ALLIANCE (QCA)

A not-for-profit organisation funded by its membership, the QCA represents the interests of small and mid-cap quoted companies, their advisors and investors. It was founded in 1992, originally known as CISCO.

The QCA is governed by an elected Executive Committee, and undertakes its work through a number of highly focussed, multi-disciplinary committees and working groups of members who concentrate on specific areas of concern, in particular:

- taxation
- legislation affecting small and mid-cap quoted companies
- corporate governance
- employee share schemes
- trading, settlement and custody of shares
- structure and regulation of stock markets for small and mid-cap quoted companies; Financial Services Authority (FSA) consultations
- political liaison – briefing and influencing Westminster and Whitehall, the City and Brussels
- accounting standards proposals from various standard-setters

The QCA is a founder member of European**Issuers**, which represents quoted companies in fourteen European countries.

QCA's Aims and Objectives

The QCA works for small and mid-cap quoted companies in the United Kingdom and Europe to promote and maintain vibrant, healthy and liquid capital markets. Its principal objectives are:

Lobbying the Government, Brussels and other regulators to reduce the costing and time consuming burden of regulation, which falls disproportionately on smaller quoted companies

Promoting the smaller quoted company sector and taking steps to increase investor interest and improve shareholder liquidity for companies in it.

Educating companies in the sector about best practice in areas such as corporate governance and investor relations.

Providing a forum for small and mid-cap quoted company directors to network and discuss solutions to topical issues with their peer group, sector professionals and influential City figures.

Small and mid-cap quoted companies' contribute considerably to the UK economy:

- There are approximately 2,000 small and mid-cap quoted companies
- They represent around 85% of all quoted companies in the UK
- They employ approximately 1 million people, representing around 4% of total private sector employment
- Every 5% growth in the small and mid-cap quoted company sector could reduce UK unemployment by a further 50,000
- They generate:

- corporation tax payable of £560 million per annum
- income tax paid of £3 billion per annum
- social security paid (employers' NIC) of £3 billion per annum
- employees' national insurance contribution paid of £2 billion per annum

The tax figures exclude business rates, VAT and other indirect taxes.

For more information contact:

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