QUOTED COMPANIES ALLIANCE

YouGov
What the world thinks

Research Report

Corporate Governance on AIM

How 900 companies adopted a corporate governance code for the first time

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Contents

Note: throughout this paper we refer to the "QCA Code", which is the QCA Corporate Governance Code, and the "UK Code", which is the UK Corporate Governance Code published by the Financial Reporting Council (FRC).

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies. It is a company limited by guarantee registered in England under number 4025281.

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The effect that the QCA Code has had on the companies themselves is very welcome and we believe that this will help improve the perception and integrity of small-cap markets in the UK

Tim Ward
Chief Executive, QCA

Will Pomroy
Director – Engagement, Hermes Investment Management
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A great opportunity to communicate

In September 2018, London Stock Exchange required all companies on AIM to adopt a corporate governance code for the first time. Of the 900+ companies on the market, around 90% chose to adopt the QCA Corporate Governance Code (the QCA Code).

It is a rare occasion that so many companies in one country adopt a governance code at the same time and we wanted to investigate what companies thought about the process and how it might have helped (or hindered) them.

This is a survey of those AIM companies, with findings from 139 respondents, complemented by results from 15 qualitative interviews with companies and investors.

We are encouraged by what we have found. There is evidence that communication between executives and non-executives is improving within companies as a result of adopting the QCA Code. We also see that it has helped prompt conversations within companies around issues like succession planning that were otherwise not being addressed.

The recommended disclosures in the QCA Code has also led to more information in key areas being made available to investors. The effect that the QCA Code has had on the companies themselves is very welcome and we believe that this will help improve the perception and integrity of small-cap markets in the UK.

The QCA Code was drafted by a group of practitioners from small and mid-cap companies, investors, and other advisors in the sector. The goal was to create a flexible, principle-based code designed specifically for smaller companies on equity markets, but also suitable for private companies, particularly those that are pre-IPO.

We believe that the results of this survey confirm to us that we have created a framework that allows smaller companies, with less resources, to communicate their governance arrangements to stakeholders without being overly burdened with one-size-fits-all prescriptive requirements. This has saved smaller companies precious time and resources that should be dedicated to growth – creating jobs and wealth in the UK and around the world, whilst allowing them to tell their story in a way that suits them.

Key findings

39% of companies say that adopting the QCA Code has helped their business.

It has done this by:

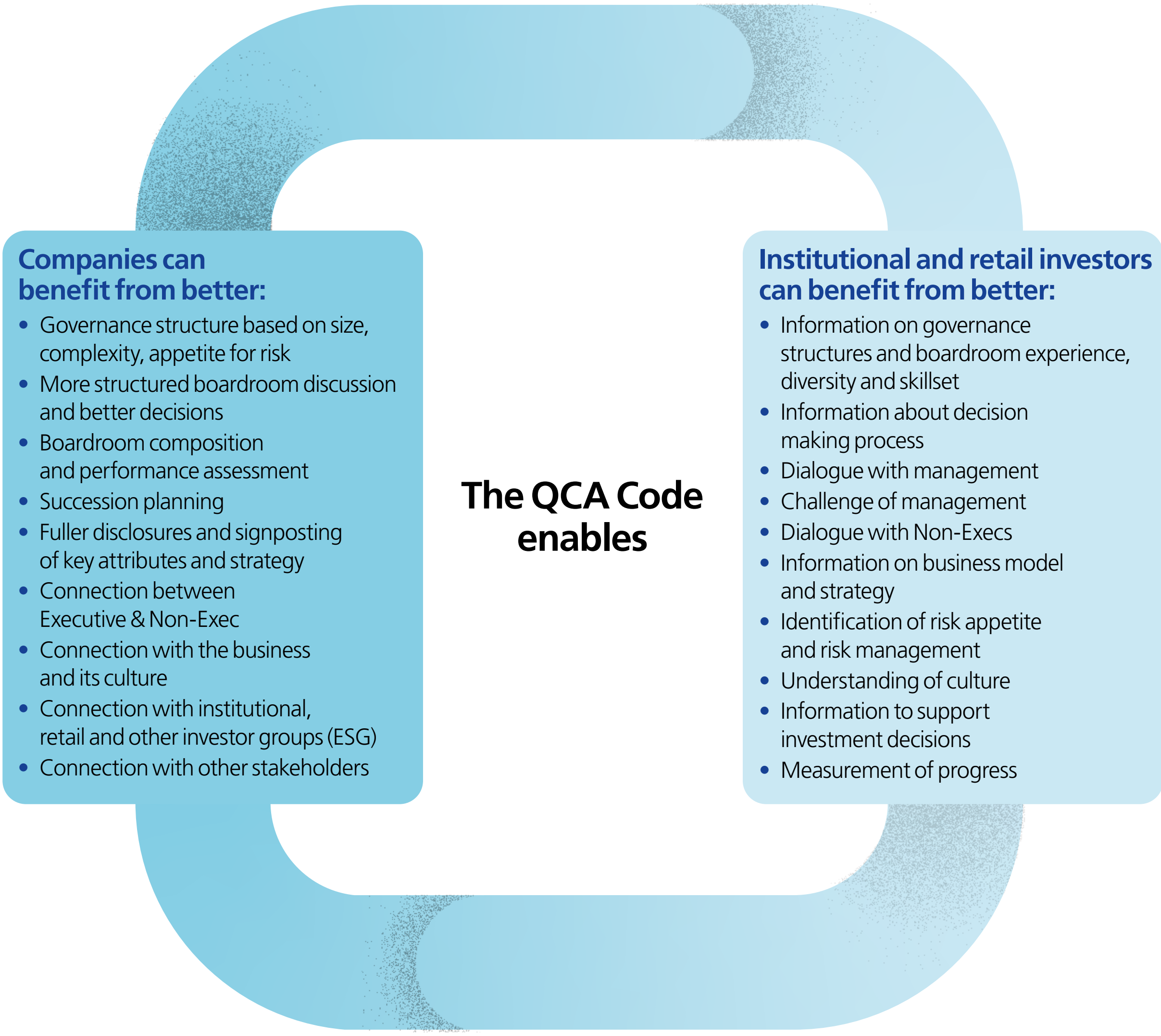
- Helping formalise new processes (42%)
- Encouraging the board to consider other points of view (31%)
- Making it easier for investors to assess them (20%)

As a result of adopting the QCA Code, 40% of companies have disclosed more information to the market, including:

- Board evaluations (40%) and board members skillsets (29%)
- Strategy and business model (28%)
- Sustainability measures (13%) and board diversity (15%)

30% of companies have considered succession planning in more detail as a result of adopting the QCA Code. 15% have disclosed more information to the market on this.

75% of companies regard the disclosure requirements of the QCA Code as "just right" and welcome the opportunity to follow it as a proportionate for smaller companies.



Oliver Rowe
Director, Reputational Research, YouGov

Companies who 'live and breathe' the QCA Code are seen to be synonymous with being 'well run'.

What did YouGov find out?

YouGov surveyed 139 AIM quoted companies and spoke in-depth with 15 company representatives and AIM investors to find out how they have been dealing with the 2018 rule change that requires them to adopt a corporate governance code.

Even prior to the rule change almost seven-in-ten firms spoken to claim they were already following a governance code. The rule change has though added an impetus for companies to re-examine their strategies and how they were communicating them. Nine-in-ten companies now tell us they have chosen to use the QCA Code, with feedback being predominantly positive. Companies have said that its robust framework has helped them examine and formalise existing behaviours and examples of good governance.

