



"The Board firmly believes that better employee representation can improve the quality of decision making. The benefits of listening to employees and engaging them in both consultation and decision making are already widely recognised." Mears Group, Annual Report. Pictured above is Amanda Hillerby, the Mears Group employee director



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Employees on boards Modernising governance

A LAPFF survey of FTSE All-Share companies

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Councillor Paul Doughty, acting chair of LAPFF

“It is surprising so few companies are choosing to appoint an employee director”

The importance of managing people well, and of ensuring that employees are engaged and have a voice at work, has probably never been more high profile in Responsible Investment. Partly this is because some companies have got it wrong – we can all think of examples like Sports Direct or Ryanair. But there are also a number of proactive initiatives underway, where investors are seeking to understand what companies are doing.

With that in mind, the Forum undertook a survey earlier this year to get a sense of how boards are responding to the revised UK Corporate Governance Code, with its new emphasis on workforce engagement.

The results are rather disappointing. Although it is welcome that many boards are identifying a director who will be responsible for workforce engagement, it is surprising that so few companies are choosing to appoint an employee director. This feels like a missed opportunity.

Nonetheless, we know from our engagements with companies that this remains a topic of considerable discussion. It also seems unlikely that public policy will stand still in this area given the interest the question of employee participation in governance has generated. So we look forward to continuing our dialogue with boards.

Overview

The introduction of the new UK Corporate Governance Code marks the first time that employee representation has been officially encouraged. A lack of prescription in the Code is understandable, but has not led to much experimentation by companies in practice.

As of January 2019, the Corporate Governance Code includes new requirements on workforce engagement. This is a development that LAPFF has backed. In responses to government consultations, the Forum has made the case that stakeholder representatives can provide a new perspective and important check and balance on board discussions and decision-making. As long-term investors, involving stakeholders in decision making can also add a longer-term perspective and not least in ensuring a closer link to the social context in which the business is operating.

However, while the Forum recognises the benefits of the new requirement, its application is in its infancy in the UK. As such, the Forum has not been prescriptive in its views about the form representation might take. Where the Forum has been more forthright is in calling for approaches that go beyond workforce engagement to participation in decision making.

It is in this context that the Forum decided to conduct a survey of FTSE companies to ascertain their views and approaches to complying with this aspect of the new code. Publication of the results of the ensuing survey is intended to inform Forum members and the wider investment community. The survey's focus was inevitably on whether and how companies are going to comply with the Code. However, as this new element beds in, there is scope for wide variation in the form in which a company complies. For example, have worker directors been appointed by the board or elected by the workforce? Given the plurality of options available, LAPFF will be engaging companies to understand what works

and what doesn't and in the process develop our thinking about how this innovation supports better decision making in the boardroom.

The survey results are positive with no company stating that this change to the Code will have a negative impact. Indeed, some are approaching the move in a positive way as highlighted by the quotes from a survey respondent and the public statement from Mears group, who have already appointed an employee to the board.

"It's entirely positive... It is one of a number of ways in which we support employee engagement and wellbeing" Survey respondent

"[T]he Board firmly believes that better employee representation can improve the quality of decision making. The benefits of listening to employees and engaging them in both consultation and decision making are already widely recognised." Mears Group, Annual Report

Such statements are surely to be welcomed. However, whilst the Forum is holding judgement on the best approaches, we think the survey findings suggest that there is much more scope for experimentation. Nevertheless, the findings are positive and, as boards become used to the idea of worker engagement and participation in decision making, we hope to see much more innovation in the future.

Executive summary

The majority of companies (66%) stated that they had decided to comply and the option they had selected. 18% of companies stated that they have decided to explain why they will not comply with this element of the code.

Almost three quarters (73%) of those who have decided how they will comply stated that they will do so by appointing a designated non-executive director. This was followed by a formal workforce advisory panel (27%). Just 5% of respondents stated that they would appoint a director from the workforce. 5% of companies stated that they would have both a formal workforce advisory panel and a designated non-executive director.

When asked why they rejected the other options, the most common response was the size of the workforce with details in the comments section suggesting that either the workforce was too large to be represented by a single person or too small.

No respondent considered that the changes to the corporate governance code would have a negative impact on the market or their company. 44% of respondents felt it would have a positive impact on their company.

Those companies that viewed the move as positive for their company were more likely to think that the reform would make a significant difference to their company.

Comments revealed that some companies were very positive about the move while others indicated concerns that no single approach would suit any all companies.

The policy background

The new Corporate Governance Code published in July 2018 (applying to accounting periods beginning on or after 1 January 2019) outlined requirements for engagement with the workforce. The new code stated that companies should use one or a combination of the following methods:

- a director appointed from the workforce;
- a formal workforce advisory panel;
- a designated non-executive director.

