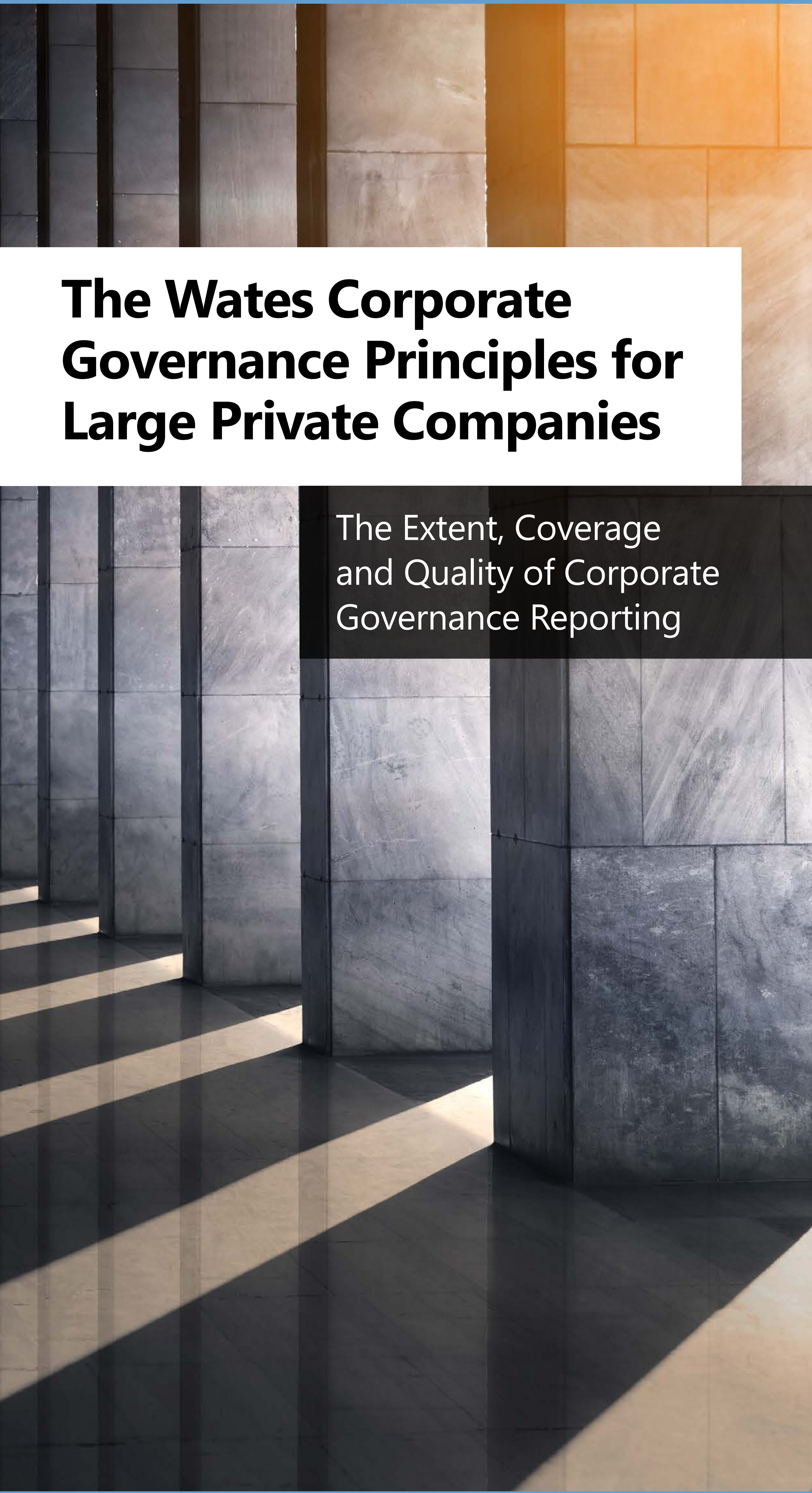

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The Wates Corporate Governance Principles for Large Private Companies

The Extent, Coverage and Quality of Corporate Governance Reporting

February 2022

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1. Foreword

It has been three years since the Coalition Group that I chaired, guided by the Financial Reporting Council, published the Wates Corporate Governance Principles for Large Private Companies. During that time, we've had the disruption of a pandemic, which delayed some reporting, but the important work of promoting good governance has continued, and indeed we have seen large private companies fulfil their responsibilities under the Companies (Miscellaneous Reporting) Regulations 2018 by producing corporate governance reports.

I am pleased to recommend to you this research report, which is the first in-depth assessment of how companies are responding to the legislation, and, of those companies who have chosen to follow the Wates Principles, the quality of their reporting.

It is relatively early to draw too many conclusions, with some companies still having completed only their first cycle of reporting against the Wates Principles, but this research provides us with the timely and rigorous analysis we need in order to inform ongoing government policy decisions about corporate governance. I'm pleased with how many companies are grasping the spirit of the Wates Principles in their governance reporting. This means they are using the principles as a tool for self-reflection and improvement, and seeing the yearly governance reporting as an opportunity, not a burden. Many companies are clearly seeking not just to tick boxes but to communicate to their stakeholders relevant information about how they are governed, with an appropriate level of detail, using clear and understandable language.

The positive response by so many companies to the Wates Principles reflects the benefits of allowing industry to develop its own guidelines through the Wates Coalition. The principles are challenging and yet flexible enough to be used by a very diverse range of companies that meet the criteria, especially in terms of ownership structure. Indeed, I continue to believe that these principles could be used by an even broader group of companies than those that are required to produce a governance report, regardless of the legislative thresholds in place.

I am sure that as companies tackle the reporting challenge in subsequent years, they will draw many lessons from experience. I hope they will also find this research report helpful, as it identifies numerous examples of good practice, and applies a very ambitious methodology, which means that even the best reporters will find many avenues for improvement.

I would hasten to add that although the methodology that the researchers used is spelled out clearly in this report, it is not intended to provide a 'check-list' or short cut for companies to use in future years. Rather, good practice will continue to evolve; and companies should focus on what sort of reporting is uniquely right for them.

The Coalition Group (with the FRC as its secretariat) will continue to review trends in how the Wates Principles are applied and to promote high-quality governance reporting. In 2022, based on this and future research, the group will consider whether further work on the principles needs to be conducted. This is an iterative and consultative process, so please do let us know of your thoughts.

In closing, I would like to thank the research team from the universities of Essex, East Anglia and Bristol, as well as the FRC for its oversight and guidance. This is an important piece of work that will inform the direction of corporate governance reporting for large private companies in the UK.

Sir James Wates, CBE

2. Executive Summary

This research project was commissioned to identify which companies within the scope of The Companies (Miscellaneous Reporting) Regulations 2018 ('the Regulations') provided a corporate governance statement for financial years beginning on or after 1 January 2019. Of those that did, the project determined how many applied the Wates Principles and how many applied an alternative corporate governance code or approach.

For companies applying the Wates Principles, the research also sought to assess the quality of reporting in terms of extent of disclosure, and to identify examples of good practice.

In answering the above questions, this report will provide an evidence 'baseline' for future comparative analysis. We also hope the information provided will lead to improvements in practice and reporting in the future.

Our research found that two-thirds of companies within the scope of the Regulations reported on corporate governance either within their directors' report or elsewhere in their annual report. Of these, 57% relied on a corporate governance code to define their arrangements, 35% stated that they relied on alternative corporate governance arrangements and just 8% failed to report meaningfully on their corporate governance arrangements.

Out of the companies which adopted a corporate governance code, the Wates Principles were by far the most widely used.

The Wates Principles were by far the most widely adopted corporate governance code. Some companies chose to refer to more than one code: ten companies referred to two codes, and one referred to three. Of those companies that did not apply a recognised corporate governance code, very few provided a rationale for non-application.

The vast majority of companies that used the Wates Principles provided some form of explanation of how each Principle was applied. Our assessment of the quality of disclosure is based on how the companies followed the guidance set out within the Principles. While it is acknowledged that companies could include other matters as part of their disclosure, the expectation for the first year of reporting was that the majority of companies would refer to the guidance; therefore, this has been used as a baseline.

When comparing how companies reported across all Principles, we found that companies tended to disclose more information about how their corporate governance practices and policies have matured over the years (e.g. the structure and composition of committees, role of independent directors, line of accountability for directors). This could indicate that companies are still in a learning phase and that they might be developing their disclosure practices as their corporate governance arrangements evolve. For instance, the development of new structures and processes relating to purpose and leadership might require more time.

Our research found that companies have been providing good levels of disclosure in terms of general information about their formal policies but relatively lower levels of disclosure when it came to how these policies are applied in practice. Overall, there is room for improvement in reporting, and we hope that some of the points raised in this report will help companies, even those not subject to the Regulations, demonstrate good practice and make improvements going forward.

3. Introduction and background

The Companies (Miscellaneous Reporting) Regulations 2018 ('the Regulations') require UK-registered large[1] private companies and others that meet the threshold but are not required to adopt a specific corporate governance code to publish a corporate governance statement setting out their corporate governance arrangements. This may include companies registered as public (i.e. unlisted public companies). In fact, many public companies, including some that are quoted in this report, have chosen to adopt Wates Principles to define their corporate governance arrangements.

In January 2018, the government invited Sir James Wates CBE to lead a coalition group, the 'Wates Coalition', with a view to devising a set of principles to guide companies in the reporting of their corporate governance arrangements. This led to the publication of The Wates Corporate Governance Principles (the 'Principles') in December 2018. The Principles are supported by guidance notes alongside each Principle.

In acknowledgement of the diversity in the structure and context of companies subject to the Regulations, the Principles were issued on an 'apply and explain' basis, giving companies the flexibility to adapt their reporting in accordance with their particular circumstances and characteristics. According to the Financial Reporting Council (FRC), a key consideration underpinning the Principles is that they *offer companies, even those not subject to the regulation, an opportunity to demonstrate good practice and how they achieve long-term success of the company.*[2]

The Principles offer companies, even those not subject to the regulation, an opportunity to demonstrate good practice.

To coincide with the publication[3] of the first round of company annual reports implementing the Principles in late 2020, the FRC commissioned this research project with two main objectives:

1. To identify which companies within the scope of the Regulations provided a corporate governance statement in their 2019 annual reports and, of those that did, how many applied the Principles or an alternative corporate governance code.[4]

2. Of those companies choosing to apply the Wates Principles, to evaluate the level of adherence to the 'apply and explain' approach and the quality of their disclosures within their corporate governance statements in terms of extent, best practices and readability.

This report presents the results of the research project. Based on evidence from the first year of adoption, we observed a notable number of companies providing disclosures about their corporate governance arrangements. We also found that a significant number of companies that relied on the Wates Principles demonstrated their commitment to the Principles by providing some explanations of how they applied these Principles.

1 The requirements apply to companies that satisfy either, or both, of the following conditions:
   1. more than 2,000 employees;
   2. a turnover of more than £200 million and a balance sheet of more than £2 billion.

2 Financial Reporting Council (2018), p. 4.

3 Due to the Covid-19 pandemic, companies were given additional time (from 9 to 12 months) to file their 2019 annual reports: https://www.gov.uk/government/publications/the-companies-etc-filing-requirements-temporary-modifications-regulations-2020/temporary-changes-to-companies-house-filing-requirements.