Investors are also taking note of the corporate governance codes that companies are adopting, as well as their compliance with them. Investors tell us that governance of a company is an important factor when they weigh up their investment decisions, with a company's chosen code and adherence to it becoming an increasingly common heuristic for them to get a sense of who the firm is.

Indeed, companies who 'live and breathe' the QCA Code are seen to be synonymous with being 'well run'. While this image is important for investors, companies report that the QCA Code has more tangible benefits than just being seen to be following something. Companies report back that there are very real parts of the Code which they feel could fundamentally improve their performance if they can find ways to weave them into their daily processes rather than just become a box-ticking exercise.

Moreover, the QCA Code has been particularly welcomed by companies flexibility and brevity often cited as its key strengths. There is an appreciation that companies feel able to 'move' and grow within the framework in a way that doesn't impact the way they operate, where a more prescriptive code might impinge. It is though also noted that while this flexibility is one of the Code's biggest strengths, it could also be the biggest danger to its success due to it being too flexible and thus not being taken seriously. Separately, some companies have called for extra guidance, mostly in the form of examples of how others are adopting the Code to share best practice and improve their understanding.

So with the first anniversary of the AIM rule change now past, this research shows that the QCA Code has been warmly received by both companies and investors for the positive part it has played to date.

1

Part 1: How do companies choose the right corporate governance code for them?

Corporate Governance and AIM

In September 2018, London Stock Exchange required all companies on AIM to adopt a corporate governance code for the first time.

Research conducted by the QCA revealed that of the 927 companies on AIM at the end of 2018:

- 89% had chosen to follow the QCA Code
- 6% had chosen to follow the UK Code
- 5% had chosen to follow a variety of other codes, such as the code of another country or territory

This breakdown appears to have been maintained over a year later, with 89% of respondents to this survey following the QCA Code and 10% following the UK Code (plus 1% following a mix of codes).

Source: QCA, Which corporate governance codes do AIM companies apply?, December 2018

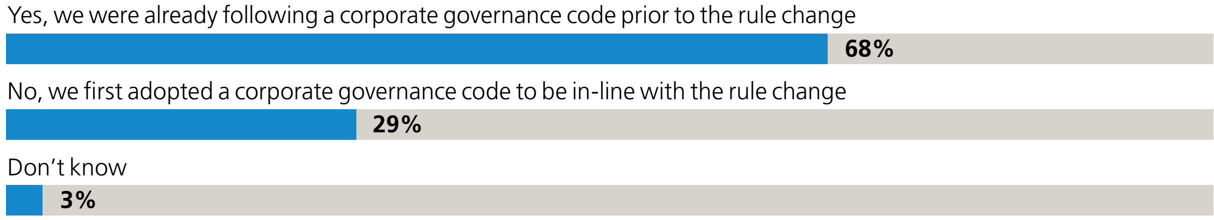
1.1 How much did the rule change instigate a change in behaviour?

We found out that roughly two-thirds (68%) of companies were already following a corporate governance code to some degree before this time, but for around one-third (29%) this was the first time they were adopting a corporate governance code and it was a direct result of the rule change.

Majority say they were already following a corporate governance code prior to the rule change

Choice of code

Q. Were you following a corporate governance code before the change to AIM Rule 26 in September 2018?



Base: All respondents (139)

1.2 How did companies choose which code to follow?

With the AIM Rule change requiring all companies to follow a corporate governance code, how did they go about choosing what was right for them?

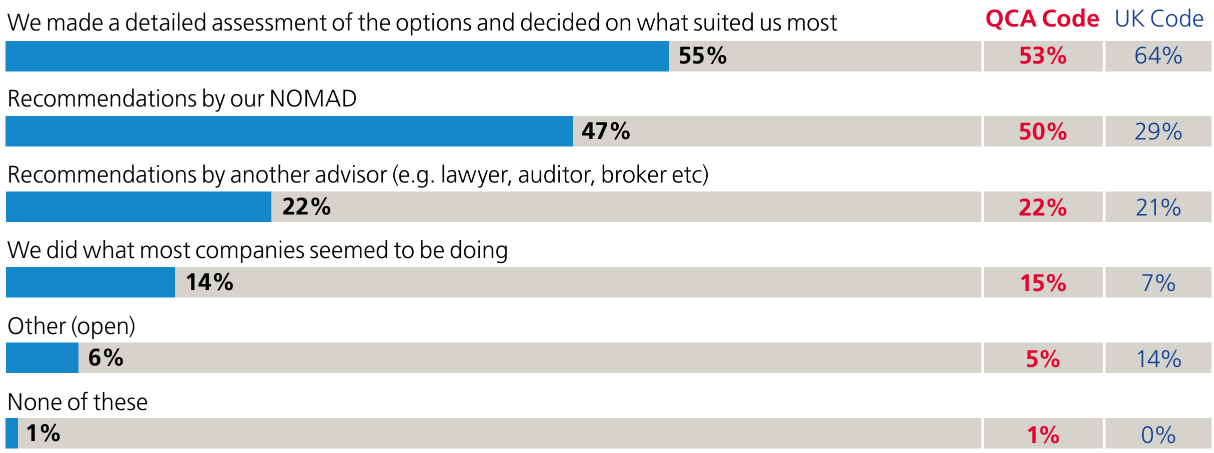
The chart below shows the most common methods and highlights how respondents following the QCA and UK Codes differed. Most popularly companies made a detailed assessment of the options available and worked out what suited them.

Secondly, the recommendations of their Nominated Advisor (or "NOMAD" – an advisor that every AIM company is required to retain) was influential, particularly for companies that adopted the QCA Code.

NOMAD recommendation is much more likely to sway companies toward the QCA Code

Code recommendations

Q. When deciding which code to follow, which of the following, if any, did you consider in your eventual decision to go with your chosen code?



Base: All respondents (139), those who have adopted the QCA Code (124), those who have adopted the UK Code (14), those who have adopted other (1)

1.3 Why did most companies think the QCA Code was best for them?

Those companies that chose to apply the QCA Code responded that this choice was made because the Code's requirements were most suited to them.

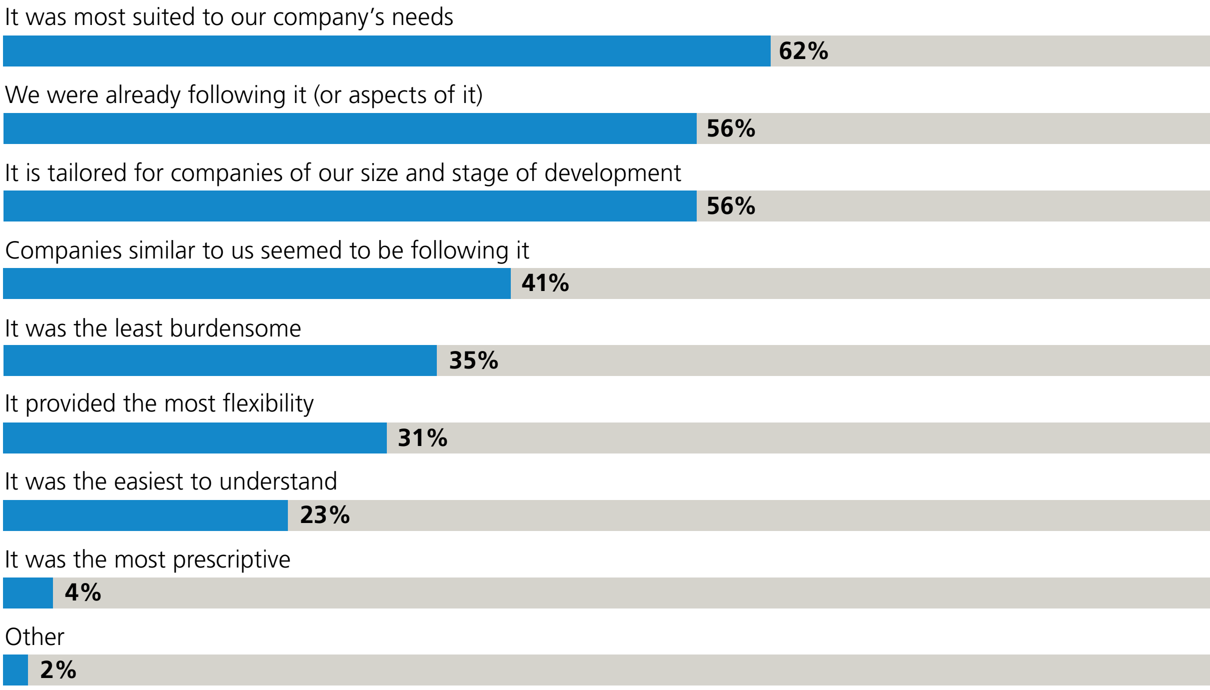
We see this as the QCA Code being more flexible for smaller and younger companies, as opposed to the UK Code which is perceived as being aimed at the largest companies on the stock market (in fact, it's a requirement for companies on the London Stock Exchange Main Market to follow the UK Code). The largest company on the Main Market is £177 billion, whilst the median company on AIM has a market value of £27 million (Source: Allenby Capital, AIM Market update Q3 2019).