These requirements are on a comply or explain basis, meaning that companies do not have to follow the Code if they explain why they do not wish to.

These new requirements on workforce engagement follow high-profile interventions by Theresa May who stated when launching her bid to become leader of the Conservative Party and therefore Prime Minister:

“I want to see changes in the way that big business is governed. The people who run big businesses are supposed to be accountable to outsiders, to non-executive directors, who are supposed to ask the difficult questions, think about the long-term and defend the interests of shareholders. In practice, they are drawn from the same, narrow social and professional circles as the executive team and – as we have seen time and time again – the scrutiny they provide is just not good enough. So if I’m Prime Minister, we’re going to change that system – and we’re going to have not just consumers represented on company boards, but employees as well.”



After Theresa May became Prime Minister, there were a series of consultations on the issue which culminated in the new code which includes the three options on workforce engagement outlined above.

Employee directors are not alien to the UK. FirstGroup has for a long time had an employee director on the board. More recently there have been employees appointed to the board at Sports Direct and Mears Group.

Employee involvement is common practice in other European countries. In the majority of European Union countries, and others such as Norway, employees are granted the right to be represented with decision making powers on the board of directors or on the supervisory board of their company.

Whilst board level employee representation is common in Europe, there is no single model. There is institutional diversity which includes:

- **board structure:** unitary (Sweden), two-tier (Germany) and mixed (France) boards.
- **the size of company:** for example in Denmark a company has to have more than 50 employees for them to have board representation, while in Germany it is 500,
- **how employee representatives are nominated:** by trade unions (France), trade unions or staff associations (Ireland), trade unions and works councils (Germany), works councils (Hungary), and from employees (Portugal),
- **how they are appointed:** appointed by the works council (Austria), by an employee vote (Norway) and by shareholders who have the right to reject nominations by the works council (Netherlands),
- **eligibility of representatives:** works council members only (Austria) only employees (Denmark) no employee or trade union (Netherlands) external trade union (for listed companies in the Czech Republic), employees and external trade unionist (Germany),
- **number/proportion of employee representatives on the board:** minimum of one (Norway) maximum one third (Netherlands) up to a half (Germany).

Prime Minister, Theresa May

Theresa May “We can make Britain a country that works for everyone”, July 2016. <http://press.conservatives.com/post/147947450370/we-can-make-britain-a-country-that-works-for>

See: Corporate Governance Green Paper (November 2016), Corporate governance reform: the government response to the green paper consultation (August 2017), FRC proposed revisions to the UK Corporate Governance Code (December 2017)

Survey results

LAPFF carried out an anonymised survey of FTSE All-Share companies to understand the approaches companies are taking in response to the new Code. Most companies have chosen to comply. Of those a large majority will designate a non-executive director for workforce engagement.

The survey

To understand what approaches companies are taking, how they view the changes and why they have not chosen particular options, the Local Authority Pension Fund Forum undertook a survey of FTSE All-Share companies.

The survey was conducted between 15 February and 13 March 2019.

57 companies responded to the survey. 39% of respondents were from the FTSE100, 40% from the FTSE 250 and 21% were small cap companies.

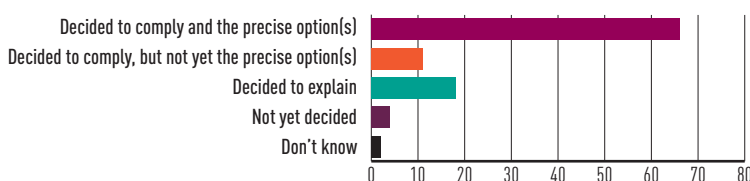
The majority of those responding (53%) were companies with over 5,000 employees.

The survey received responses from across different industries, with highest responses from those in consumer goods (19% of responses), financials (17%), and consumer services (15%).

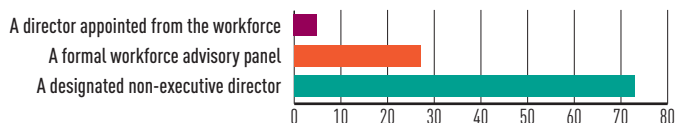
The survey was conducted on an anonymised basis.

Whilst the survey represents the views of 20% of the FTSE 100 and around 10% of the FTSE 350, the survey is likely to represent the views of those most engaged in the new requirement.

Whether companies have decided to comply or explain %



Chosen options of those who have decided to comply and the precise option(s) %



Most companies have made a decision about how to comply with the Code.

