CORPORATE GOVERNANCE BEHAVIOUR REVIEW 2017

With the government having unveiled its proposals for reforming UK corporate governance to boost public trust in business, our **fifth annual review** identifies how directors can improve their annual reporting to better connect with their shareholders.

OUR **TOP FIVE** TIPS

- Describe the relationship between your company's strategy and your governance arrangements effectively, and explain your board's role in realising the company's objectives.
- Articulate your company's story in an engaging way and take the time to avoid boilerplate disclosures.
- Set out clearly how your board's performance is evaluated and what is being done as a result.
- Provide a single total remuneration figure for each of your directors within a focused remuneration report.
- Explain each director's role to demonstrate how your board has the appropriate balance of skills and experience.

As the shake-up of corporate governance in the UK continues to dominate the political agenda, it has never been more important for directors to review their approach to communicating with their most important constituents – shareholders.

A key component to this is ensuring that companies take full advantage of the opportunity to showcase their story in an original way to engage their shareholders. Articulating this effectively – and taking care to shun bland, boilerplate statements – will yield huge benefits for companies, as investors will buy into the company's strategy for the year ahead.

At the same time, this strategy must be clearly linked to your company's governance arrangements. Directors should choose their corporate governance code wisely and demonstrate how this supports long-term growth and the success of the company. This includes remuneration. Investors want companies to set out clear and transparent explanations in a remuneration report as to how an executive's pay is linked to the execution of the company's strategy.

Yet all of this is only possible if a board contains an appropriate balance of skills and experience. Not only should each director's role be well-defined, but the board should also be proactively evaluating its own performance on a regular basis to ensure that the company's leadership has the necessary skills to grow.

Our annual review

We have benchmarked the corporate governance disclosures made from a random selection of 100 small and mid-size quoted companies taken from the Main Market, AIM and NEX Exchange, and compared these against the minimum disclosures set out in the Quoted Companies Alliance Corporate Governance Code for Small and Mid-Size Quoted Companies (the QCA Code). A group of institutional investors then examined the results of our analysis in detail at a discussion roundtable. Their reflections have led to this year's top five recommendations for companies to improve their corporate governance disclosures.

The QCA Code enables quoted companies to adopt corporate governance arrangements appropriate to their particular needs. Companies are expected to provide clear explanations that convey the approach and ethos of their own arrangements. Effective corporate governance reporting is only achieved when investors clearly understand the governance arrangements in place, the rationale behind such decisions and the culture established by the board of directors. Investors can then utilise this information to appreciate how the company's strategy is conceived, managed and implemented.

The UK corporate governance agenda

2017 has seen the government seeking to address the issues of executive pay and boardroom diversity. Its package of reforms, announced in August 2017, will see new laws requiring all listed companies (ie. those on the Main Market of the London Stock Exchange) to disclose the ratio of CEO pay to the average pay of a company's UK workforce. Listed companies with significant shareholder opposition to executive pay packages will also have their names published on a new public register.

Meanwhile, the Financial Reporting Council is currently reviewing the UK Corporate Governance Code. This will see, among other things, remuneration committees assume greater responsibility in demonstrating how pay and incentives align across the company.

On board diversity, the government remains committed to its target of women comprising 33% of company boards by 2020. This is also accompanied by a voluntary approach to reporting the ethnic diversity of boards. The two issues of pay and diversity come together in the new gender pay gap regulations, which came into force on 5 April 2017. These require all employers with more than 250 employees to publish average gender pay gap statistics on their website by 4 April 2018.

OUR TOP FIVE GOVERNANCE REPORTING RECOMMENDATIONS

1. Demonstrate clear links between strategy and corporate governance

As we have found over the last four years, one of the hardest things for small and mid-size quoted companies to do is to offer investors the necessary insight to understand how their strategy links with, and is supported by, their governance arrangements. The generic language used in many of the disclosures continues to contribute to this problem. Whilst investors acknowledge that linking corporate governance to strategy is a challenge, they continue to tell us that this is a key disclosure. They want to see a clear articulation of strategy (Disclosure 20 of the QCA Code) and an explanation of how the application of their chosen corporate governance code supports the company's long-term success and strategy for growth (Disclosure 3 of the QCA Code). **Ensuring that a company's corporate governance structures and processes are appropriate, and that they help to deliver long term growth and shareholder value, is of fundamental importance to investors.**

A good starting point is to focus on producing a clear depiction of the company's business model. If a company has described this clearly to investors, it should be easier to define how governance links to strategy. Companies should focus on how their strategy relates to their business model, and how the strategy and corporate governance arrangements benefit shareholders in the long term. They should also avoid empty statements and provide specific and informative explanations of what they do with regards to governance.