Investors and other stakeholders expect larger, more mature companies to have governance structures that are more established and formal. However, for smaller 'growth companies' this is often not appropriate, and meeting the same requirements as companies many times bigger would be burdensome and a distraction from their main goal in their current stage of development – growth.

62% of respondents chose the QCA Code because it most suited their company's needs

Choosing the QCA Code

Q. Why did you go with the QCA Code rather than the UK Code. Please select all which apply.



Base: All respondents who have adopted the QCA Code (124)

For younger companies (who have only been trading for 5 years or less), the QCA Code is more suited to their needs than average (72%). They also acknowledge the flexibility more (50%) compared to established companies who have been trading for over 5 years (25%).

> *"For certain investors, [following the QCA Code] elevates our standing"* (Company)

> *"[Following the QCA Code] gave us a path to grow, i.e. gradually comply with more."* (Company)

1.4 A key strength of the QCA Code was stated as being the increased flexibility afforded

> *"Because of the sort of company we are… we wanted a certain degree of flexibility and I suppose tolerance. We didn't want something that would tie us up in bureaucracy at this stage in our development… for example, there is a requirement to have a balanced board… which is quite difficult for a company in our industry to achieve at this stage. We'll be moving towards it at some point but we need some time to get there."* (Company)

> *"The perception was that [the UK Code was] over-prescriptive, over-detailed, required a lot of formal efforts to comply with rather than just being best practice which we'd all comply with by default anyway, and it's a bit more box-ticking. All of that may be wrong, but that's certainly the perception."* (Company)

> *"[The] QCA Code is the well-known, recognised, well-evolved, well-researched smaller companies' code that most people are complying with by default anyway, so it was always going to be the one we accepted. Not quite without question, that would be over-simplifying, but certainly, we weren't expecting to find any issues with it. Then quickly going through the ten principles, everyone sort of said, 'Yes, that makes sense, and it's sufficiently flexible. If we do have a particular issue, we can probably deal with it.'"* (Company)

Interviewees appreciate the flexibility of the QCA Code being less prescriptive and more principles based. It is seen as an 'enabling' rather than 'policing' code. This is particularly true of smaller companies who may find it tougher to adhere to some rules.

> *"It's more a case of a set of good solid principles which allow any investor to be able to have a conversation around the principles of a company and get a sense of them. I think it's a better tool and framework for the dialogue of a company than the UK Code which very quickly went down to a 'we don't think that's worked and therefore we don't adhere to it'."* (Investor)

Companies have a range of questions when considering the QCA Code, but are mainly concerned with current practice and the impact on their resources

Q. What questions, if any, came up internally in the process of choosing which code to follow?

> *"We take governance seriously but we don't want to be run by governance"* (Company)

> *"The main question was how onerous the code would be and whether it would require disclosure of information we felt would be competitively disadvantageous."* (NED, London)

> *"How flexible the code was for a growing company with limited financial resources."* (CFO, South East)

> *"Which code was fit for purpose for a business our size giving us good corporate governance whilst remaining practical and business enhancing."* (NED, London)

> *"How burdensome adoption is likely to be"* (CFO, not headquartered in the UK)

"We take governance seriously but we don't want to be run by governance"

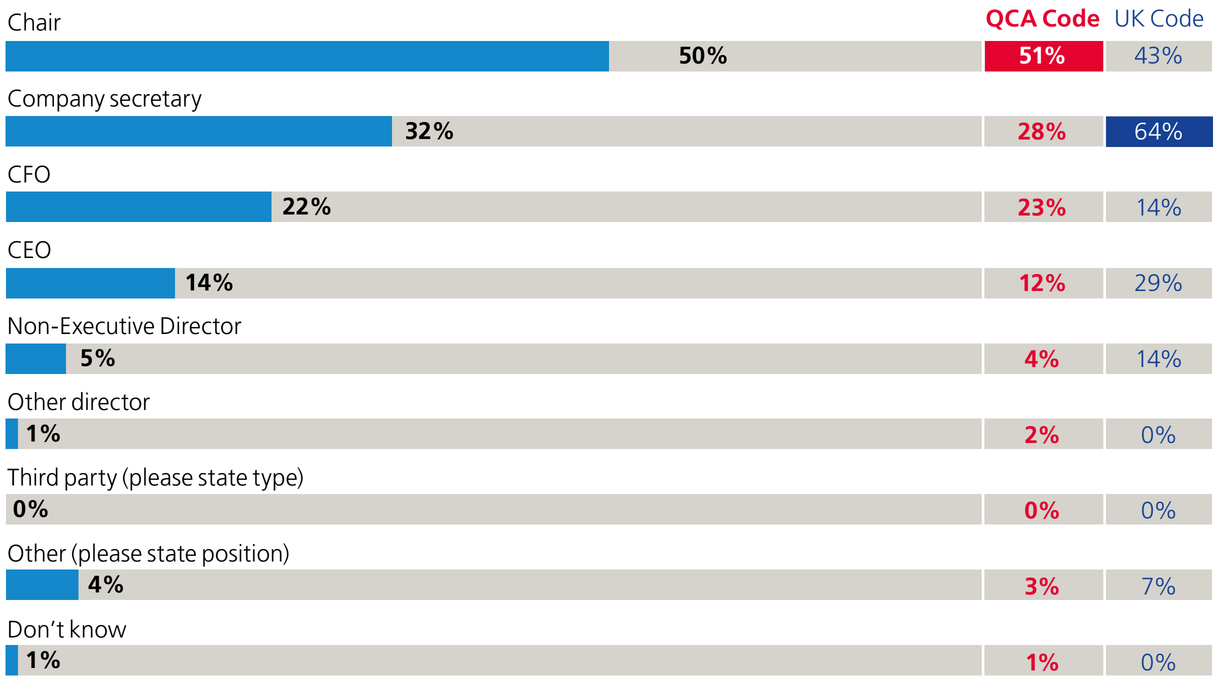
1.5 Who is responsible for overseeing implementation of corporate governance codes in companies?

For most companies it is the Chair that is responsible for ensuring that the corporate governance code is implemented (and this is what is recommended in the QCA Code).