The survey aimed to find out the preparedness of companies for the new Code, so companies were asked whether they had made a decision about their approach to the Code's new requirements.

The majority of companies (66%) stated that they had decided to comply and the precise options chosen.

A further 11% stated that they had decided to comply but had not chosen the precise option and 18% have decided to explain.

A majority of companies that have decided to comply will appoint a designated Non-Executive director

Almost three quarters (73%) of those who have decided how they will comply stated that they will do so by appointing a designated non-

executive director.

The second most favoured option is having a formal workforce advisory panel, which a quarter (27%) of respondents stated their company would introduce.

Just 5% of respondents (two companies) stated that they would appoint a director from the workforce.

5% of companies stated that it would have both a formal workforce advisory panel and a designated non-executive director.

Company size given as main reason why other options not chosen

Companies were asked the main reason why they had decided against the other option or options.

The most common response was the size of the workforce regardless of which option they had rejected, with around a quarter of respondents indicating size as the main issue. →

For those rejecting the option of a formal workforce advisory panel, after the size of the company (27%), there were concerns that it might create conflicts of interest (18%), would delay decision making (18%) and would be a distraction (9%).

A quarter (26%) of companies that decided against having a director appointed from the workforce cited company size followed by concerns that it would create conflicts of interest (16%); would create two classes of directors (13%); would be tokenistic (16%); and that there was a lack of skilled or suitable candidates (10%).

For the handful of companies that decided against a designated non-executive director, a third (33%) stated that it would look tokenistic, followed by company size (22%), company sector (11%) and concerns that it would create conflicts of interest (11%).

Why companies stated they will be explaining

Of those that stated they would be explaining, the top reason was the size of the company. This was followed by respondents stating that it would be tokenistic. Others felt it might provide conflicts of interest, would be a distraction or would create two classes of directors.

Those undecided on the options not looking at appointing a director from their workforce

Although the number of respondents stating that the company had decided to comply but not which option was small, none stated that they were looking to appoint someone from the workforce and stated they were looking at the other two options.

The respondents all stated that they expected to make a decision about which option within the next six months.

No company stated that reforms would have a negative impact on the market or their company

The survey asked a set of questions about the impact the reforms might have. No respondent felt that the changes to the Corporate Governance Code would have a negative impact

on the market or their company

44% of respondents felt it would have a positive impact on their company and 54% stated that it would be neutral.

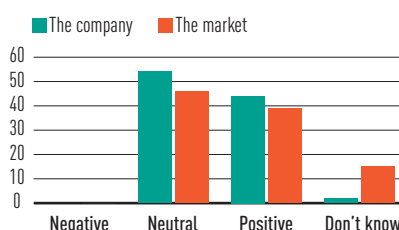
39% said that it would have a positive impact on the market, 46% stated it would be neutral and 15% stated they did not know.

Most (56%) felt that it would have a small difference to their company. 13% stated that it would make a significant difference and 26% stated that it would make no difference

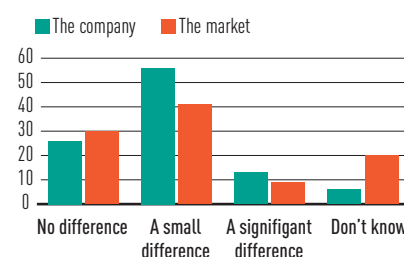
Meanwhile, 41% stated that it would have a small difference for the market, 30% no difference, 20% did not know and 9% a significant difference.

Those companies that viewed the move as positive for their company were more likely to think that the reform would make a significant difference to their company. Those who viewed it neutrally were more likely to view it as having no difference.

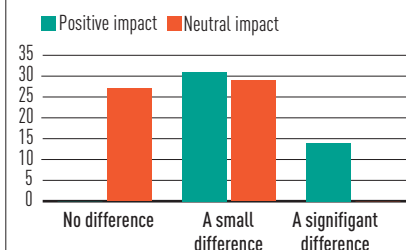
Whether changes to the code viewed as positively or negatively %



Whether changes to the code are likely to have a difference to the company or the market %



Scale of difference for viewing reforms as positive or neutral %

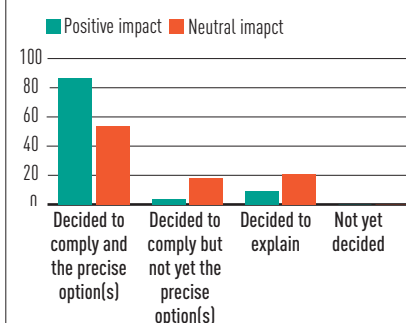


Companies that view reforms as positive are most likely to comply and have decided the option

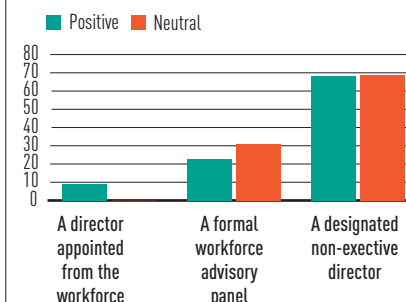
Those companies that view the reforms as positive for the company are most likely to have chosen to comply and the precise option(s). Equally they are much less likely to have decided to explain.