4 Other corporate governance codes applied are the UK Corporate Governance Code, the Ofwat Principles, the Quoted Companies Alliance Code, the Corporate Governance Guidance and Principles for Unlisted Companies in the UK and other national (non-UK) codes.

4. Research approach

4.1. Methodology

This research project is based primarily on content analysis of the corporate governance statements within a company's annual report. Content analysis is the systematic and replicable analysis of text and involves its codification and collection into various categories. This enables the consistent assessment of the simple *presence/absence* of information on a particular topic, as well as of the *extent* to which that topic is addressed. Content analysis relies on the development of a pre-agreed coding scheme mapped to a particular set of expectations, which in this research project is a corporate governance code. The text from corporate governance statements was manually coded, and computer software (NVIVO 12) was used to record and organise the results to facilitate subsequent analysis.

The research project was done in two phases. The first phase (Part A) required the research team to identify companies within the scope of the Regulations that had provided information about their corporate governance practices and the corporate governance codes adopted, if any. The Companies House database[5] was used to obtain the annual reports of all companies within scope of the Regulations for financial years ending between December 2019 and March 2020.[6] All annual reports were examined to ascertain the presence of a statement (or section) reporting on 'corporate governance arrangements'. Such statements were then analysed to ascertain:

1. whether each company applied a formal corporate governance code and, if so, which one(s); and

2. in cases where a company did not apply any corporate governance code, what information was provided about any alternative arrangements used.

The second phase of the research project (Part B) focused only on those companies that declared their adoption of, or mentioned a reliance on, the Wates Principles in their corporate governance arrangements. The statements regarding the corporate governance arrangements[7] of these companies were further analysed to evaluate how they had applied the Wates Principles and the quality of their disclosure. This was done by recording the extent of disclosure and examples of best practices, and by assessing readability using standardised scales.

Following the 'apply and explain' approach, companies should explain *how* the Wates Principles have been implemented. Indeed, the Foreword to the Wates Principles calls for meaningful disclosure that does not use *'somebody else's words'*, emphasising the need for company-specific detail so that users of corporate governance reports can understand how the Principles have been implemented in practice. Our coding scheme thus sought to address these aspirations by initially considering: a) the level of adherence to each Principle, and b) the characteristics/attributes of the relevant disclosures in order to evaluate the quality of the explanations.

5 Companies within the scope of the Regulations are required to submit their annual reports to Companies House.

6 Usually, UK private companies are required to submit their annual reports to Companies House within nine months of their financial year-end. However, for reports submitted during 2020, companies were given an additional three months in which to submit their reports. Therefore, annual reports for the year ending 31-12-2019 had to be submitted by 31-12-2020, while annual reports for the year ending 31-03-2020 had to be submitted by 31-03-2021. Since this research project started in February 2021, only annual reports for years ending between 31-12-2019 and 31-03-2020 were considered.

7 We considered only the statements of corporate governance arrangements in this phase since the Regulations require companies to disclose their corporate governance practices within this statement. Other parts of the annual reports were analysed only when companies provided a clear cross-reference to these sections, i.e. when there was an indication of the page number(s) of the section being cross-referenced.

To investigate the adherence to the 'apply and explain' approach, each Principle was analysed to evaluate whether companies explained how the Principle was applied. Companies were coded as either 1, where an explanation had been provided, or 0, where an explanation was either not provided or it was insufficient.

The quality of the disclosures provided in relation to the six Wates Principles was evaluated by considering three main dimensions. The first of these was the *extent* of disclosure. This allowed us to evaluate the presence of meaningful information that could help users to understand how the Principles were implemented in practice. To assess the *extent* of disclosure, each Principle was broken down into separate elements for analysis.

For instance, Principle One: Purpose and Leadership was broken down into three main areas: purpose, values and culture, and strategy. A set of relevant elements for each area was then identified (for each Principle) and included in a disclosure checklist. Appendix 1 provides more details on the methodology used; Appendix 2 provides example disclosure checklists for two Principles.

Secondly, we identified relevant disclosures for each Principle that can be considered as examples of best practice. These disclosures were included in the analysis in the form of extracts from annual reports to highlight the qualitative features that help users of corporate governance statements to understand how companies have applied the Wates Principles.

Lastly, we assessed the formal readability of the corporate governance statements because more readable narratives are deemed more transparent.[8] Readability seeks to gauge the ease of understanding of a text based on its written style.[9] We analysed the readability of the corporate governance statements produced by all companies that applied the Wates Principles using three standardised scales (Flesch–Kincaid Grade Level, Gunning Fog index, and SMOG index) which indicate the level of education needed for a reader to understand the text (in this case, the corporate governance statement). Please see Appendix 1 for more details on these scales, and the methodology used.

4.2. Sample selection

Companies are within the scope of the Regulation if they satisfy either or both of the following criteria:

1. they have more than 2,000 employees; and/or
2. they have a turnover of more than £200 million and a balance sheet of more than £2 billion.

Using the data available from the Fame database for the 2019/2020 financial year, the Department for Business, Energy and Industrial Strategy (BEIS) and the FRC identified 1,815 UK large companies likely to fall under the scope of the Regulation. Of these, 515 companies with financial year-ends between April and November 2020 were excluded since their deadline to submit an annual report to Companies House had not yet expired when the data collection started.

The annual reports of the remaining 1,300 companies were then searched for in the Companies House online database, and a further 94 companies were excluded because their annual reports were not available. As a result, 1,206 annual reports were analysed for Part A. With regard to Part B, the corporate governance statements analysed were only those of companies applying the Wates Principles, a total of 348 companies (see Table 1).

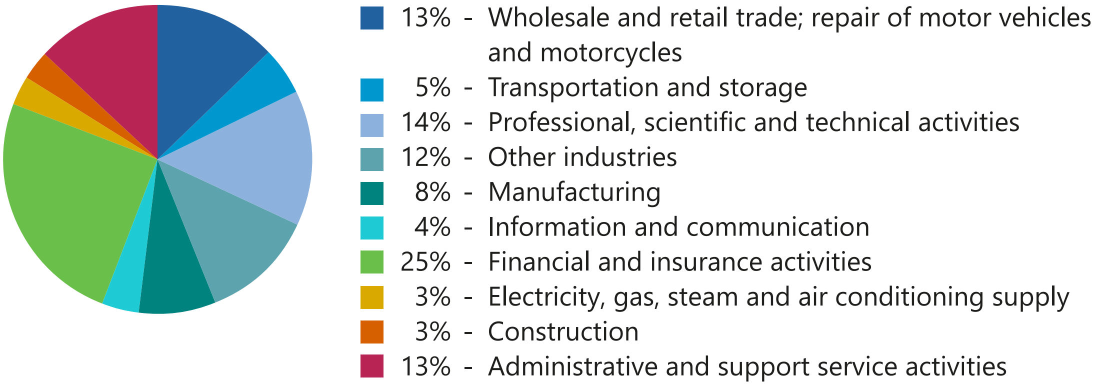
8 Guay, W., Samuels, D., & Taylor, D. (2016); Michelon, G., Sealy, R., & Trojanowski, G. (2020).
9 DuBay, W. H. (2004).

Table 1: Sample selection for Part A	
Number of companies within the scope of the Regulations	**1,815**
Number of companies excluded with a financial year-end between April and November 2020	(515)
Number of companies with no available annual report on the Companies House website	(94)
Total companies analysed for Part A analysis	**1,206**
Number of companies excluded, as they did not use the Wates Principles	(858)
Total companies analysed for Part B analysis	**348***

* For the analysis of readability, 10 more companies were excluded as the format of their annual reports could not be processed.

Figure 1 shows the distributions by industry of the full sample of companies analysed in Part A. The majority of these companies belong to industries that provide services related to financial and insurance activities (25%); professional, scientific and technical activities (14%); administrative and support service activities (13%); and the wholesale and retail trade, and repair of motor vehicles and motorcycles (13%).

Figure 1: Sample composition for Part A (1,206 companies) by industry (UK SIC 2007)



The Other industries category includes industries with fewer than 35 companies. It is composed of the following industries: activities of extraterritorial organisations and bodies (6); agriculture, forestry and fishing (4); arts, entertainment and recreation (12); education (5); human health and social work activities (27); mining and quarrying (33); other service activities (25); public administration and defence (6); real estate (10); water supply, sewerage, waste management and remediation activities (16).

A similar distribution by industry emerged when only the companies that have adopted the Wates Principles are considered (see Figure 2). These companies mostly operate in industries that provide services related to financial and insurance activities (31%); professional, scientific and technical activities (14%); and administrative and support service activities (12%).

Figure 2: Sample composition for Part B (348 companies) by industry (UK SIC 2007)

- 10% - Wholesale and retail trade; repair of motor vehicles and motorcycles
- 5% - Transportation and storage
- 14% - Professional, scientific and technical activities
- 8% - Other industries
- 8% - Manufacturing
- 3% - Information and communication
- 31% - Financial and insurance activities
- 5% - Electricity, gas, steam and air conditioning supply
- 4% - Construction
- 12% - Administrative and support service activities

The Other industries category includes industries with fewer than 10 companies. It is composed of the following industries: activities of extraterritorial organisations and bodies (1); agriculture, forestry and fishing (1); arts, entertainment and recreation (4); education (1); human health and social work activities (2); mining and quarrying (6); other service activities (6); real estate (1); water supply, sewerage, waste management and remediation activities (4).

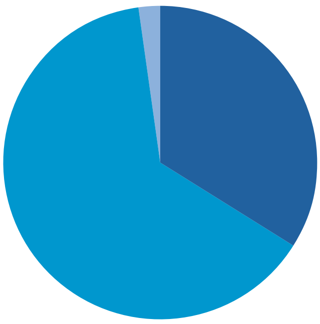
5. Findings

5.1. Part A. Information on corporate governance arrangements disclosed by UK large private[10] companies

Figure 3 shows that out of the 1,206 companies analysed, 410 companies did not provide any information about their corporate governance arrangements, while the remaining 796 companies either included a statement of their corporate governance arrangements in their annual reports (770) or discussed their corporate governance practices but did not prepare a specific statement regarding corporate governance (26).

It is important to note, however, that the Fame database provides an indication rather than an exact figure for the number of companies in scope of the Regulations and it is acknowledged that this is likely to be an over-estimate because of the way data is collected from various data sets. The number of companies not disclosing a corporate governance statement when they should have done so is therefore likely to be lower than the figures suggested in this report. BEIS and the FRC will consider how the accuracy of the figures can be improved ahead of any new research.

Figure 3: Number of companies engaging with some type of disclosure about their corporate governance (CG) arrangements



- 410 - Companies that did not prepare a CG statement and did not discuss CG
- 770 - Companies that prepared a CG statement
- 26 - Companies that did not prepare a CG statement but discussed CG in other sections of the annual report

Of the 796 companies that published a corporate governance statement or discussed their corporate governance in other sections of the annual report, 454 stated they had applied a corporate governance code. Most of these (98%) referred to the application of one main corporate governance code, while a small number (2%) reported they applied more than one corporate governance code.

