Corporate Governance Reform Green Paper – Consultation Response from CMI

February 2017

The Chartered Management Institute (CMI) is pleased to provide this brief response to the government's Corporate Governance Reform Green Paper.

As the professional body for management and leadership with a member community of some 130,000 managers, we are responsible for standard-setting and raising standards in organisations across the economy. We recognise that good corporate governance is a crucially important part of good management and leadership. We therefore welcome the government's focus on this agenda and the Prime Minister's recognition that "business must earn and keep the trust and confidence of their customers, employees and the wider public". Unfortunately, our evidence is that this is too often neglected.

In this paper we offer some context about the imperative for change, and general views relating to the areas of the Green Paper dedicated to executive pay and employee voice.

Context

Our influential *Management 2020* report (2014) with the Commission on the Future of Management and Leadership, to which members of all main parties contributed alongside leading employers, considered this agenda. As Commission Co-Chair Peter Ayliffe noted in his foreword, the effect of short term attitudes in business was to create "a ticking time bomb of myopic management".

The Commission offered numerous recommendations to improve the UK's management and leadership. Some have been realised, for example the new Trailblazer management and leadership apprenticeships which CMI is proud to support. The report also called on employers to "ensure successful long-term leadership" by focusing on three critical areas: how they define their purpose, how they lead and develop their people, and how they invest in their potential. Specific recommendations included:

- Define and publish the social purpose of your company, ensuring it covers more than just shareholder return.
- Look at contributions to employees, customers, communities and the environment, as well as just the financials. Make sure that metrics are attached to all these areas, and that they are measured and published each year.
- Recruit chief executives who are willing to focus on long-term sustainable growth, not just short-term metrics.
- Support executives and chief executives in championing the corporate values, code of conduct and being role models.
- Reward chief executives for their ability to deliver value to all stakeholders – not just shareholders. For example, link bonuses to revenue growth, job creation, employee engagement scores, diversity and the percentage of young people hired each year, and not just financial results and total shareholder return, which can be achieved through cost-cutting and asset-stripping.
- Insist on transparency and ensure that these metrics are published in annual reports.
- Have a mechanism for measuring and potentially limiting chief executive pay, and give shareholders veto rights.

These recommendations and the principles that underlie them inform our response to the Government's present consultation.

1. Executive Pay

The latest data from the National Management Salary Survey from XpertHR and CMI indicates that there is a widespread disconnect between performance and pay in many UK organisations, and that earnings increases among senior leaders are outstripping those at lower levels. While public debate is typically focused on the UK's largest businesses, this evidence suggests that similar patterns are to be found in many different businesses.

The NMSS 2016 incorporates data for 105,394 individuals submitted by 425 organisations. The survey captures performance data from those employers, where they have such ratings: the 2016 survey found that among managers who were deemed by their organisations to be under-performing, 23% still received bonuses. CMI is concerned that bonuses remain divorced from performance in too many organisations. We have argued that solutions require adoption of good management practice: clear targets, alignment of bonus criteria with performance, and preparedness to have difficult conversations with those who don't achieve criteria, whatever level that may be.

The wider perception that this is not done successfully across business may be why 74% of managers surveyed by CMI in December 2016 support the government in taking action to curb runaway executive pay.

Question: "Thinking about the wider political and business environment, how far do you support or oppose the following government measures?" - Responses for "measures to curb runaway executive pay"

Strongly support	Somewhat support	Neither support nor oppose	Somewhat oppose	Strongly oppose	Don't know	Strongly support
45%	29%	16%	6%	2%	3%	45%

CMI's "Future Forecast" survey of 1,118 managers, November-December 2016

Moreover, support is strong at all levels of management seniority: 66% of respondents at Director or Partner support such measures, indicating widespread recognition of the need to address this issue.

CMI therefore supports the government in bringing forward measures to curb excessive and unearned pay – and specifically to strengthen transparency and support Remuneration Committees in achieving these ends.

With large UK businesses entering a new era of transparency about pay thanks to the introduction of the government's policy on gender pay gap reporting, which CMI has strongly supported, we believe that this is the right time to require companies to disclose more detail about the relationship between CEO and senior executive pay and average pay levels in an organisation. While we would not back a specific methodology at this point, we support the principle of transparency and suggest exploring the use of the same reporting threshold as required under the gender pay gap reporting regulations, that is, employers with over 250 employers. We would support the development of common standards that ensure accuracy and robustness of data, which allow comparison where appropriate – and which also allow users of such data to understand its potential limitations.