Responsibility for governance mainly sits with the Chair for those who follow the QCA Code and with the company secretary for those who follow the UK Code

Code implementation responsibility

Q. Who in your company is responsible for ensuring the code is implemented?



Base: All respondents (139), those who have adopted the QCA Code (124), those who have adopted the UK Code (14), those who have adopted other (1)

The chart above shows that for companies following the UK Code it is more likely to be a company secretary responsible for implementation – this may be a reflection that many smaller companies don't have a person specifically employed as a company secretary. The CFO often has wider responsibilities in areas such as governance and investor relations, as no dedicated specialist yet exists in the company.

62%

said the QCA Code suited their company more than the UK Code

2

Part 2: How did companies find the process of adopting the QCA Code?

2.1 The benefits of proportionate codes

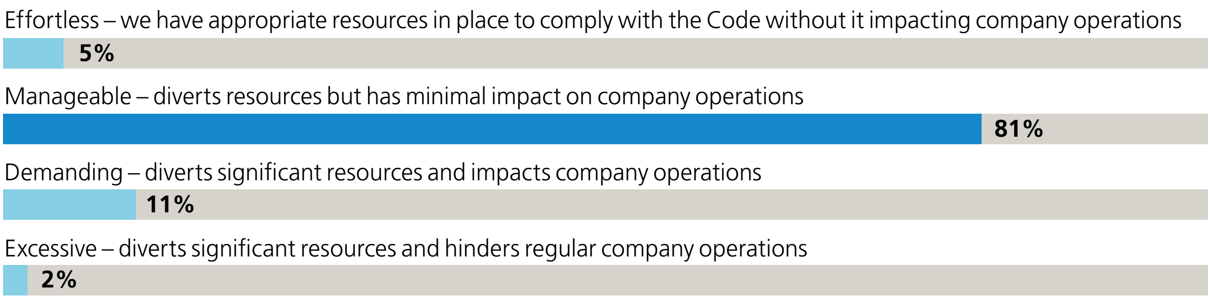
The vast majority (81%) found the process of adopting the QCA Code manageable, with just 2% describing it at excessive. 75% also described the disclosure requirements of the QCA Code as just right.

It is important to allow growth companies to adopt codes that set requirements for companies that are proportionate to their size and doesn't require them to divert resources they don't have. One-size-fits-all codes may not be suitable for all markets.

Adhering to the QCA Code is manageable for companies, although doing so does divert some company resources

Time spent

Q. Thinking about the resources (e.g. time, money, human, etc.) involved in complying with the QCA Code, which of the following best describes the impact this has on the resources of your company?



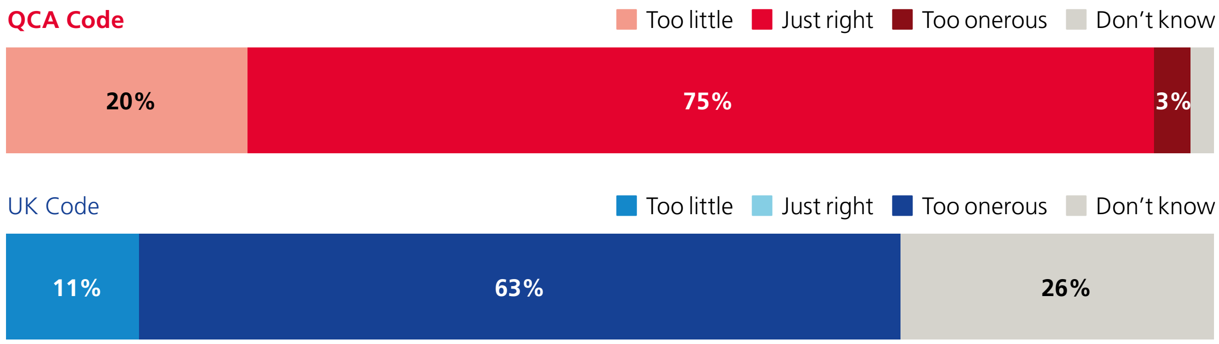
Base: All respondents who have adopted the QCA Code (124)

"Whilst there isn't a pound, shilling, pence cost, there is a time cost and we shouldn't underestimate the amount of time involved in doing that exercise properly." (Company)

The disclosure requirements under the QCA Code are seen as just right by three-quarters, and in contrast to the perception of detailed requirements of the UK Code

Disclosure requirements

Q. Are the disclosure requirements of the...



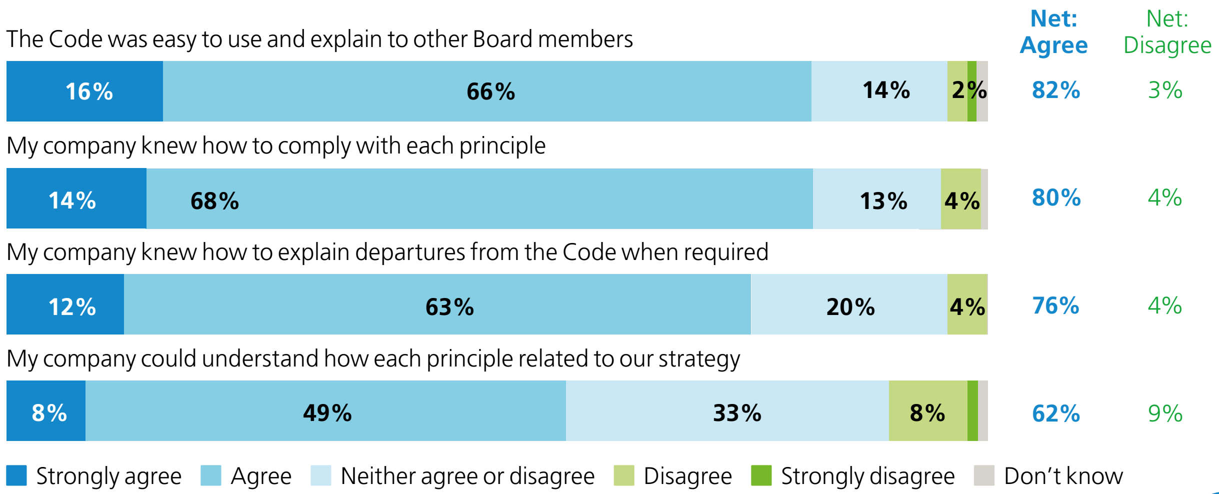
Base: All respondents (138), those who have adopted the QCA Code (124), those who have adopted the UK Code (14).

It should be noted that where companies see the requirements as 'too little' the QCA Code emphasises that a company is always free to provide additional disclosure to tell its story.

Respondents said that the QCA Code is easy to use and explain to other board members, and companies broadly knew how to comply with its principles

QCA Code statements

Q. To what extent, if at all, do you either agree or disagree with the following statements about the QCA Code?



Base: All respondents who have adopted the QCA Code (124)

"I think [the principles] are all fairly common sense. We've always taken a fairly responsible attitude to governance so there was nothing in there which [was a] surprise, or [was] particularly painful for us to commit to." (Company)

"I think it's practical, I think it's not too prescriptive. It's more principles-based, which I like. I think it covers the right agenda." (Investor)

"It steers the pragmatic course of making sense of what is increasingly a major burden on businesses having to comply with governance, [while also] hopefully [giving] investors a sense that actually this is a well run [company] …it has all stakeholders in mind. I think it's a pragmatic middle ground, which acts as a framework for people to get behind." (Company)

3

Part 3: What has been the impact of adopting the QCA Code for companies?