Of the remaining 410 companies that did not make a statement regarding the adoption of any corporate governance code, 277 companies provided explanations about adopting alternative corporate arrangements. These companies developed their own corporate governance arrangements or, when part of a group, stated that they followed the corporate governance arrangements defined by the parent company or group to which they belong. The Regulations require individual entities to report on their own governance; therefore, if a subsidiary's governance is aligned to a parent this should be fully explained, with examples of the impact on the subsidiary and additional details of where governance diverts from the parent company.

Of the 796 companies that published a corporate governance statement or discussed their corporate governance in other sections of the annual report, 454 had applied a corporate governance code.

10 "Large Private" is used as a proxy for all the companies within the scope of the Regulation.

Only a few companies discussed their reasons for not adopting an official corporate governance code, which is a requirement of the Regulations. Instead, the majority stated that the selected arrangements were more suitable due to their privately held nature, size and/or the ownership structure of their business.

Finally, 65 companies (8%) published a corporate governance statement but did not communicate any information about their governance arrangements. Instead, these companies disclosed information about the corporate governance arrangements adopted by other companies within their group (parents or subsidiaries) or provided general statements about their arrangements without providing any meaningful information. Table 2 sets out these details.

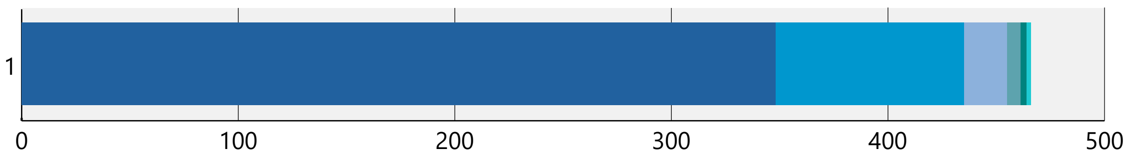
Table 2: Type of corporate governance arrangements adopted	Number	%
Companies that applied a corporate governance code	454 [(a)]	57
- Companies that applied one corporate governance code	443	
- Companies that applied two corporate governance codes	10	
- Companies that applied three corporate governance codes	1	
Companies that relied on alternative corporate governance arrangements	277 [(b)]	35
Companies that prepared a corporate governance statement but did not discuss any corporate governance arrangements	65	8
Total	**796**	

(a) Eight companies out of the 454 that declared the application of a corporate governance code did not prepare a corporate governance statement but disclosed this information in another section of the annual report.
(b) 18 companies out of the 277 that disclosed alternative corporate goverance arrangements did not prepare a corporate governance statement but disclosed this information in another section of the annual report.

77% **of those adopting one corporate governance code followed the Wates Principles.**

The Wates Principles were the most widely adopted corporate governance code, with 348 companies adopting them (i.e. 77% of those adopting at least one corporate governance code) (see Figure 4). Other codes were followed; these ranged from the UK Corporate Governance Code to the Institute of Directors' Corporate Governance Guidance and Principles for Unlisted Companies in the UK.[11]

Figure 4: Corporate governance codes applied by companies[12]



- 348 - Wates Principles
- 87 - UK Corporate Governance Code
- 20 - Industry-specific codes
- 6 - Other national corporate goverance codes
- 3 - Quoted Companies Alliance Code
- 2 - Corporate Governance Guidance and Principles for Unlisted Companies in the UK

11 Corporate Governance Guidance and Principles for Unlisted Companies in the UK https://www.iod.com/Portals/0/PDFs/Campaigns%20and%20Reports/Corporate%20Governance/Governance%20code%20for%20unlisted%20companies.pdf

12 Although the number of companies that adopted a corporate governance code is 454, Figure 4 sums up to 466 because 11 companies applied two or three corporate governance codes.

Demonstrating adoption of the Wates Principles was reported in a number of ways: some companies provided explicit statements to indicate adoption of the Wates Principles, while others did not specifically discuss the adoption of the Principles but used headings from the Principles or followed the language set out in the Principles. Companies using these approaches were assumed to be Wates Principles adopters.

5.2. Part B. Quality of corporate governance arragengements reporting by UK large private companies under the Wates Principles

Overview of the main findings

The focus of this part of the report is on the 348 companies adopting the Wates Principles to define their corporate governance arrangements. Their corporate governance statements have been analysed to evaluate the overall quality of their disclosures in relation to the six Wates Principles.

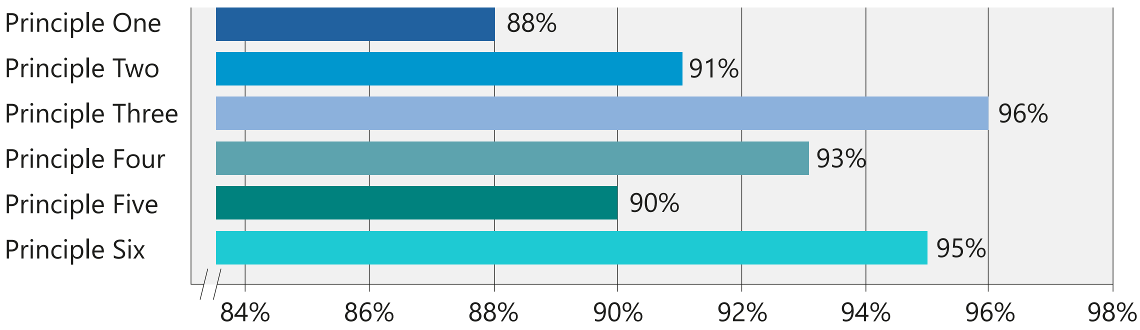
In analysing these companies, we first examined the application of each of the six Wates Principles and then the quality of their disclosure, in terms of extent, using a detailed checklist (see Appendix 2 for the checklist used); this included examples of best practice. Finally, companies' corporate governance statements' readability was assessed by applying three different metrics. The Principles are set out below:

- **Principle One (Purpose and Leadership)** emphasises the purpose of the company and how this is developed and promoted by the board. It also acknowledges the role of the board in ensuring that the company's values, strategy and culture are aligned with its purpose.
- **Principle Two (Board Composition)** discusses the effectiveness of the board. In particular, it outlines the role of the chair, the importance of diversity within the board in terms of skills, backgrounds, experience and knowledge, and also recognises that the size of a board should be based on the scale and complexity of the company.
- **Principle Three (Director Responsibilities)** focuses on the board and individual directors' understanding of their responsibilities and accountability. It discusses the policies and procedures in place to support effective decision-making and independent challenge.
- **Principle Four (Opportunity and Risk)** discusses how the board should ensure the long-term sustainable success of the company by identifying opportunities and risks.
- **Principle Five (Remuneration)** focuses on the executive remuneration policy and its alignment with the company's long-term sustainable success.
- **Principle Six (Stakeholder Relationships and Engagement)** discusses the importance of stakeholder engagement and the key role of the board in fostering such relationships. Special emphasis is placed on the relationship between the board and the workforce.

Application of the Wates Principles

Figure 5 shows the percentage of companies that provided explanations of how the six Wates Principles were applied. Principles Three and Six were the most frequently explained.

Figure 5: Proportion of companies explaining the application of the Wates Principles



Extent of disclosure for the six Wates Principles

We considered the content of the narratives companies used to explain their application of the six Wates Principles to evaluate the extent to which these explanations used the guidance provided alongside the Principles. The highest average level of disclosure was in relation to Principle Four, while Principle One received the lowest. See Figure 6 for details. For each principle there were individual companies with a disclosure score of zero. On the other hand there were individual companies whose disclosure scores were as high as 85% (Principle Four).

The highest average level of disclosure was in relation to Principle Four (Opportunity and Risk).

Figure 6: Average disclosure score by Principle

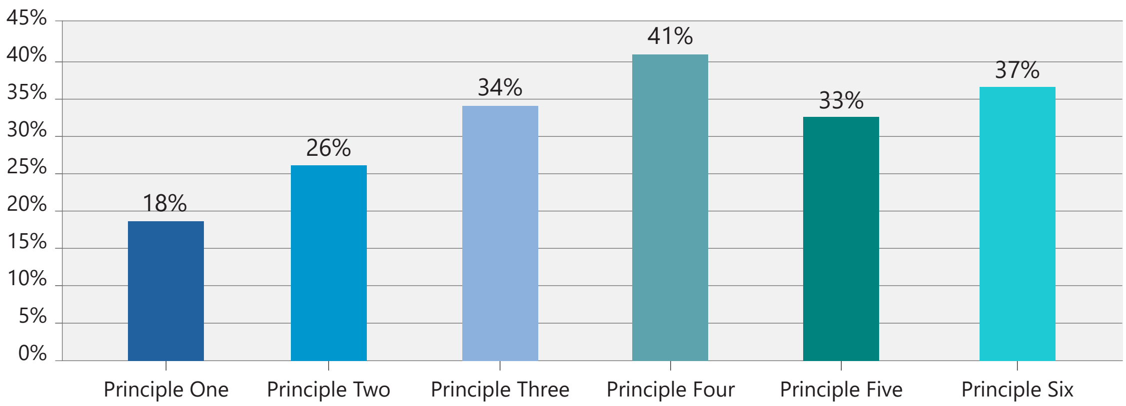
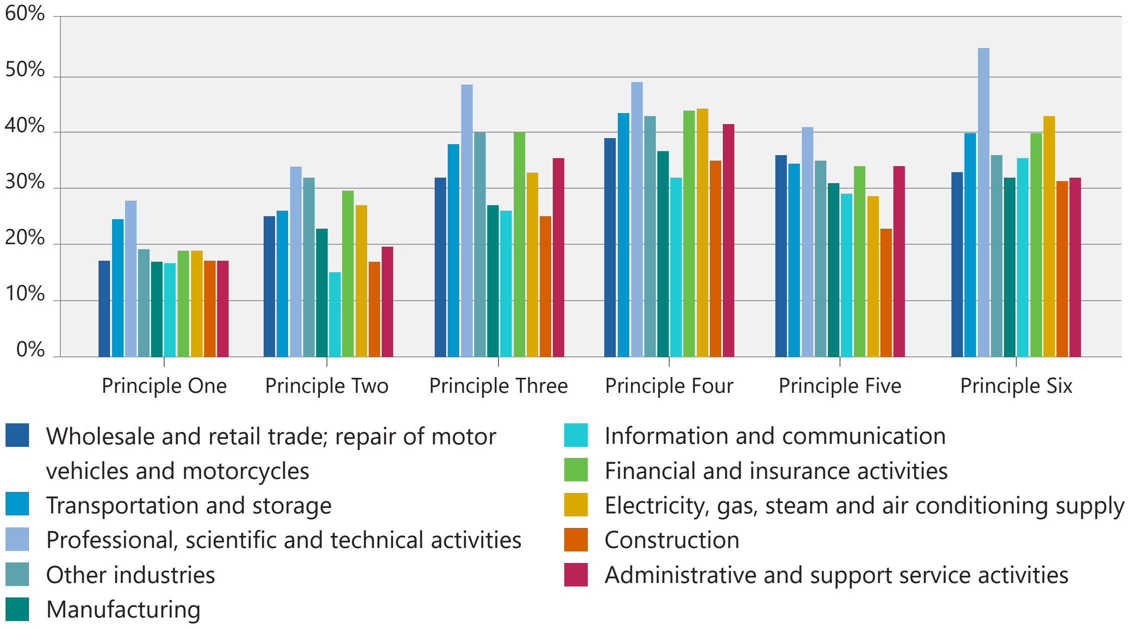


Figure 7 provides an overview of the disclosure scores recorded for the six Wates Principles by industry. It shows that companies operating in the professional, scientific and technical activities sector provided the highest level of disclosures for all six Wates Principles. A possible explanation for this is that they operate in a relatively regulated environment. Companies operating in the information and communication sector and those in the construction sector provided relatively fewer disclosures.