Those companies that view the reforms as positive for the company are more likely to appoint a director from the workforce and less likely to appoint a formal workforce advisory panel.

Whether complying for those viewing reforms as positive or neutral %



How a company intends to comply by view of reforms as positive or neutral %



➔ Differences between FTSE 100 and FTSE 250

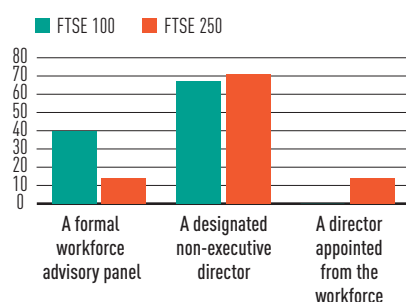
There were similarities between FTSE 100 and 250 companies in their approach to the requirement with 68% of the FTSE 100 stating that they have decided to comply and the option versus 61% in the FTSE 250. 14% of the FTSE 100 and 17% of FTSE 250 stated that they would be explaining.

There appeared to be some differences between the approaches that FTSE 100 and FTSE 250 companies were taking to the options. No company in the FTSE 100 that responded was planning to appoint a director from the workforce compared with two (14%) from the FTSE 250. There were similarly high proportion of companies that intended to appoint a designated non-executive director. Noticeably fewer companies from the FTSE 250 intended to have a formal workforce advisory panel.

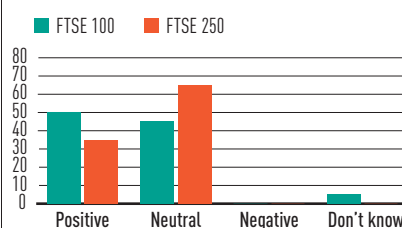
The most common answer amongst the FTSE 100 for choosing not to appoint a director from the workplace was the size of the company (40% when excluding 'don't knows'). In the FTSE 250 it was concerns that it would be tokenistic (33% when excluding don't knows) with one in five citing company size.

Regarding the impact of the reforms, FTSE 100 companies were more likely to say that the reforms would be positive and more likely to say that the reforms would make a difference to their company.

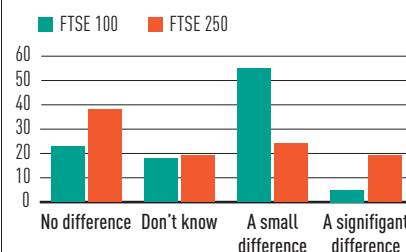
Chosen options, FTSE 100 and FTSE 250 %



Will the reforms have a positive or negative impact on your company? %



What scale of difference does your company think it will make to the company %



Comments from companies: size; one-size fits all; and a positive move

In the survey there was space for comments about reforms, which are summarised below.

Size. Some of the comments focused on the application of the Code. A number pointed to the small size of their company as the company had few employees. For others, size related to the large number of staff members and questioned how one person could represent/engage a global or diverse workforce. One commented that they were adopting a range of workforce engagement mechanisms at different levels because of the scope, diversity and geographical spread of their employees.

Wait and see. A couple of respondents stated that they wanted to see how things worked out. For example, one respondent noted that they wanted to see how their preferred option bedded in before looking at introducing another of the Code's means of engagement.

Positive step. Some comments were favourable about the move. One respondent noted "It's entirely positive... It is one of a number of ways in which we support employee engagement and wellbeing." Another commented that it is a: "Welcome development, though needs to be managed carefully."

One size fits all. However, whilst no one responding to the survey suggested implementation would have a negative impact there was a note of scepticism from some of the respondents. There were a couple of comments that the company had in place other means of engagement which they felt achieved the same ends. One person commented that it was an example of introducing one rule to fit all companies, which might work for some but not for others. Another cautioned that there are a number of ways that companies can engage with their workforce and it would be wrong to fixate on one person. Someone else noted existing duties of directors to consider employees and felt the governance requirements were unlikely to change actual outcomes.

A positive move. One respondent felt shareholders should be open to being flexible and accepting the approach adopted by the company because it will be tailored to a specific company - its culture, size and circumstance.