We also broadly welcome measures to move business towards a longer timeframe for evaluation of senior executive's performance and pay. Significant businesses are successfully defining their longer-term social purpose and seeking to escape from the tyranny of short term financial metrics as the only measures of success, as highlighted in our 2014 report *Management 2020.* Companies like Unilever have scrapped quarterly financial reporting, for example. Moreover, they have increasingly clearly defined the social purpose of their brands and the consequent obligations they have to their stakeholders including employers, customers and the communities in which they work.

2. Strengthening the employee, customer and wider stakeholder voice

The final *Management 2020* report incorporated a survey of over 2,000 UK leaders and managers, who were asked about their organisation's current approach with regard to purpose and the role it plays in governance.

	Average score	N/A	Not at all / Poor	Could do better	Good / very good
We define and publish the long-term purpose of our organisation, ensuring it covers measurable commitments to all stakeholders	6.5	10%	21%	27%	42%
We track the annual progress towards our overall stated purpose at our AGM / annual review and discuss during at least one board meeting.	7.5	10%	12%	22%	58%

Source: *Management 2020,* CMI, 2014

CMI looked at best practice from many leading businesses including established large companies like Unilever and John Lewis Group as well as small start-ups and mid-sized companies. What became clear was that when defining and publishing any long-term business strategy, any board should ensure that this includes measurable commitments not just to financial targets but also to the long-term purpose of the organisation. These would be need to be relevant to a range of stakeholders including customers and suppliers, employees, local community/society, the environment and investors.

Executives should then be rewarded for their ability to deliver shareholder value to all of these stakeholders, not just shareholder return. As the Commission concluded, too many boards fail to take this broader perspective. There is a need to encourage and enable more long-term thinking at board level.

2.1 Corporate Governance and Management Trust

Failure to provide clarity on an organisation's purpose and performance are fundamental drivers to an increasing dissatisfaction between middle managers and leadership teams. In 2016 we surveyed 1,500 UK managers from all levels of seniority to explore trust and communication within business around this issue and discovered that there is a strong relationship between trust, communication and growth, with higher trust levels correlating strongly to high performing companies. (*The Middle Manager Lifeline,* CMI, September 2016.)

While trust was seen as being critical to organisational performance by 85% of middle managers and 88% of senior leaders surveyed, only 36% of Britain's middle managers said they fully trusted their leaders. Communication from senior leaders was seen as being the fundamental reason behind this breakdown – only 37% of middle managers believe their leadership team is transparent in their dealings and actions, 31% believe their leadership team works closely with them to communicate their vision and strategy and a mere 9% of middle managers say they are regularly informed or consulted around the information with which they are provided.

CMI asked middle managers specifically what they wanted from boards and executive leadership teams to restore trust and identified five principal behaviours they wanted to see:

- 63% want leaders to reveal their thinking about important issues
- 54% want leaders to admit their mistakes
- 51% want leaders to encourage people to raise issues
- 48% want to be inspired by their leaders about the ambition and strategy of their business
- 46% want their leaders to act consistently with the company's values

What is clear is that an open and transparent culture with clear lines of communication from worker to board is required to restore trust and belief in effective corporate governance.

Our 2016 Future Forecast launched in November 2016, prior to the green paper, and included a question relating to the potential for government to require worker representation on boards. Although the government has now ruled out this approach, we note that a majority of CMI members were receptive to the idea: a total of 63% were strongly or somewhat supportive. We recognise that government wishes to explore alternative models to achieving its aims in this area, and the important point is that managers support the principle of amplifying employee voice at the top of businesses.

Question: "Thinking about the wider political and business environment, how far do you support or oppose the following government measures?" - Responses for "Requiring large companies to have worker representation on boards"

Strongly support	Somewhat support	Neither support nor oppose	Somewhat oppose	Strongly oppose	Don't know
29%	34%	21%	9%	4%	3%

CMI's "Future Forecast" survey of 1,118 managers, November-December 2016

We would be happy to work with BEIS to convene our Companions – CMI's senior members – to discuss potential options in this regard. We would also be pleased to meet BEIS to discuss how we might support the evolution of this agenda in our capacity as the professional body for management and leadership.

Contact

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