Figure 7: Overall disclosure score by Principle and industry



Companies operating in the professional, scientific and technical activities sector provided the highest level of disclosures.

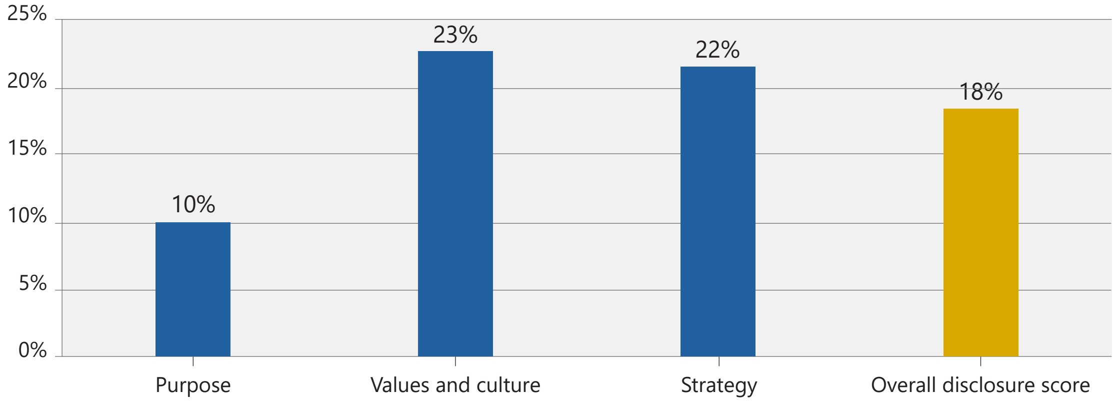
Principle One: Purpose and Leadership

Principle One introduces recommendations on disclosures related to the company's purpose and leadership. It reads as follows:

An effective board develops and promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.

Principle One had the lowest disclosure score among the six Principles. We found companies disclosed on average less than one fifth of the disclosure elements (18%) within the Purpose and Leadership Principle. In particular, the first area of interest – 'Purpose' – presents the lowest score. See Figure 8 for details.

Figure 8: Principle One – Overall disclosure score and breakdown by area



Purpose

We found that almost half of the companies (45%) disclosed their stated purpose. A further 14% provided a statement that could be interpreted as a purpose but was not labelled as such. The rest of the companies (41%) did not provide any explicit or implicit disclosure of their purpose in their corporate governance statements.

When it came to more in-depth disclosures about company purpose, companies generally exhibited low scores. Less than 2% of the companies disclosed information about the link between their purpose and their behaviours, whether their purpose is aligned with company's business practices and business model, or the process in place for the board to understand shareholders' views on the company's purpose.

We found a slight improvement in the disclosures about the processes in place for the board to build positive relationships with stakeholders by engaging in dialogue with them about their company's purpose. Finally, only two companies discussed the processes in place for the board to incorporate shareholders'/stakeholders' views into its decison-making process on the company's purpose. The results are presented in Table 3.

Table 3: Principle One – Purpose

	No (%) of disclosing companies
Q1. Does the company disclose its purpose? (0/1)	157 (45%)
Q2. Does the company discuss:	
a. the link between behaviours and purpose? (0/1)	3 (1%)
b. if its purpose is aligned with its business practices/business model? (0/1)	6 (2%)
c. the processes that are in place for the board to obtain a clear understanding of shareholder views on the company's purpose? (0/1)	4 (1%)
d. the processes that are in place for the board to build positive relationships with stakeholders by engaging in dialogue with them in relation to the company's purpose? (0/1)	27 (8%)
e. the processes that are in place for the board to incorporate shareholders' /stakeholders' views into its decision-making process in relation to the company's purpose? (0/1)	2 (1%)

Although few companies provided the above disclosures, some good practices emerged. For example, EDF Energy Customers Limited provides an explanation of how the board builds positive relationships with stakeholders in relation to its purpose:

> **The Board has developed and promoted the purpose of the company through the Group's communications team which supports the Company to ensure appropriate tailored communications are issued that support the Company's strategy, sustainable business plan and brand vision. The Company also has an open and ongoing dialogue with trade unions and other employee representatives.**
>
> EDF Energy Customers Limited, Annual Report, July 2020, p.11

Almost half of the companies (45%) disclosed their stated purpose.

Only two companies discussed the processes in place for the board to incorporate shareholders'/ stakeholders' views into its decison-making process on the company's purpose.

Values and culture

The second area analysed within Principle One is values and culture. This exhibited the highest average disclosure score among the three areas of this Principle. More than half of companies (51%) explained their culture. These companies described their culture, values, attitudes and behaviours as manifested in their operations and relationships with their stakeholders. Six more companies (2%) provided disclosures that could be interpreted as reporting on company culture but were not labelled as such; the rest (47%) did not provide any relevant information about their culture. An example of a good disclosure of a company's culture is from Dyson Technology Limited, which states:

> **Dyson operates globally and its success and continued growth depends on four shared principles that guide its work: Transparency, Loyalty, Fairness, and Independence. Dyson's internal Code of Conduct called 'The Code: ThinkDo' explains how Dyson puts these principles into practice ... Dyson wants everyone in the business to be empowered to make good decisions, so we have created the Code to support our work and guide us on how to conduct our business, always acting with integrity.**
>
> Dyson Technology Limited, Annual Report, November 2020, p.4

More than half of companies (51%) explained their culture.

In addition, Table 4 shows that a large number of companies identified their values; however, the rest of the related disclosures exhibited rather low scores. Within these low scores, a relatively higher number of companies disclosed who is involved in the management of culture and discussed the attitudes and behaviours of the company and their process to ensure alignment between behaviours and culture. However, considerably fewer companies explained what their values mean and how information relating to culture is passed to the board. Finally, very few companies reported on how the board monitors culture and how values guide the board's decision-making.

Only a few companies explained what their values mean and how information relating to culture is passed to the board.

Table 4: Principle One – Values and culture	No (%) of disclosing companies
Q1. Does the company disclose its culture? (0/1)	178 (51%)
Q2. Does the company:	
a. identify its values (i.e. a list of values)? (0/1)	145 (42%)
b. explain what its values mean? (0/1)	59 (17%)
c. explain how values guide decision-making at the board level? (0/1)	5 (1%)
d. discuss its attitudes and/or behaviours? (0/1)	76 (22%)
e. discuss the process in place to ensure that behaviours are aligned with culture? (0/1)	93 (27%)
f. discuss who is involved in the management of culture? (0/1)	99 (28%)
g. discuss how information relating to culture is passed to the board? (0/1)	46 (13%)
h. discuss how the board monitors the company's culture? (0/1)	18 (5%)

Strategy

The final area within Principle One – 'Strategy' – exhibits similar disclosure scores to values and culture, with an average disclosure score of 22%. Slightly more than half of the companies (51%) were found to explicitly discuss issues relating to strategy. The review of the corporate strategy disclosures revealed that 16 companies (5%) provided commentary that could potentially fall into this area without, however, explicitly referring to strategy. The remaining 44% did not provide any information about their strategy. We also found that only a few companies provided additional reporting on how strategy aligns with other matters, as shown in Table 5.

Table 5: Principle One – Strategy	No (%) of disclosing companies
Q1. Does the company disclose its strategy? (0/1)	177 (51%)
Q2. Does the company discuss:	
a. how it implements its strategy throughout the organisation? (0/1)	63 (18%)
b. the connection between its strategy and its purpose? (0/1)	37 (11%)
c. the connection between its strategy and its culture? (0/1)	26 (7%)

A good example of the disclosure of a company's strategy comes from Ageas Insurance Limited:

This purpose, as well as the Ageas Group-wide values of 'Care, Dare, Deliver and Share', form the basis of the Ageas Connect UK 2020 strategy set by the Ageas UK Boards and are embedded into Ageas UK's way of working. The purpose and values underpin Ageas UK's strategic priorities of 'Grow', 'Modernise', 'One Business' and 'Winning Team'.

Ageas Insurance Limited, Annual Report, April 2020, p.7

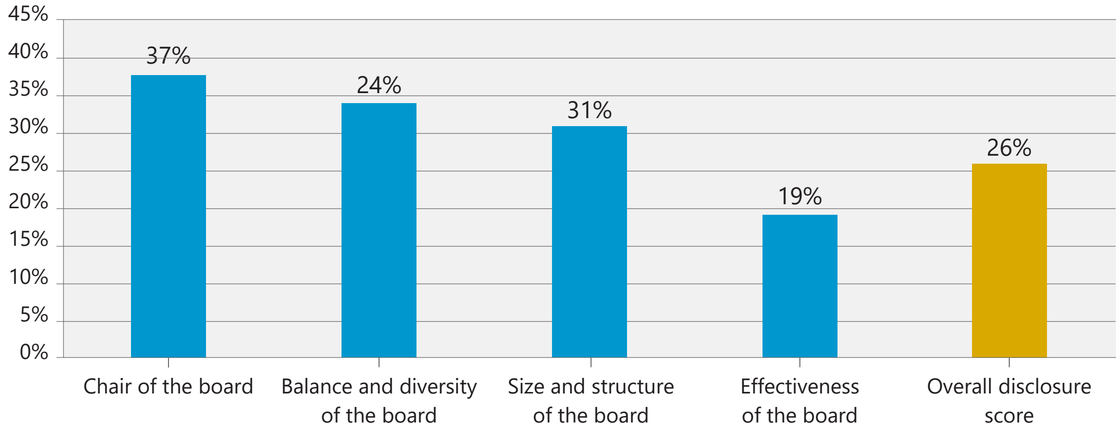
Principle Two: **Board Composition**

Principle Two introduces recommendations for companies in relation to board composition, stating that:

Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.

We found an average disclosure score of 26% for Principle Two. Out of the four areas identified within the guidance for this Principle, there was a relatively greater extent of disclosure related to the chair of the board, but less on the size and structure of the board, and substantially less discussion about the balance, diversity and effectiveness of the board (Figure 9). See Figure 8 for details.

Figure 9: Principle Two – Overall disclosure score and breakdown by area



Note: For the area 'Chair of the board', items in AQ2 were not applicable to seven companies as they did not have a Chair. Therefore, for these seven companies, the score for 'Chair of the board' was computed by considering only the disclosure made in AQ1.

The chair

More than half of the companies disclosed some information about the chair of their board. Interestingly, this figure was marginally less where the chair was also the Chief Executive Officer of the board. Only ten companies discussed how the chair promotes open debate and facilitates constructive discussion within the board (Table 6).

More than half of the companies disclosed some information about the chair of their board.