2. Avoid boilerplate disclosures

With the increasingly limited availability of investment research and other independent commentary, the annual report and accounts is often the only source of primary information available to stakeholders. It represents a vital first impression. It is essential that sufficient time and resources are dedicated to producing a report with a clear and concise narrative around the company's activities over the past reporting period. The key performance indicators (KPIs), the description of the business model, together with the company's strategy and its implementation, must be set out transparently.

A well-performing company articulates the business story and the company's ambition and purpose; this will enhance engagement with all interested parties. Focusing the narrative and explanations on the areas that are critical to the business provides a better understanding of the issues faced and helps to manage expectations of future performance.

Investors want to read statements that are unique to a company and that express the company's distinctive character. The direct message from investors is be honest and truthful in drafting your company's report.

Companies should focus on the 'explain' aspect of corporate governance, rather than just blind compliance. Investors want to know what you do and why you do it. Even if your company complies with certain aspects of a code, you should also explain why that approach is best for the company. Reports should be forward-looking and explain what has changed from the previous year and what key challenges are coming up in the next year. Most importantly, businesses should not try to hide non-compliance with a governance code – investors prefer companies to highlight this and explain what they do instead. Indeed hiding non-compliance goes against the principles of comply and explain.

Investors can tell when companies have copied standard-wording in their disclosures. They read hundreds of annual reports each year so they quickly recognise statements lifted from other reports.

3. Evaluation of board performance

An effective board evaluates its own performance on a regular basis. Effective companies tell shareholders the outcome of any assessment or the objectives they have set as a result of the process. They clearly set out the criteria for board performance and how this is measured. **The knowledge that there is a culture of engagement and challenge within the boardroom environment, along with a commitment to seek continual improvement, reassures shareholders**.

Investors also want to know how the procedures around performance evaluation have evolved, that a plan of action for improvement has been identified, how far it has progressed, and whether it is progressing successfully.

Disclosures on board evaluation provide a good opportunity to illustrate the culture within the business, and demonstrate how that culture influences the behaviours of all those involved with the company. The impact and value of such disclosures in establishing confidence and trust should not be underestimated.

Investors want to see companies assessing the quality of directors and ensuring that boards have the appropriate balance of skills within the team. Small and mid-size quoted companies should demonstrate the benefits of board evaluation (Disclosures 17 and 18 of the QCA Code), explaining the performance procedures, including the frequency and result of the evaluation and any action taken.

4. Include a remuneration report

There is increasing concern at the level of CEO pay and the disparity with the pay of the average employee.

Shareholders want to understand the links between the company's strategy, its performance, and how executives are being incentivised and rewarded for executing the strategy well.

Investors want frank discussions with companies so that they can understand how the company's objectives are being achieved and how the directors are being remunerated. Clarity and transparency in matters of remuneration are important foundations upon which trust between companies and shareholders is built. Establishing well-structured remuneration arrangements indicates good governance - but this can only be fully appreciated if the arrangements are articulated effectively to all shareholders.

The regulations governing the remuneration-related disclosures are extensive, particularly for listed companies. Since 2013 the Companies Act 2006 requires a listed company to prepare a detailed directors' remuneration report for each financial year. Although AIM and NEX Exchange companies are not subject to these regulations, many investors now expect to see this information. However, the optional nature does lead to a lack of comparability and unnecessary concern from an investor perspective. It is important to ensure that consideration is given to the materiality and proportionality of the disclosures and the particular needs of your shareholders.

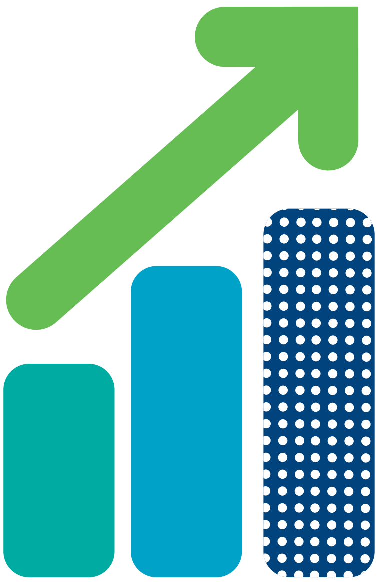
Crucially, the objective of any disclosure is to ensure a proper understanding of the nature and amounts involved. The reader must be able to appreciate the connection between the company's strategy and performance and how executives are being rewarded for their contribution to any successes (Disclosure 6 of the QCA Code). Preparers of accounts should also consider the practical approach to good remuneration disclosures, detailed in the QCA Remuneration Committee Guide.