3.1 Assessing the impact

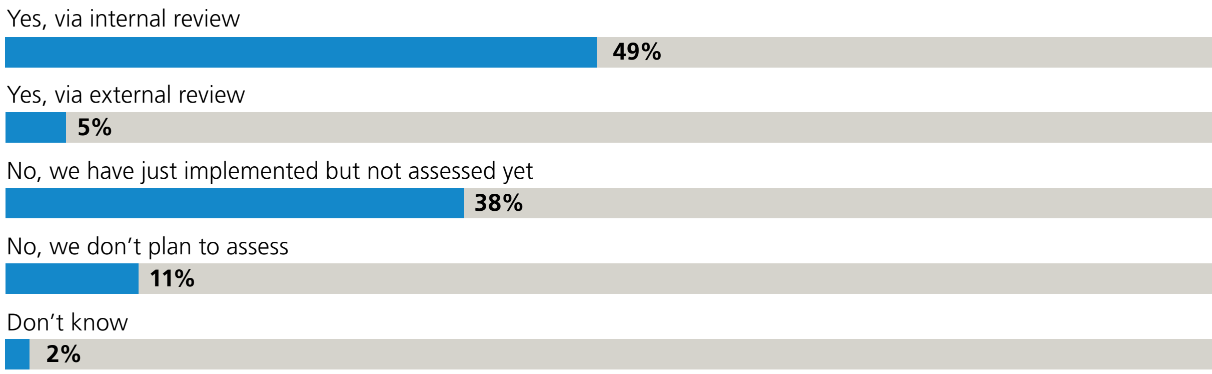
Adopting a code is one thing, assessing its impact is another.

We found that around half of companies have made an internal assessment of the impact of adopting their chosen code. 5% had gone through an external review and 38% had not yet done either, but planned to.

Half have already assessed the impact of adopting the code although two-fifths have merely implemented and not yet assessed its impact

Impact of adopting the code

Q. Has your board assessed the impact of adopting your code on your company?



Base: All respondents (139)

3.2 Governance – good for business?

More than a third of companies say that adopting their chosen code has helped the running of their company, just 1 in 10 say it has hindered. Around half say it has neither helped nor hindered.

An effective and supportive corporate governance code should enable companies to run their businesses better, improve their stakeholder communications and address relevant issues. It should not put excessive or arbitrary requirements on them that serve to distract from running their business. As such, the QCA Code's intention is to be an 'enabling' code, rather than a 'policing' code.

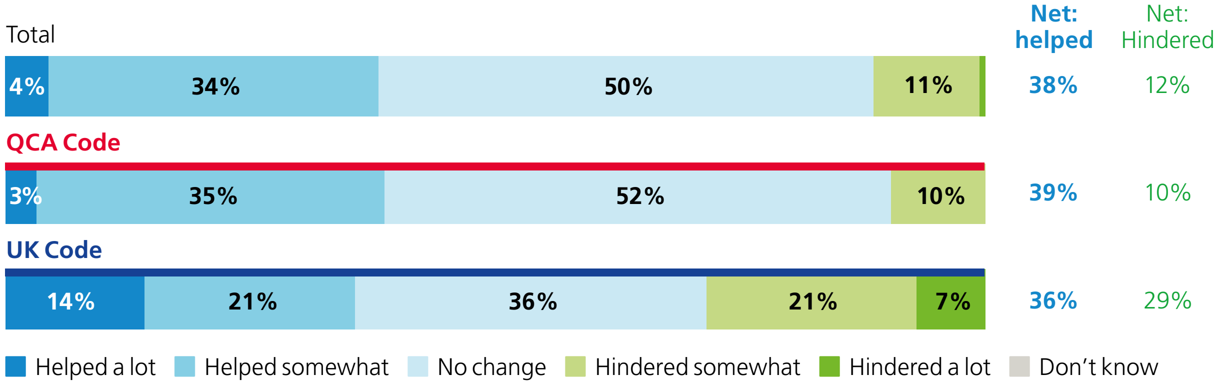
Evidence in the below charts indicates that following the QCA Code has:

- Encouraged good communication for companies
- Triggered difficult conversations on issues like succession planning
- Helped formalise board processes

More than a third of the sample agree that adopting their chosen code has helped the running of their company, just 1 in 10 say it has hindered

Helped or hindered

Q. Overall, has adopting your chosen code helped or hindered the running of your company?



Base: All respondents (139), those who have adopted the QCA Code (124), those who have adopted the UK Code (14), those who have adopted other (1)

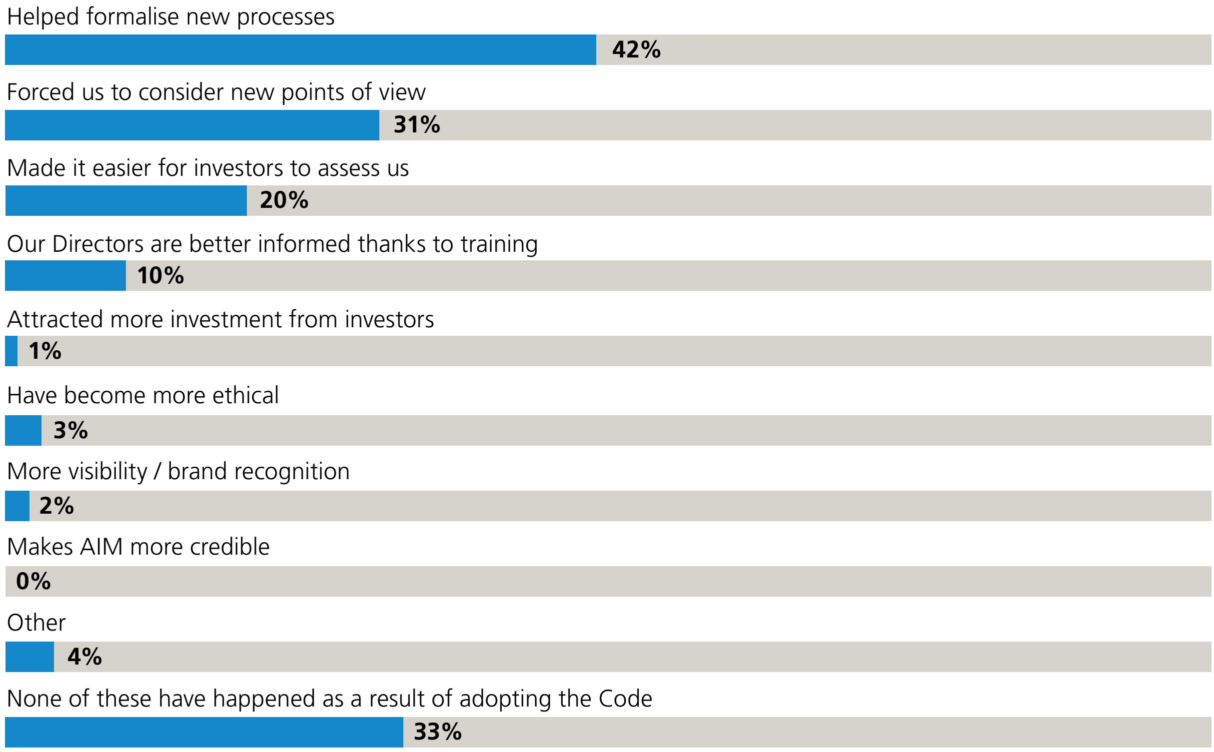
42%

said the QCA Code helped their company formulate new processes

The QCA Code has been credited with helping to formalise processes and forcing company boards to consider new points of view

QCA Code – benefits

Q. What benefits for your company, if any, have come from adopting the QCA Code?



Base: All respondents who have adopted the QCA Code (124)

We found that by providing a framework, the QCA Code allows for the formalising and benchmarking of existing behaviours and conversations

> *"I think it's catalysed the internal conversations of the companies and got them to be more systematic in their view of what governance is and how they go about reporting against this."* (Investor)