Table 6: Principle Two – Disclosures related to the chair of the board	No (%) of disclosing companies
AQ1. Does the company disclose information about the chair? (0/1)	202 (58%)
AQ2. Does the company discuss [(a)]:	
a. what the role and responsibilities of the chair are? (0/1/NA)	104 (31%)
b. how the chair promotes open debate and facilitates constructive discussion? (0/1/NA)	10 (3%)
c. whether the chair is also the CEO? (0/1/NA)	177 (52%)

(a) The AQ2 disclosure items for the chair of the board for seven companies were not applicable as these companies report that they do not have a chair.

Heathrow Finance PLC is a good example of a company that provides extensive disclosure in relation to the chair. The company clearly explains that the roles of the Chair and Chief Executive Officer are separate and that:

the Chairman is responsible for: leading and managing the HAHL Board, its effectiveness and governance; ensuring HAHL Board members are aware of and understand the views of key stakeholders; helping set the tone from the top in terms of the purpose, goal, vision and values for the whole organisation; and creating the conditions for overall Board effectiveness.

Heathrow Finance PLC, Annual Report, February 2020, p.90

The company also explained how the chair promotes open debate and facilitates constructive discussion by stating that the Chairman is:

responsible for ensuring that Directors receive accurate, timely and clear information. To ensure that adequate time is available for Board discussion and to enable informed decision-making, briefing papers are prepared and circulated to Directors a week prior to scheduled HAHL Board meetings.

Heathrow Finance PLC, Annual Report, February 2020, p.93

Balance and diversity

As Table 7 shows, 260 (75%) companies disclosed general information about their board's balance and diversity. However, only a small fraction of these discussed how the directors' characteristics allow the board to achieve effective decision-making and how the board understands the company's business needs and stakeholder interests.

The picture is better when it comes to companies disclosing information about their efforts to promote diversity in board membership and whether they have a company-wide diversity and inclusion policy. Finally, although many public companies usually refer to the Hampton-Alexander review, very few Wates reporting companies did so.

Table 7: Principle Two – Disclosures related to the balance and diversity of the board	No (%) of disclosing companies
BQ1. Does the company disclose information about its board's diversity? (0/1)	260 (75%)
BQ2. Does the company discuss:	
a. the set of characteristics that allow the board to achieve effective decision-making? (0/1)	41 (12%)
b. how the board understands the company's business needs and stakeholder interests? (0/1)	42 (12%)
c. the efforts to promote diversity in the board? (0/1)	93 (27%)
d. a broad company diversity and inclusion policy? (0/1)	98 (28%)
e. specific targets; e.g. those related to the Hampton-Alexander review (gender diversity) and McGregor-Smith review (ethnic diversity)? (0/1)	21 (6%)
f. any examples of initiatives started/groups created to promote diversity and inclusion? (0/1)	29 (8%)

Nomura International PLC was one of the few companies that provided extensive disclosure in relation to the balance and diversity of the board, as shown in the following statement:

The Board is committed to providing equal opportunities and ensures all Board members are aware of their obligations in ensuring that the Company's environment retains a culture which is conducive to good working and high performance. The Nomura Group is committed to providing equal opportunities throughout its Board appointments, including in the recruitment, training and development of Board members. The Company set a target in 2015 to appoint two female Board members by 2018, which was exceeded with the appointment of three female Board members by 2018. The NEHS Governance and Nomination Committee leads the process of identifying and nominating candidates for appointment to the Board, ensuring appropriate actions are taken to further broaden the diversity of the Board and to nominate candidates for appointment based on merit and assessment against objective criteria.

Nomura International PLC, Annual Report, March 2020, p.16

Another example of a company that provided detailed disclosures about board diversity is JPMorgan Securities PLC: it reported that it has not yet achieved its set target for women's representation in the board.

In 2014 the JPMorgan Chase group set an internal target to achieve 30% representation of women on its boards in EMEA. The Company has formally adopted this target in a diversity statement approved by the Board and included in the terms of reference of its Nominations Committee. At 31 December 2019, female directors represented 27% of the Board.

JPMorgan Securities PLC, Annual Report, April 2020, p.47

Size and structure of the board

Most companies disclosed some general information about the board's size and structure. Table 8 shows that three-quarters of the companies provided some type of disclosure in this area. Nevertheless, fewer companies provided a discussion on how they evaluated the suitability of their board's size and structure. This figure is further reduced when considering how the size and structure of the board facilitated constructive challenge and effective decision-making. A significant number of companies disclosed whether they had an independent non-executive director on the board, but very few discussed the procedure to appoint non-executive directors or their roles.

Table 8: Principle Two – Disclosures related to the size and structure of the board

		No (%) of disclosing companies
CQ1.	Does the company disclose information about its board's size/structure? (0/1)	261 (75%)
CQ2.	Does the company discuss:	
	a. considerations made to evaluate the suitability of the board's size and structure? (0/1)	80 (23%)
	b. how the size and structure of the board facilitates constructive challenge and effective decision-making? (0/1)	68 (20%)
	c. the presence of independent non-executive directors? (0/1)	148 (43%)
	d. the procedure to appoint non-executive directors? (0/1)	38 (11%)
	e. the role of non-executive directors? (0/1)	51 (15%)

Heathrow Finance PLC is a good example of a company that provided extensive disclosure in relation to the size and structure of the board:

> **The HAHL Board believe that its size and composition are appropriate to meet the strategic needs and challenges of the business and to enable effective decision-making. The composition of the HAHL Board is partly determined by the Shareholders' Agreement, which provides that each Shareholder controlling ten per cent or more of the issued ordinary shares of FGP Topco Limited, is entitled to appoint one director to the HAHL Board. It is considered to be in the interests of the HAHL Group for each Shareholder to be represented on the HAHL Board. In addition, there are four independent Non-Executive Directors whose purpose is to challenge and provide external expertise. The HAHL Board does not have a majority of independent Non-Executive Directors and it is felt that the numbers associated with ensuring a majority of independent Non-Executive Directors would make the HAHL Board unwieldy and unduly costly.**
>
> Heathrow Finance PLC, Annual Report, December 2019, p. 93

Most companies disclosed some general information about the board's size and structure.

Effectiveness

Consideration of board effectiveness was the element with the lowest disclosure score. As shown in Table 9, less than half of companies disclosed general information about board effectiveness. This number is further reduced when we assessed whether companies disclosed how they evaluated their board's effectiveness, including whether there were any actions taken following an evaluation.

Very few companies disclosed information about the procedures in place to guarantee directors' objectivity. We were surprised that a relatively low number of companies disclosed the procedures in place for supporting the professional development of their directors. In the cases where this was described, there was no narrative relating to how directors embraced such opportunities.

Very few companies disclosed information about the procedures in place to guarantee directors' objectivity.

Table 9: Principle Two – Disclosures related to the effectiveness of the board

	No (%) of disclosing companies
DQ1. Does the company disclose information about its board effectiveness? (0/1)	160 (46%)
DQ2. Does the company discuss:	
a. how it evaluates its board's effectiveness? (0/1)	95 (27%)
b. how the board acts on the evaluation? (0/1)	14 (4%)
c. the procedures in place to guarantee its directors' objectivity? (0/1)	7 (2%)
d. the procedures in place for its board's professional development? (0/1)	113 (32%)
e. how directors embrace professional development opportunities? (0/1)	0 (0%)

Yorkshire Water Services Limited is the company that provided the most extensive disclosure in this area, disclosing five items that we assessed companies against out of the total of six. The annual report[13] included a detailed section in which the company discussed the processes and procedures in place to foster the effectiveness of the board.

13 See p. 92 of https://www.yorkshirewater.com/media/4xbdos0n/final-yw-arfs-1920-print-version.pdf

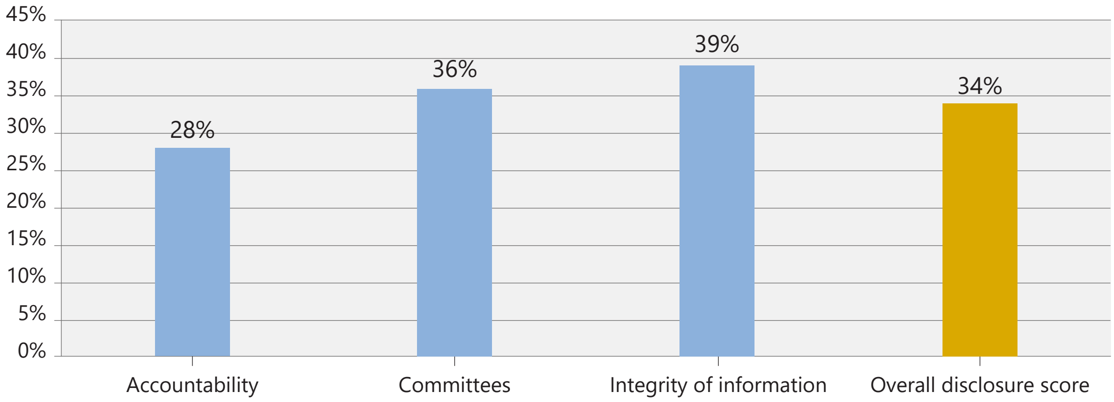
Principle Three: **Director Responsibilities**

Principle Three aims at promoting the board and directors' accountability and effective decision-making, stating that:

The board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge.

Figure 10 shows the breakdown of the disclosure score for Principle Three into three main areas: accountability, committees and integrity of information. The average disclosure score for Principle Three was 34%.

Figure 10: Principle Three – Overall disclosure score and breakdown by area



Note: For the area 'Committees', items in BQ2 were not applicable to 84 companies that did not report having committees. Therefore, for these 84 companies, the score for 'Committees' was computed by considering only the disclosure made in BQ1.

Accountability

Around 80% of the companies disclosed at least some general information related to the accountability of their directors (see Table 10). Focusing on specific information about accountability, the items disclosed the most are related to how the board established and maintained corporate governance practices that provided clear lines of accountability and responsibility, followed by a discussion of the policies in place to identify and manage conflicts of interest and the lines of accountability for the directors. Fewer companies provided information on the processes in place to periodically review the governance processes, the policies in place to clarify the relationship between the company and its owners, and the lines of accountability for the board as a whole. Only one company disclosed information about the actions taken as the result of the governance review processes; five companies disclosed the actions that they will take in the future as the result of these processes.

Around 80% of the companies disclosed at least some general information related to the accountability of their directors

Table 10: Principle Three – Disclosures related to accountability		No (%) of disclosing companies
AQ1.	Does the company disclose information about accountability? (0/1)	279 (80%)
AQ2.	Does the company discuss:	
	a. the lines of accountability for the board as a whole? (0/1)	30 (9%)
	b. the lines of accountability for the directors? (0/1)	135 (39%)
	c. how the board establishes and maintains corporate governance practices that provide clear lines of accountability and responsibility? (0/1)	165 (47%)
	d. the policies in place to identify and manage conflicts of interest? (0/1)	140 (40%)
	e. the process in place to periodically review the governance processes? (0/1)	71 (20%)
	f. any outcomes of its review process looking back? (0/1)	1 (0%)
	g. any outcomes of its review process looking forward? (0/1)	5 (1%)
	h. the corporate governance policies and practices in place to clarify the relationship between the company and its owners? (0/1)	49 (14%)

Cabot Credit Management Limited provided an example of good disclosure in relation to the accountability of the board and its directors, covering five of the eight items in that area. This is the only company that not only explained the processes in place to periodically review the governance process; it also discussed the outcomes of these review processes looking back and looking forward, as shown in the following statement:

The Holdco Board and individual directors have a clear understanding of their accountability and responsibilities and policies and procedures support effective decision-making and independent challenge. As part of our Governance review this year, we conducted a thorough review of the allocation and responsibility across the Holdco Board in relation to risk and compliance, audit and remuneration. As a result, we separated our audit and risk committee to ensure independent challenge and reviewed and updated our Terms of Reference for each Statutory Committee of the Holdco Board comprising an Audit Committee, a Risk & Compliance Committee and a Group Remuneration Committee. We also commenced the review of our Group Delegated Authorities Framework and have taken steps to simplify this and align it with the regulatory governance that we have put in place with the introduction of the Senior Managers and Certification Regime applicable to our UK regulated businesses. This work will continue into 2020. In addition to this, we also commenced a review of our operational governance framework, which includes a review of our policies, and this work will continue into 2020.