The board should ensure that the remuneration report describes how the policy links to the company's strategic objectives and KPIs, and demonstrates that the amounts paid are proportionate in terms of the value created. In particular, for an annual bonus scheme, information about how bonuses are determined based on the company's performance and individual targets should be easy to identify. Similarly, for share plans, details of financial targets should be provided. **Investors tell us that for full transparency on remuneration, information is best presented in a tabular format showing a single total remuneration figure for each director, analysed between salary, benefits, bonus, pension and share plans (value of awards).**

5. Ensure that board roles are adequately described

Companies usually highlight each director on the board and include a biography in the annual report and accounts. However, **investors are particularly interested in the board structure and why each director is on the board – namely the specific skills he or she brings to the team** (Disclosure 9 of the QCA Code). It cannot be assumed that people can work this out from a biography. There should be a clear distinction between executive and non-executive directors and clarity as to whether the chair is executive or non-executive. The roles of each individual director should also be clear – for example, CEO or CFO, as this helps investors determine whether the board has the appropriate balance of skills and experience.

Effective chairs oversee the board to not only help develop good governance, but also to ensure the board's approach supports the plan for sustainable long-term growth in shareholder value. Such chairs are seen to be independent and capable of challenging the CEO and CFO. Investors consider sector knowledge to be important, as a deep understanding of the markets in which the the business operates enables the chairman to challenge the executive team more effectively.



OUR ANALYSIS

This section details our measure of corporate governance behaviour by showing the percentage of the sample that included the minimum disclosures of the QCA Code.

*when assessing item one, we have excluded Main List companies given that they are required to adopt the UK Code, therefore, cannot adopt the QCA Code. However, we have included item two to indicate companies that reference compliance with a corporate governance code.

> Companies that don't provide sufficient disclosures may find it increasingly difficult to attract investment. And those that do are better able to build a reputation as a stable and trustworthy company, attracting more investor attention.
>
> Charlotte Cuthbertson
> Miton Group plc

CHAIRMAN'S GOVERNANCE REPORT

No	Disclosure	2017	2016	2015	2014	2013
1	The narrative reporting of the company should include a report by the chairman of how the QCA Code is applied (see note*).	50%	26%	31%	22%	20%
2	There was reference to the application of a corporate governance code.	93%	82%	68%	83%	81%
3	The report should include how such application supports the company's long term success and strategy for growth.	9%	4%	7%	1%	3%

AUDIT COMMITTEE REPORT

No	Disclosure	2017	2016	2015	2014	2013
4	An audit committee report should explain the major tasks undertaken and demonstrate an independent oversight of both management and external auditors.	45%	53%	41%	36%	20%
	It should include details of the significant issues considered by the committee in relation to the financial statements and how these issues were addressed.	34%	48%	32%	–	–
5	There should be an explanation to shareholders of how audit objectivity and independence is safeguarded, particularly if the auditor provides significant non-audit services.	36%	49%	37%	35%	31%
6	The audit committee also acts as the committee focused on risk if there is no designated risk committee and, as such, the committee should indicate how this role has been undertaken.	37%	43%	30%	28%	17%

REMUNERATION COMMITTEE REPORT

No	Disclosure	2017	2016	2015	2014	2013
7	A remuneration committee report should explain how the company's remuneration policy and practice align with the company's strategy.	54%	68%	55%	61%	68%

DETAILS OF DIRECTORS

No	Disclosure	2017	2016	2015	2014	2013
8	The identity of all the directors, their roles and committee memberships must be disclosed.	87%	93%	94%	79%	93%

RELEVANT SKILLS AND EXPERIENCE

No	Disclosure	2017	2016	2015	2014	2013
9	The relevant skills and experience that the executive and non-executive directors bring to the board should be described.	98%	99%	92%	73%	91%

Annual reports represent a unique opportunity for your company to inspire and foster trust from your shareholders – don't waste it.