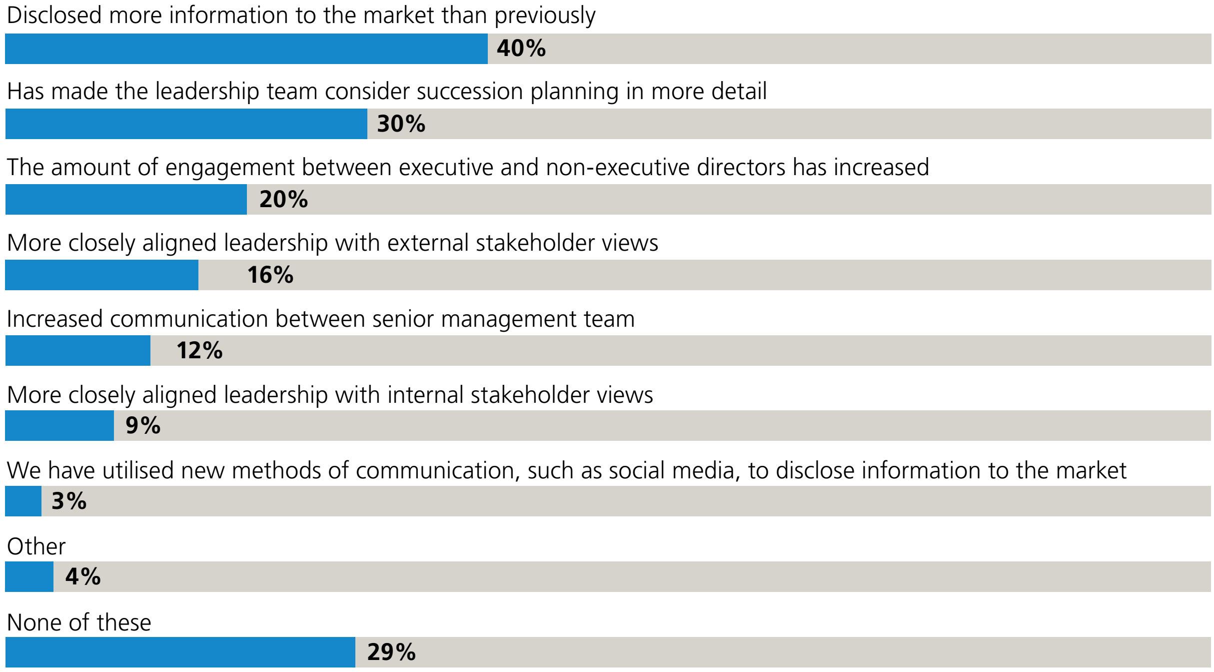
It also helps companies reconsider what they were already doing and provides a framework they can work to, as well as help them to see if they are doing everything they can

> *"What the QCA Code helped to do was to be quite specific in saying, 'Right, well in terms of what we are communicating, have we addressed these items, and if not we should or if we don't think we should, why wouldn't we?' From a signposting point of view I thought it was quite helpful… Then I think the other thing probably was around the board evaluation side of things and development of the board… in the end, I couldn't justify why we wouldn't do a board evaluation."* (Company)

> *"I think the reaction has been 'Okay. So, this is what good looks like, we've got a framework to work within.' I think it's helped that there's a generally accepted framework because I think it's one of the things where 'What does good governance look like?' and there's quite a wide spectrum of views. I think it has helped put some definition around what good looks like."* (Company)

The changes in company behaviour since adopting the QCA Code are broadly seen as positive, particularly in terms of succession planning, communication between the senior management team and new methods of market disclosure.

Q. What, if anything, has your company done differently since adopting the QCA Code?

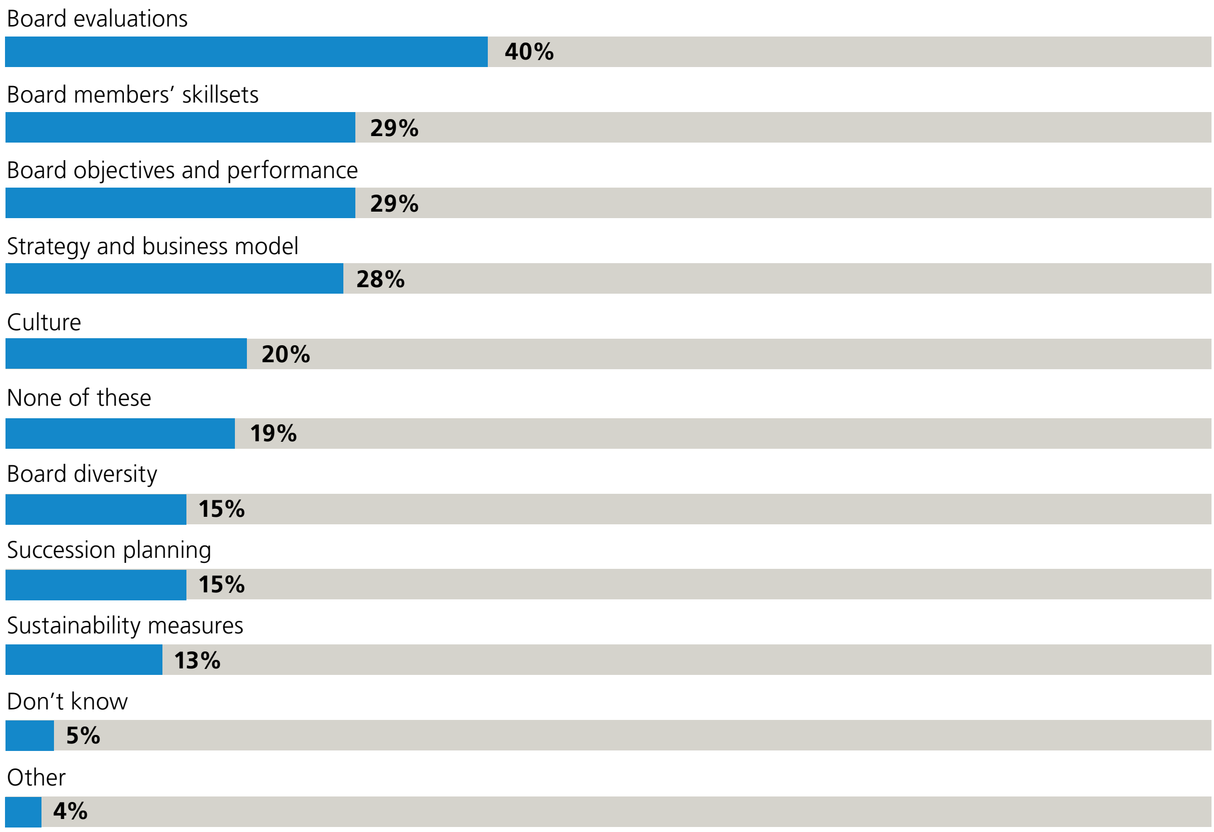


Base: All respondents who have adopted the QCA Code (124).

The main areas of new information being disclosed to the market relate to the board and strategy/business model.

Disclosures – new information

Q. Which areas in particular, if any, have seen the greatest amount of new information being disclosed to the market by your firm since adopting the QCA Code?



Base: All respondents who have adopted the QCA Code (124).

3.5 Communication between the board, senior leadership team, and NEDs has increased, with many using the Code as a reference point in their meetings.