Cabot Credit Management Limited, Annual Report, December 2019, p.14

A high number of companies disclosed information about the decision to delegate some functions of the board to committees.

Committees

The second area within Principle Three relates to board committees. Table 11 shows that a high number of companies disclosed information about the decision to delegate some functions of the board to committees. When focusing on specific information about committees, our findings show that most of these companies provided information about the functions and authorities delegated to the committees. A relatively small number of companies discussed the means adopted to ensure independence, and even fewer explained how these means have improved decision-making. Finally, a small number of companies provided disclosures in relation to the experience/skills of the committee members; such disclosures may help readers to understand the suitability of individuals chosen for the committees.

Table 11: Principle Three – Disclosures related to committees

	No (%) of disclosing companies
BQ1. Does the company disclose the delegation of some board functions to committees? (0/1)	264 (76%)
BQ2. Does the company discuss[(a)]:	
a. the functions and authorities delegated to the committees? (0/1/NA)	206 (78%)
b. the means adopted to ensure independence of the committees? (0/1/NA)	75 (28%)
c. how these means have improved decision decision-making? (0/1/NA)	34 (13%)
d. if members have relevant experience/skills? (0/1/NA)	42 (16%)

(a) BQ2 disclosure items for committees were not applicable for 84 companies, as these companies did not set up any committee.

Dyson Technology Limited was one of the companies that provided extensive disclosure on the delegation of functions to committees. The following statement shows how Dyson explained the means adopted to ensure the independence of the committees and how these means improved decision-making:

> **The Independent NEDs are wholly independent in that they have no material business or relationships with Dyson that might influence their independent judgement. In addition, certain governance responsibilities are delegated to other Board committees (Audit, Remuneration and Treasury). These committees include Independent NEDs, together with the Dyson family, who support effective decision-making and to challenge constructively management's decisions … The Independent NEDs constructively challenge and help develop strategy and review business performance (including the performance of senior management) against the agreed goals and objectives.**
>
> Dyson Technology Limited, Annual Report, December 2019, pp. 5–6

Integrity of information

We found that 70% of companies provided some general disclosure in relation to this area by reporting on the main source of information used by the board (see Table 12). Almost half of the companies explained how their information systems ensured the quality and integrity of information. In addition, many disclosed who was in charge of the assurance of the company's control systems and supporting policies, and if the internal audit supported the integrity of information. In relation to reporting on the type of information system in place, companies exhibited a very low level of disclosure.

Table 12: Principle Three – Integrity of information	No (%) of disclosing companies
CQ1. Does the company disclose the sources of information its board relies on? (0/1)	245 (70%)
CQ2. Does the company discuss:	
a. the information systems it has in place? (0/1)	10 (3%)
b. how the information systems ensure the quality and integrity of the information provided? (0/1)	158 (45%)
c. if the internal audit supports integrity of information? (0/1)	112 (32%)
d. who assures the company's control systems/policies (internally or externally)? (0/1)	147 (42%)

DPDgroup UK Ltd is an example of a company that provided good disclosure in relation to the integrity of information:

The SMT receives regular and timely information on financial and non-financial performance, supported by Key Performance Indicators ('KPIs'). Analysts provide the SMT with specific information requests, and have the necessary processes to ensure the integrity of the information. Key financial information is collated from the Company's accounting systems.

The Company's Finance function is appropriately qualified to ensure the integrity of this information and is provided with the necessary training to keep up to date with regulatory changes. Financial information is externally audited and financial controls are reviewed by the Company's internal audit function.

DPD Group UK Limited, Annual Report, December 2019, p. 7

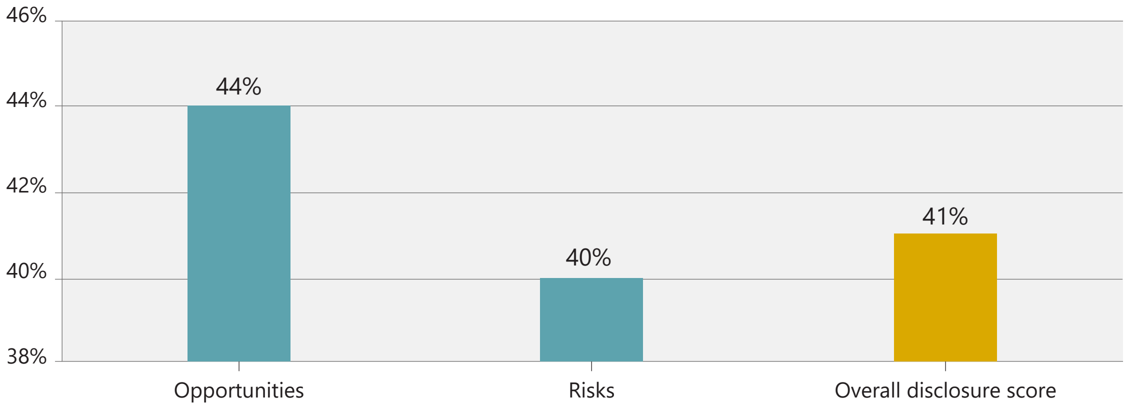
Principle Four: **Opportunities and Risk**

Principle Four introduces recommendations in relation to the processes in place to identify opportunities to promote long-term value creation and manage risks. It reads as follows:

A board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks.

The overall disclosure score for Principle Four is 41% (see Figure 11), which was the highest among all six Principles. Figure 11 also reports the breakdown of Principle Four's recommendations into the two main areas covered by the principle; that is, opportunities and risk, with significantly more disclosure being provided for opportunities than for risks.

Figure 11: Principle Four – Overall disclosure score and breakdown by area



The difference between the two areas reflects the fact that the guidance related to opportunities is more general, allowing companies more discretion. In contrast, the guidance related to risks and responsibilities is more detailed and well established, and, therefore, more specific information is needed to obtain higher scores.

Indeed, when we considered the first item of the disclosure score for the two areas (see items AQ1 in Table 13 and BQ1 in Table 14), which evaluates the presence of generic information on risks and opportunities, we found the opposite trend. Overall, more companies provided at least some general information about their risk management practices than provided at least some general information about their opportunities.

The overall disclosure score for Principle Four is 41%, which was the highest among all six Principles.

Opportunities

General information about corporate opportunities was disclosed by 74% of Wates Reporting companies. However, specific information was disclosed by significantly fewer. The processes by which future opportunities are identified were discussed by less than half of the companies, while slightly more companies provided information on the role of the board in considering and assessing how the company creates value over the long term (see Table 13). The disclosure of examples of the opportunities discussed at the board level was provided by a limited number of companies.

General information about corporate opportunities was disclosed by 74% of Wates Reporting companies.

Table 13: Principle Four – Disclosures related to opportunities

		No (%) of disclosing companies
AQ1.	Does the company disclose information about its opportunities? (0/1)	256 (74%)
AQ2.	Does the company discuss:	
	a. what processes the company has in place to identify future opportunities? (0/1)	149 (43%)
	b. how the board is involved in considering and assessing how the company creates value over the long term? (0/1)	170 (49%)
	c. examples of opportunities discussed at board level? (0/1)	38 (11%)

Western Power Distribution PLC and the companies within the group are examples of companies that provided extensive disclosure in relation to opportunities. Western Power Distribution PLC clearly disclosed the processes in place to identify opportunities, provided information about the role that the board plays in relation to the identification of opportunities and long-term value creation, and gave several examples of opportunities that were discussed at board level, as shown in the extract below:

> **The Board is constantly engaged in considering technological advances and is invested in the development of smarter ways of working throughout the business. Publication of our DSO plan and the launching of a new brand, 'Flexible Power', to seek market-provided sources of flexibility (which will allow us to accommodate increasing demand for electricity without having to build a larger network), are recent examples of how innovation and technology can be harnessed to create business opportunities through efficiently meeting the needs of our stakeholders.**
>
> Western Power Distribution PLC, Annual Report, March 2020, pp. 23

A significant number of companies provided information about the internal channels used to communicate information on principal risks and risk appetite.

Risks

With regards to risks, Table 14 shows that most of the companies disclosed very general information about corporate risks and risk management. The most detailed disclosures related to the roles and responsibilities in the risk monitoring and review processes, and to the development of the company's risk management systems. A significant number of companies provided information about the internal channels used to communicate information on principal risks and risk appetite. Very few companies disclosed information about the use of scenario analysis in their risk management or the external channels used to communicate risk information.

Table 14: Principle Four – Disclosures related to risks		No (%) of disclosing companies
BQ1.	Does the company disclose information about its risk management? (0/1)	314 (90%)
BQ2.	Does the company discuss:	
	a. its material/principal risks? (0/1)	118 (34%)
	b. the use of a scenario analysis in its risk assessment? (0/1)	20 (6%)
	c. roles and responsibilities in relation to developing the company's risk management systems? (0/1)	203 (58%)
	d. roles and responsibilities in relation to determining the nature and extent of the company's principal risks? (0/1)	108 (31%)
	e. roles and responsibilities in relation to determining its 'risk appetite'? (0/1)	90 (26%)
	f. its internal communication channels on risk information? (0/1)	153 (44%)
	g. its external communication channels on risk information? (0/1)	12 (3%)
	h. roles and responsibilities in relation to agreeing a monitoring and review process? (0/1)	229 (66%)

Allianz Holding PLC represents an example of a company that provided extensive information in relation to the corporate governance arrangements in place for risk management. It clearly explained that the Chief Risk Officer (CRO) and the Board Risk Committee (BRiCo) were responsible for the risk management systems of the company. It also clarified that the assessment and identification of the company's principal risks lies with the Risk Department, which facilitated these processes with the Management Board and the senior managers, while the board was responsible for setting and revising the risk appetite.

The company also provided information about the internal and external communication channels on risk information. Information about the principal risks was provided via clear cross-references to the Risk and Capital Management section of the annual report (see Allianz Holding PLC, Annual Report, December 2019, pp. 35–36).