Will Pomroy
Hermes Investment
Management Limited

A non-executive chairperson should be independent, accountable, and available to shareholders. They should also be capable of challenging the executives, where appropriate.

Nick Hawthorn
Downing LLP

INDEPENDENT DIRECTORS

No	Disclosure	2017	2016	2015	2014	2013
10	Those directors considered to be independent should be identified. The reasons for their independence should be explained and particular attention given to circumstances where the status of independence may be impaired.	18%	19%	30%	33%	43%

COMMITTEES

No	Disclosure	2017	2016	2015	2014	2013
11	There should be a brief description of the work of each board committee and its role.	94%	92%	94%	75%	95%
12	Committee responsibility and accountability should be explained.	77%	73%	75%	67%	87%

MEETINGS AND ATTENDANCE RECORDS

No	Disclosure	2017	2016	2015	2014	2013
13	There should be disclosure of the number of meetings during the year of the board and of the committees.	55%	77%	47%	57%	70%
14	The attendance records of each director should be provided.	44%	69%	44%	51%	67%

RISK MANAGEMENT AND INTERNAL CONTROL

No	Disclosure	2017	2016	2015	2014	2013
15	There should be a summary of the systems of risk management and internal control and the uncertainties facing the business.	89%	91%	84%	89%	73%
16	An explanation should be provided of how risks align with the strategy of the company, as well as linking into key performance indicators, remuneration policies and corporate responsibility activities.	72%	50%	63%	51%	38%

PERFORMANCE EVALUATION

No	Disclosure	2017	2016	2015	2014	2013
17	There should be a description of the performance evaluation procedures for each director, the whole board and each committee focusing on their objectives and outcomes.	22%	44%	34%	27%	14%
18	Include a summary of how evaluation procedures have evolved from the previous years, the result of the evaluation and action taken or planned as a result.	9%	3%	11%	10%	2%

INFORMATION SUMMARY

No	Disclosure	2017	2016	2015	2014	2013
19	There should be a summary of information received by the board and by individual committees.	14%	5%	3%	2%	5%

The share price is not considered in isolation. When assessing a company, we want to see that its governance structures and processes are on an upward trajectory, developing as it grows.

Daniel Jarman
BMO Global Asset Management

SUMMARY OF STRATEGY

No	Disclosure	2017	2016	2015	2014	2013
20	There should be a clear articulation of the strategy of the company.	95%	87%	92%	41%	56%

DESCRIPTION OF ROLES

No	Disclosure	2017	2016	2015	2014	2013
21	There should be a description of the roles and responsibilities of the chairman, chief executive and, if applicable, the senior independent director.	39%	33%	30%	48%	65%

MATTERS RESERVED FOR THE BOARD

No	Disclosure	2017	2016	2015	2014	2013
22	There should be a list of the types of decisions reserved for the board.	43%	38%	46%	39%	32%

NON-EXECUTIVE APPOINTMENT TERMS

No	Disclosure	2017	2016	2015	2014	2013
23	Terms and conditions of appointment of non-executive directors should be stated.	28%	23%	20%	4%	12%

TERMS OF REFERENCE: AUDIT AND REMUNERATION COMMITTEES

No	Disclosure	2017	2016	2015	2014	2013
24	Terms of reference of the audit committee and the remuneration committee should be included.	43%	46%	35%	42%	41%

TERMS OF REFERENCE: NOMINATION COMMITTEE

No	Disclosure	2017	2016	2015	2014	2013
25	Where there is a nomination committee, the terms of reference of the nomination committee should be included. If there is no separate nomination committee, there should be an explanation of the processes by which the whole board determines nomination and senior appointment matters.	29%	40%	30%	33%	29%

ROLE OF EXTERNAL AND INTERNAL ADVISERS

No	Disclosure	2017	2016	2015	2014	2013
26	An explanation should be given of the role of any external advisers to the board or its committees (in particular, the remuneration committee) and any internal advisory responsibilities, such as the roles performed by the company secretary and the senior independent director in advising and supporting the chairman. Where the company secretary is also a director, the company should provide an explanation for this.	10%	11%	12%	4%	6%

When it comes to the annual report, tell me something that the company or the board has done that has made a difference over the last year.