"I sit on a board of a couple of PLCs, and it's become much more of a kind of reference point, which I think is really healthy. Whereas before it was just a page in the report and accounts that were pretty much templated. (Company)

"Yes, I think there's probably been some increase[in disclosure]… I think that, in a large part, speaks to the AIM rule change [that] has catalysed a number of companies to take a look at what they are currently saying and obviously go through it all and refresh most of it. So a lot of it has simply improved by it being looked at again with a slightly more sceptical or sensible eye." (Investor)

"We tightened up our communication dialogue a little bit… partly as a result of the Code and partly as a result of the AIM Rules change." (Company)

"I think the one thing that I think the Code has forced upon us, that's perhaps worth mentioning, is succession planning." (Company)

"I think things are a bit more thought through. Some of the thorny things like succession planning, those kinds of issues. Highlighting of certain risks within the business is maybe a bit more high profile. Communication. Responsibilities [being] communicated more effectively. I think these are all just steps in the right direction rather than a complete change in direction." (Company)

"I think there has been more content in the annual reports.. Obviously very varied, some are better, some are worse, but it has generally caused a good certain amount of discussion about the whole issue." (Investor)

3.6 Interviewees say the Code has helped to give a more confident view about the way in which AIM companies behave, helping to codify existing behaviours

"I think anything which forces AIM companies to behave properly, vis-a-vis shareholders and stakeholders more generally, must be a good thing and I think codes like this do contribute to that. So, it would be quite hard, I think, to draw a direct link between this Code and a clear definable benefit but just what it adds to the context of being an AIM quoted company is very positive, in my view." (Company)

"I think it's wholly appropriate and a good thing. I think that AIM companies, on the whole, are much smaller and much more immature and the QCA Code gives them much greater flexibility to explain what they are doing and why they are doing it, and hopefully get them kind of engaged in understanding what is good corporate governance rather than being put off by the UK Code." (Investor)

40%

said they had disclosed more information to the market than previously after using the QCA Code

4

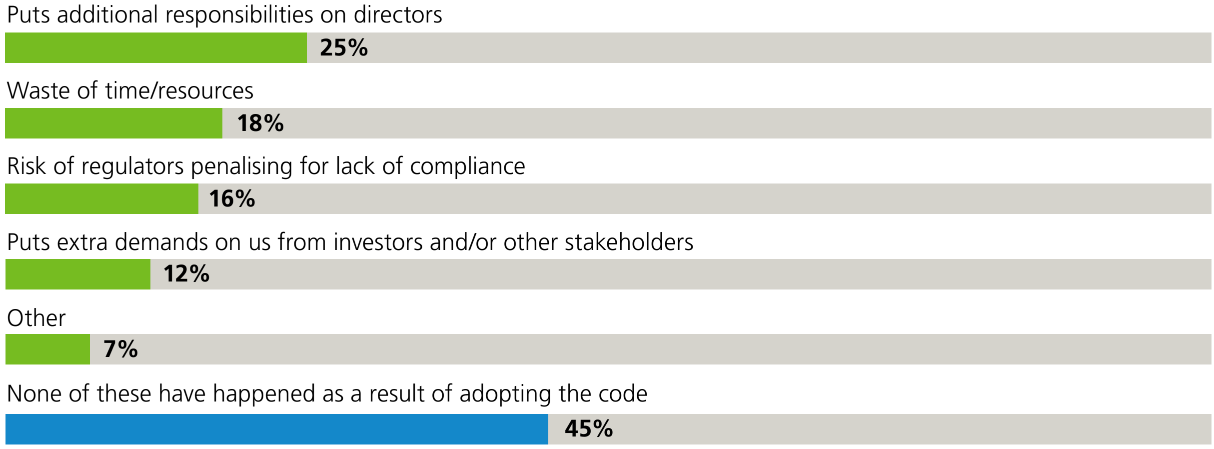
Part 4: What are the downsides of codification?

The QCA Code is broadly welcomed by companies and its flexibility and brevity are greatly appreciated. Companies appreciate the freedom that they can move within it, although some extra guidance on how to adhere to it has been requested.

Likewise, there is the potential danger that this is too flexible, and as such may not be taken seriously. The QCA Code needs to strike that balance of maintaining the lauded advantages in its framework, whilst also encouraging companies not to treat is as just another box-ticking exercise.

Disadvantages

Q. What disadvantages for your company, if any, have come from adopting the QCA Code?

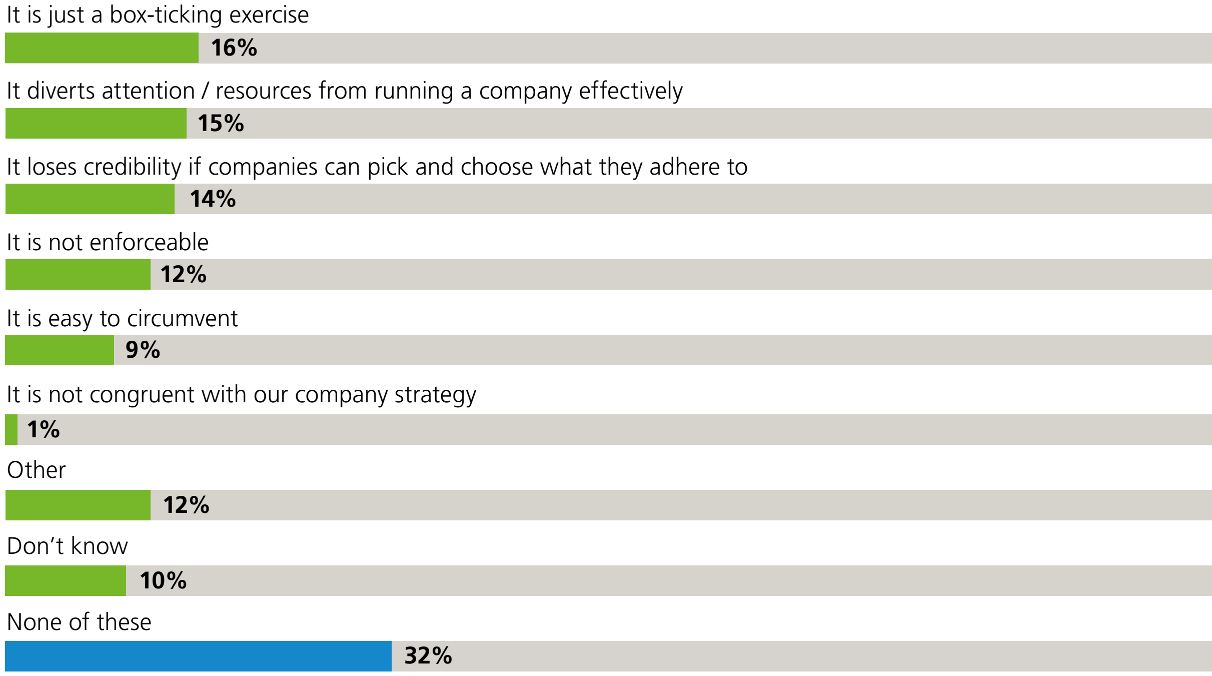


Base: All respondents who have adopted the QCA Code (124).

As to weaknesses, even with the lower level of requirements, a minority regard the process of adopting the QCA Code as a box-ticking exercise or a distraction.

Key weaknesses of the QCA Code

Q. What do you perceive to be the key weaknesses of the QCA Code?



Base: All respondents (139).

4.2 The flexibility of the Code can simultaneously be seen as both its strength and its weakness, with its interpretability potentially weakening its credibility.