Principle Five: Remuneration

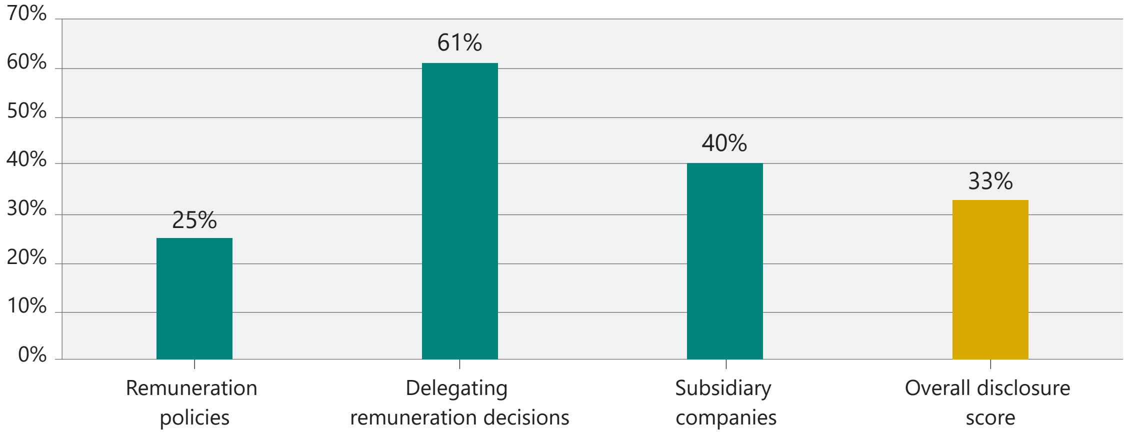
Principle Five introduces the recommendation to link executive pay with the long-term sustainable success of a company. It reads:

> **A board should promote executive remuneration structures aligned to the long-term sustainable success of a company, taking into account pay and conditions elsewhere in the company.**

Figure 12 shows the disclosure score for Principle Five broken down into three main areas, that is, remuneration policies, delegating remuneration decisions, and subsidiary companies. The overall disclosure score for Principle Five was just 33%.

Our findings show that companies provided more information about discussion over the delegation of remuneration decisions and, if a subsidiary, on the remuneration practices adopted by the parent company. Generally, remuneration policies were not widely disclosed, with only around a quarter of the companies using the Wates Principles reporting on this.

Figure 12: Principle Five – Overall disclosure score and breakdown by area



Note: For the area 'Delegating remuneration decisions', item BQ2b was not applicable to 240 companies that did not set up a remuneration committee. Therefore, for these 240 companies, the 'Delegating remuneration decisions' score was computed by considering only the disclosure made in BQ1 and BQ2a. The area 'Subsidiary companies' (CQ1 and CQ2) was not relevant to 55 companies that were not subsidiaries. In addition the CQ2 item was not relevant to a further five companies that, although they were subsidiaries, did not rely on their parents' remuneration policy.

Remuneration policies

General information on remuneration policies was provided by most of the companies, as shown in Table 15. However, when focusing on specific information about remuneration policies, our findings show that the extent of the disclosure provided tended to be substantially lower. Several companies provided information about how their remuneration policies took into account practices in the sector and the company's response to matters such as any gender pay gap. A similar number of companies disclosed whether policies took into account the broader operating context and how their remuneration structures for directors and senior managers were aligned with the company's performance. Fewer companies explained their rationale on remuneration structures, their consideration of risks in relation to the remuneration levels and the pay ratios considered. Most of the companies did not provide any disclosures about the alignment of remuneration structures for directors and senior managers with the company's purpose/values/strategy and examples of the remuneration decision-making process. Overall, the average disclosure score for remuneration policies was 25%.

Table 15: Principle Five – Disclosures related to remuneration policies

		No (%) of disclosing companies
AQ1.	Does the company disclose information about its remuneration policies? (0/1)	270 (78%)
AQ2.	Does the company discuss:	
	a. how the remuneration structures for directors and senior managers are aligned with the company's performance? (0/1)	104 (30%)
	b. how the remuneration structures for directors and senior managers are aligned with the company's purpose/values/strategy? (0/1)	14 (4%)
	c. a rationale for or explanation of its remuneration structures? (0/1)	63 (18%)
	d. if the policies on remuneration structures and practices take account of the broader operating context within the company's wider workforce's pay and conditions? (0/1)	101 (29%)
	e. if the policies on remuneration structures and practices take account of the broader operating context and the company's response to matters such as any gender pay gap? (0/1)	120 (34%)
	f. how the company's remuneration policies take account of practices in the sector? (0/1)	114 (33%)
	g. pay ratios on a voluntary basis (e.g. gender pay ratio/manager–employee ratio)? (0/1)	34 (10%)
	h. if remuneration levels take risks into account? (0/1)	47 (14%)
	i. examples of the remuneration decision-making process? (0/1)	6 (2%)

Overall, the average disclosure score for remuneration policies was 25%.

Yorkshire Water Services Limited provided the most extensive disclosure in this area. The annual report included a detailed section[14] on p. 116, appropriately cross-referenced, where the company provided a report of the company's remuneration policies. The report also provided detailed explanations of all the items analysed. This company is one of the few that provided an example of the decision-making processes used for remuneration by illustrating in detail how the board reviewed the remuneration policy for executive directors.[15]

14 See p. 116 of https://www.yorkshirewater.com/media/4xbdos0n/final-yw-arfs-1920-print-version.pdf
15 See Yorkshire Water Services Limited, Annual Report, March 2020, pp. 112–113.

Delegating remuneration decisions

Table 16 shows that most of the companies provided some general information about delegating remuneration decisions. When we analysed the disclosures about this area in more detail, we found that a rather large number of companies discussed whether there was a remuneration committee. Moreover, a significant number of companies discussed the independence of the remuneration committee members.

Table 16: Disclosures related to delegating remuneration decisions	No (%) of disclosing companies
BQ1. Does the company disclose information about remuneration decisions? (0/1)	265 (76%)
BQ2. Does the company discuss:	
a. whether there is a remuneration committee? (0/1)	207 (59%)
b. if the company has a remuneration committee, does it discuss the independence of its members? (0/1/NA)[(a)]	40 (37%)

(a) Item BQ2b was applicable to only 108 companies, as the remaining 240 companies do not have a remuneration committee.

Subsidiary companies

Most subsidiaries disclosed whether they relied on their parent's remuneration policy.

The last area of disclosures within Principle Five focuses on subsidiaries, with the aim of evaluating whether subsidiary companies discuss whether, and how, they rely on their parents' remuneration policies. Among the 348 companies that applied the Wates Principles, we used several sources (including annual reports, company websites and the Fame database) to identify subsidiary companies. We found that 293 companies are subsidiaries.

Table 17 shows that, overall, most of these companies disclosed whether they relied on their parents' policy; however, only a few provided cross-references to the parent company's remuneration policy in their corporate governance statement. This finding is in line with the other findings of our research, which reveal a weak use of cross-references.

Table 17: Principle Five – Disclosures related to subsidiary companies	No (%) of disclosing companies
CQ1. If the company is a subsidiary, does it rely on its parent's policy? (0/1/NA)	193 (66%)
CQ2. If yes, is there any cross-reference in the corporate governance statement to the parent company's policy in relation to the subsidiary? (0/1/NA)	40 (14%)

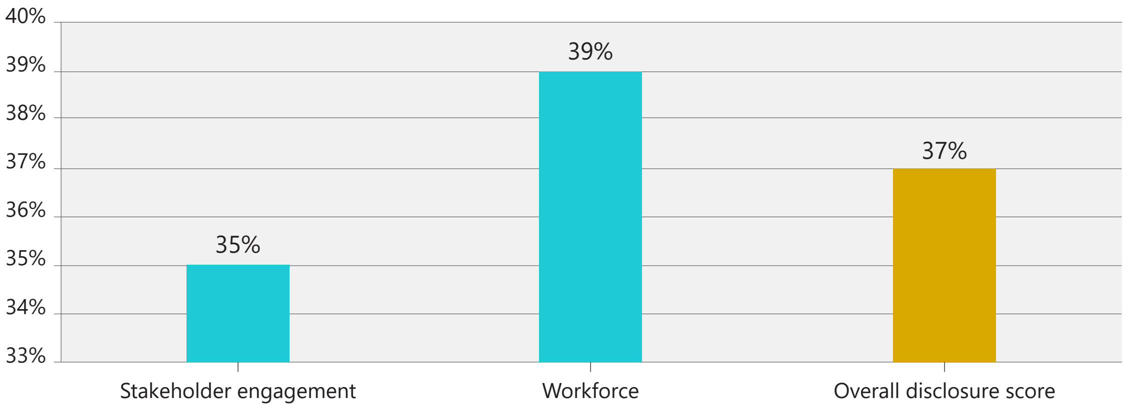
Principle Six: Stakeholder relationships and engagement

Principle Six introduces recommendations aimed at promoting effective relationships and engagement with corporate stakeholders, including the workforce. It reads as follows:

Directors should foster effective stakeholder relationships aligned to the company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.

The overall level of disclosure for Principle Six was in line with that of the other Wates Principles. On average, companies disclosed around 37% of the items recommended by Principle Six. Figure 13 reports the breakdown of Principle Six's recommendations into its two main areas: stakeholder engagement and workforce. It shows that slightly higher disclosure was provided in relation to workforce than stakeholder engagement.

Figure 13: Principle Six – Overall disclosure score and breakdown by area



Note: For the area 'Workforce', all items were not applicable to 22 companies which were found not to have any employees. Therefore, the 'Workforce' score was obtained by considering only 326 companies.

Stakeholder engagement

General information about stakeholder engagement was disclosed by almost all the companies (see Table 18). A very high number of companies also provided details about who their key stakeholders are, and more than half illustrated the channels used to receive feedback from them.

More specific information about stakeholder engagement practices was reported less often. Only 20% of the companies discussed the dialogue that the board had with stakeholders to predict future developments and trends and realign strategy, whereas only 10% of companies provided information on the international standards or frameworks followed on environmental, social and/or community impact. This low number was not unexpected, as frameworks and standards continue to emerge and develop.

A very high number of companies provided details about who their key stakeholders are, but only 20% of them discussed the dialogue that the board had with these stakeholders.

Fewer companies provided information in relation to the dialogue that the board had with stakeholders to understand the effects of company policies and practices, whether any dialogue with stakeholders impacted board decision-making, and how such engagement had helped to inform decisions at board level.

Table 18: Principle Six – Disclosures related to stakeholder engagement

	No (%) of disclosing companies
AQ1. Does the company disclose information about its relationship and engagement with its stakeholders? (0/1)	318 (91%)
AQ2. Does the company discuss:	
a. who its stakeholders are? (0/1)	300 (86%)
b. what dialogue the board has with stakeholders (excluding the workforce) to understand the effects of company policies and practices? (0/1)	27 (8%)
c. what dialogue the board has with stakeholders (excluding the workforce) to predict future developments and trends and realign strategy? (0/1)	70 (20%)
d. how this dialogue with stakeholders (excluding the workforce) has impacted board decision-making? (0/1)	21 (6%)
e. what formal and informal channels there are to receive appropriate feedback from stakeholder discussions (excluding the workforce)? (0/1)	195 (56%)
f. if they follow international standards or frameworks on environmental, social and/or community impact? (0/1)	35 (10%)
g. examples of how engagement has helped inform decisions at board level? (0/1)	20 (6%)

The companies that are part of Lloyds Banking Group (Bank of Scotland PLC, HBOS PLC and Lloyds Bank PLC) are examples of companies that provided good disclosures in relation to stakeholder engagement. These companies provided a brief description in their corporate governance statement of how they have applied Principle Six in relation to stakeholder engagement and cross-referenced this to the Section 172(1) Statement, where they provided detailed information on how they engaged with their stakeholders. The statement below describes how engagement with stakeholders has helped Lloyds Bank PLC to inform the board's decisions in relation to EU exit preparations:

Given the Bank's UK focus, our performance is inextricably linked to the health of the UK economy, and throughout 2019 the Bank continued to prepare for an EU exit. Given the importance of this topic for the Bank and the country, numerous stakeholders were engaged to inform our approach, including customers, colleagues, shareholders, suppliers, regulators and government. As part of this engagement process, the Chairman was an active member of CityUK's EU exit Steering Group, working with other major financial institutions to inform government decision-making. The extended EU Exit Executive Forum was established, chaired by the Chief Financial Officer, with comprehensive cross-organisation representation, to provide an update to the Board on EU exit contingency planning. Additional updates from the EU Exit Forum were also submitted to the Board Risk Committee and the Executive level Group Risk Committee. Engagement was also undertaken with politicians, officials, media, trade and other bodies to reassure on commitments to Helping Britain Prosper..