Charles Henderson
Invesco Asset Management Limited

PUBLISHED MATERIAL

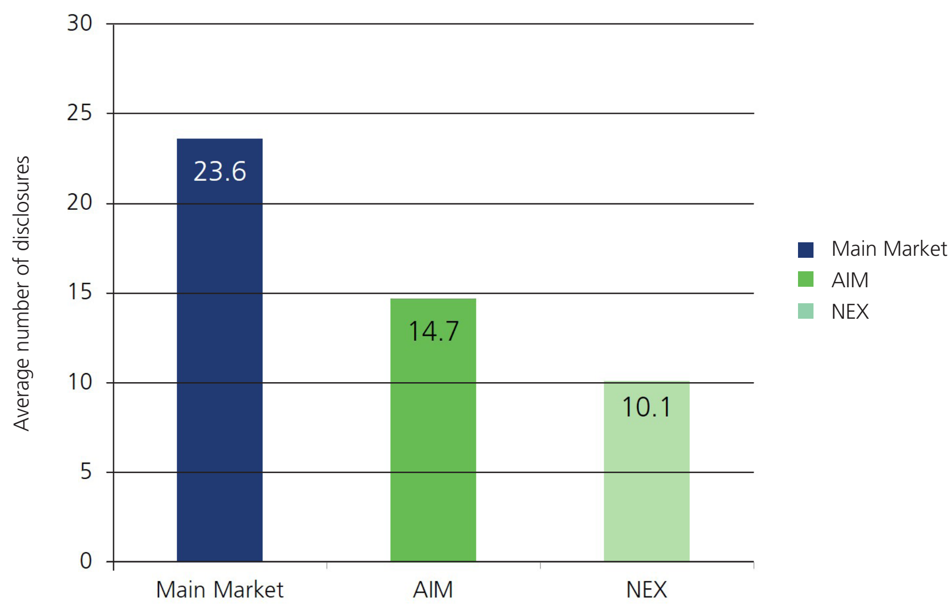
No	Disclosure	2017	2016	2015	2014	2013
27	The annual report and other governance-related material should be on the website.	100%	100%	99%	100%	98%
28	Notices of all general meetings over the last three years should be on the website.	87%	49%	58%	53%	63%

RESULTS OF SHAREHOLDER VOTING

No	Disclosure	2017	2016	2015	2014	2013
29	Voting decisions should be posted on the company website.	70%	37%	54%	33%	65%
30	Where votes at a general meeting are by show of hands, the votes by proxy received by the company, including abstentions or votes withheld, should be reposted as soon as practical after the meeting. Where votes are conducted on a poll, the actual votes, including votes withheld or abstentions, should be reposted as soon as practical after the poll.	4%	27%	14%	18%	65%

AVERAGE NUMBER OF CORPORATE GOVERNANCE DISCLOSURES

Market	Number of companies in the sample	Average number of disclosures	Minimum number of disclosures	Maximum number of disclosures
Main Market	16	23.6	6	28
AIM	67	14.7	6	25
NEX Exchange	17	10.1	5	25



METHODOLOGY

The analysis was conducted on a random sample of 100 annual reports and accounts and the corporate websites of companies with equity securities admitted to trading on a London market (the Main Market of the London Stock Exchange, AIM and the NEX Exchange Growth Market) across all sectors in July and August 2017. Note that the sample of companies analysed in prior years is different to those analysed in 2017.

UHY Hacker Young assessed these annual reports and accounts and governance disclosures on their corporate websites against the minimum disclosures of the Quoted Companies Alliance Corporate Governance Code for Small and Mid-Size Quoted Companies 2013.

The assessment was completed on a straightforward binary measure: did the company disclose the requirement or not. We have not sought to judge the qualitative nature of the disclosure.

We would like to thank those investors that provided invaluable feedback on this project and Edward Craft, Partner at Wedlake Bell and member of the Quoted Companies Alliance Corporate Governance Expert Group.

ABOUT US

UHY Hacker Young

At UHY it is our mission to be exceptional accountants and business advisers delivering seamlessly integrated client service. Through our international network of 325 offices across 99 countries, we harness global intelligence and combine this with local presence and knowledge to share technical and commercial insight.

Our people have a deep understanding of a number of diverse sectors ranging from education to natural resources, from automotive to healthcare. It is this depth and breadth that gives us tangible and proven insight into the commercial landscapes in which our clients operate. It also allows us to apply our expertise to our clients, particularly those listed on the UK markets, irrespective of their market and sector.

Quoted Companies Alliance

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies. We campaign, we inform and we interact to help our members keep their businesses ahead. Through our activities, we ensure that our influence always creates impact for our members.

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