> *"Because it's relatively simple and flexible, it's easy to be seen to be adhering to it without actually changing anything in practice. So I think there's always a balance between keeping something principles-based and simple and actually clearly articulating what specifically you're expecting or hoping companies to be doing as a result of the principle."* (Company)

> *"It's very difficult trying to be all things to all men and women. Where I might have a view that one of the aspects would be just a no-go for me and want to be a little bit firmer on one of those aspects. Therefore, as in all these things, there has to be an element of compromise, but you've got to have that in any code, I don't think that's specific to the QCA Code."* (Investor)

One interviewee also made the point that the requirement for increased disclosure was a competitive threat

> *"The ease of which you articulate your strategy of the business. I think this is quite an interesting area in that on one level you could take it to mean well you don't want to be too expansive, because from a competitive point of view, the wider market knowing what your plans are and things that you're looking at, but equally you've got an obligation to keep shareholders up to date and aware of things."* (Company)

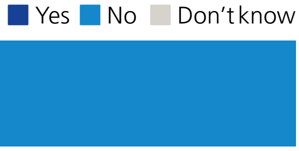
97% of those who follow the QCA Code plan to continue to adopt it.

Looking forward

Q. Do you intend to continue to adopt the QCA Code?

Companies that adopt the QCA Code:

[Those that follow the UK Code] Would you consider changing to adopt the QCA Code?



Base: Those who have adopted the QCA Code (124), those who have adopted the UK Code (14).

Appendix 1: Methodology

Qualitative

30-45 minute telephone depth interview with a broad remit across big picture topics (15 interviewees):

Quantitative

10-12 minute online survey (139 respondents):

Majority of the respondents surveyed adopted the QCA Code

Choice of code

Q. As per AIM Rule 26, which corporate governance code has your company adopted?

Base: All respondents (139).

90% can be said to have adopted at least some aspect of the QCA Code

Demographics

Base: All respondents (139).

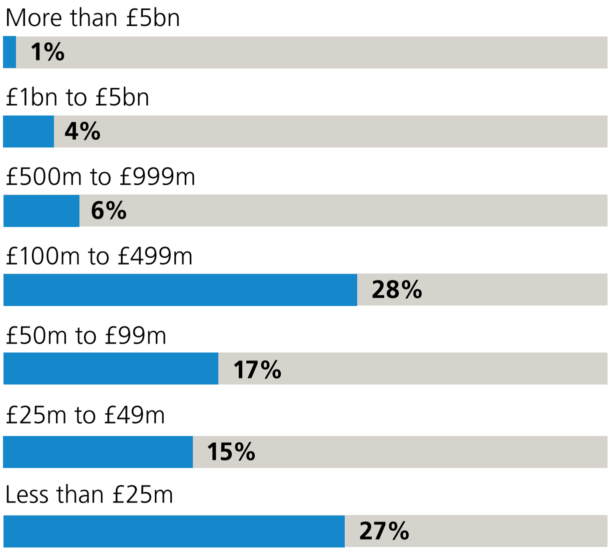
Sectors

Sector	%
Technology, electricals, telecommunications, software	23%
Oil, gas, mining, forestry & paper	14%
Healthcare, pharmaceuticals, biotech	12%
Banking, financial & equities (excluding insurance)	8%
Support services	6%
Media	6%
Construction & materials	5%
Retail (non-food)	4%
Industrial engineering, metals & transportation	4%
Travel & leisure	4%
Food beverage production & retail	3%
Utilities (water, electric, gas)	1%
Real estate	1%
Household, personal & leisure goods	1%
Aerospace & defence	1%
Insurance (life & non-life)	1%
Automobiles & parts	1%
Other	4%

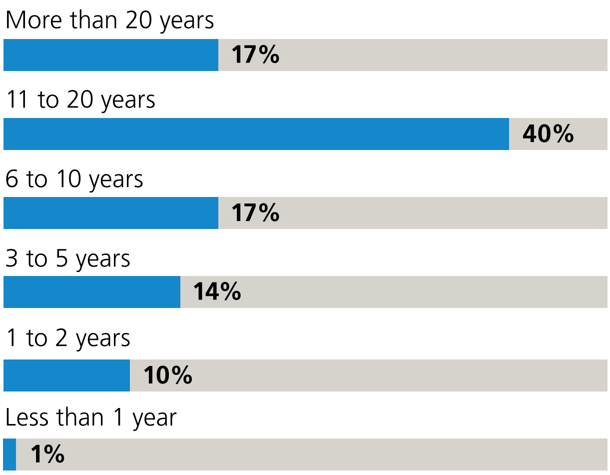
Regions

Region	%
London	36%
South East	12%
West Midlands	8%
East of England	8%
Not headquartered in the UK	7%
South West	6%
Yorkshire & Humberside	6%
North West of England	4%
East Midlands	4%
Scotland	4%
Wales	2%
Northern Ireland	1%
North East of England	1%

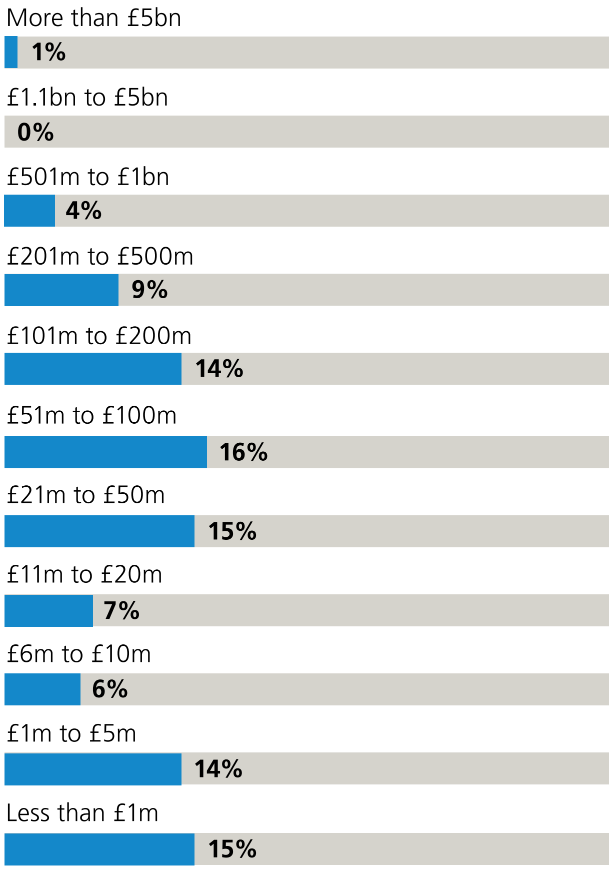
Company size



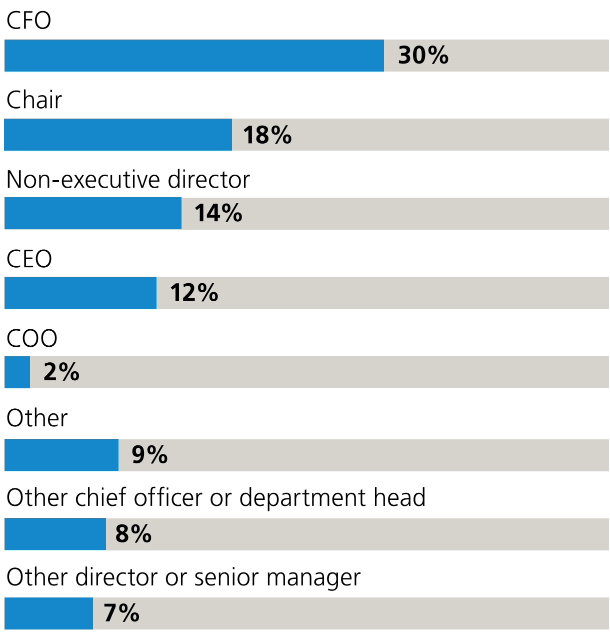
Trading time



Turnover



Role



QUOTED COMPANIES ALLIANCE

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