Lloyds Bank PLC, Annual Report, December 2019, p.10

Workforce

The last area of disclosures within Principle Six concerns the relationships that companies have with their workforce. Since 22 companies did not have any employees, these companies were not considered in the analysis of this Principle. A very high proportion of companies provided some general information about the relationship with their workforce (see Table 19). Only some companies provided specific information on this relationship, with the channels used to receive feedback from the workforce and the procedures for employees to raise concerns being the most disclosed items.

As for stakeholders, far fewer companies disclosed detailed information about the type of dialogue that the board had with its workforce. Information about the dialogue that the board had with the workforce to understand the effects of company policies and practices was disclosed by 18% of companies, while information about the dialogue to predict future developments and trends and realign strategy was disclosed by 13%. The lowest level of disclosure in this area was about how the dialogue with the workforce had impacted board decision-making.

Table 19: Principle Six – Disclosures related to the workforce

		No (%) of disclosing companies[a]
BQ1.	Does the company disclose information about its relationship and engagement with its workforce?	288 (88%)
BQ2.	Does the company discuss:	
	a. what dialogue the board has with the workforce to understand the effects of company policies and practices?	60 (18%)
	b. what dialogue the board has with the workforce to predict future developments and trends and/or realign strategy?	42 (13%)
	c. how this dialogue has impacted board decision-making?	28 (9%)
	d. what formal and informal channels are used to facilitate a meaningful two-way dialogue with the workforce to share ideas and concerns with senior management?	221 (68%)
	e. what procedures are in place for raising concerns (e.g. speaking up and whistle-blowing policies)?	127 (39%)

(a) The items in this area are not applicable for 22 companies, as these companies were found not to have any employees.

A good example of a company that provided details of how it engaged with its workforce is Ageas Insurance Limited. The following statement shows how the company used a number of channels to facilitate a meaningful two-way dialogue with its workforce:

The Company keeps employees up to date on strategy and performance through a variety of channels, including formal leadership events, employee briefings, the Employee Forum and a digital employee communication tool. Regular meetings with the Employee Forum have continued on a quarterly basis, and are supported by the HR Director and members of the UK Executive team, facilitating the escalation and cascade of key messages from and to the Executive team and the Ageas UK Boards. The Ageas UK Boards have agreed that the Chair of the Remuneration Committee, an INED, will attend the Employee Forum on an annual basis and meet twice yearly with the Chair of the Forum, without the Executive present, in order to enhance the engagement between the Employee Forum and the Ageas UK Boards.

Ageas Insurance Limited, December 2019, p.11

The lowest level of disclosure in relation to workforce engagement was about how the dialogue with the workforce had impacted board decision-making.

6. Cross-references

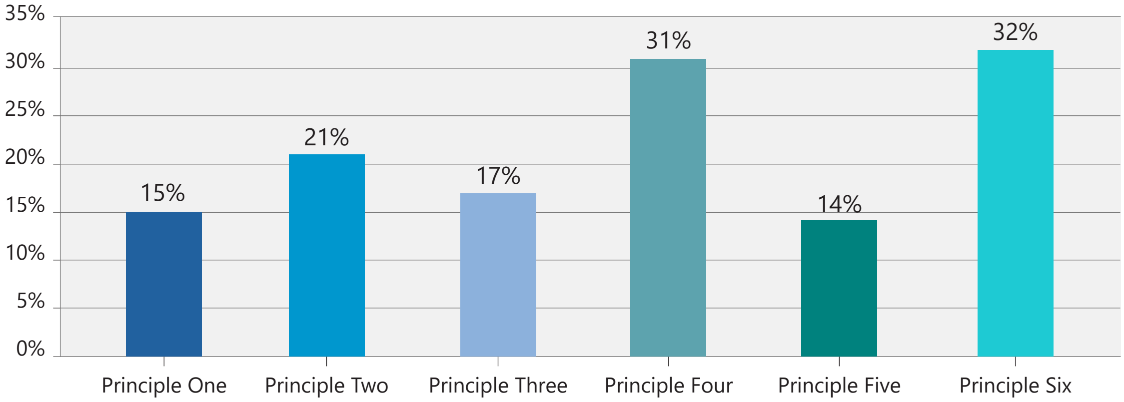
This last section discusses the use of cross-references to other parts of companies' annual reports that have been prepared following the Wates Principles. The Wates Principles highlight the importance of avoiding the duplication of information between different sections of the annual report, and for this reason encourage the use of cross-referencing.

Figure 14 shows how cross-references were used to disclose the information related to each of the Wates Principles. Principles Six and Four were found to be those for which cross-references were used the most, and Principles One and Five the least. Arguably, these results are not too surprising, given that Principle Six and Principle Four, focus on stakeholders and risk and opportunities. These are topics usually reported on in other parts of the annual report, such as Section 172 disclosures, the risk management report, or the strategic report, whereas information on board composition, directors' responsibilities, and remuneration are usually included within the corporate governance statement.

It is also important to note that the use of cross-references has a direct effect on the disclosure scores that companies have obtained for the six Principles. This is because in cases where a clear cross-reference was used for any Principle (e.g. referring to a page number), the referenced part of the annual report was also analysed to evaluate the extent of disclosure of the related principle.

Cross referring to other parts of the annual reports were mainly used when reporting on disclosing information on risk and stakeholders.

Figure 14: Use of cross-references to other parts of the annual report per Principle



For Principle Six, we also specifically looked for cross-references to Section 172. This is because explanations in support of applying Principle Six are closely aligned to other disclosure requirements of the Regulations within Section 172. We found that 29 companies prepared a unique section in which the Wates Principles were discussed together with Section 172. Of the remaining 319 companies, 112 (35%) used cross-references to Section 172 when explaining Principle Six.

7. Readability of corporate governance statements

The final dimensions analysed to assess the quality of the disclosures following the Wates Principles relate to the level of readability of the corporate governance statements produced by the companies that applied the Principles. Readability is defined as the ease of understanding a text due to the style of writing.

Table 20 provides an initial overview of the readability of these corporate governance statements by focusing on their length.[16] These statements were on average not very long (less than 2,000 words). However, the length of the statements varied considerably, from a low of 74 words to more than 11,000 words. Companies operating in the wholesale and retail trade; repair of motor vehicles and motorcycles industry were found to provide, on average, the shortest corporate governance statements, whereas those operating in electricity, gas, steam and air conditioning provided the longest statements.

Although it is interesting to see how long corporate governance statements are and make a comparison between sectors, we are not suggesting that length of disclosure equals a good quality disclosure. However, a statement of 74 words is unlikely to offer meaningful transparency on company governance to the reader.

Corporate Governance statements were on average not very long (less than 2,000 words).

Table 20: Descriptive statistics of the length of corporate governance statements written following the Wates Principles

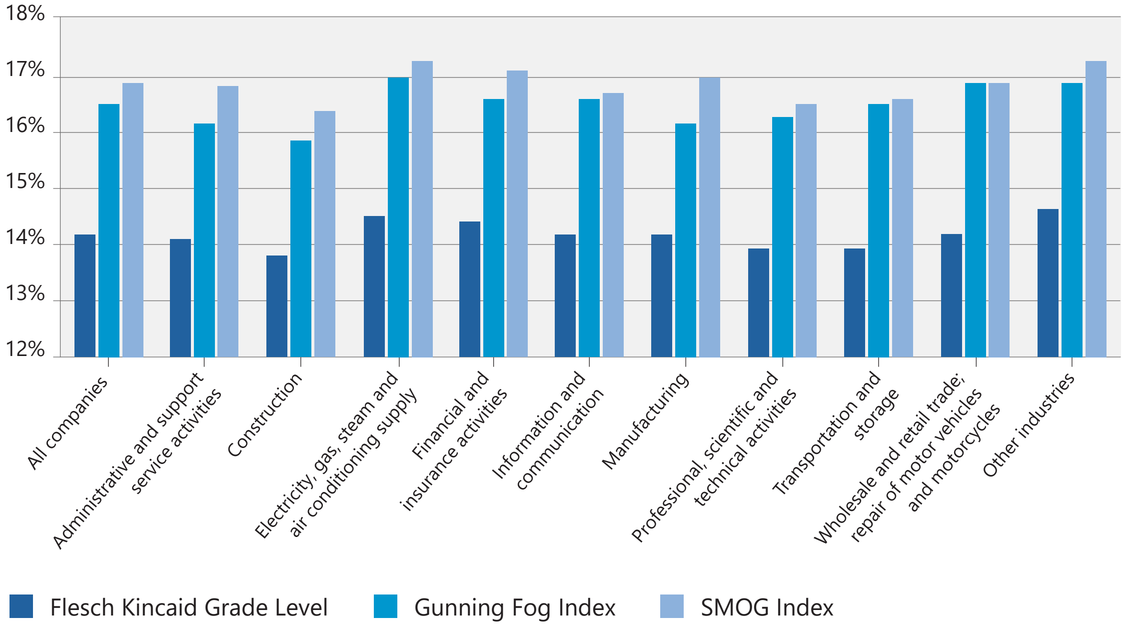
	No. of Words				
	N	Average	Min	Max	SD
Full sample	338	1,985	74	11,247	1,523
By industry					
Administrative and support service activities	38	1,770	82	6,531	1,349
Construction	14	2,247	430	4,387	1,365
Electricity, gas, steam and air conditioning supply	17	3,572	1,222	4,589	1,343
Financial and insurance activities	106	1,916	77	6,548	1,224
Information and communication	10	2,275	283	5,018	1,859
Manufacturing	27	1,643	74	7,562	1,495
Professional, scientific and technical activities	48	2,083	131	6,128	1,585
Transportation and storage	19	2,127	77	6,124	1,624
Wholesale and retail trade; repair of motor vehicles and motorcycles	34	1,352	261	3,864	972
Other industries	25	2,194	132	11,247	2,515

We used three scales to assess the readability of Wates corporate governance statements: the Flesch–Kincaid Grade Level, which shows the level of education needed to be able to understand the text, based on the US grade level of education; the Gunning Fog Index, which indicates the number of years of formal education needed to read and understand the text; and the SMOG index, which estimates the years of education that an average person needs to understand any piece of writing.

16 For the analysis of readability, 10 more companies were excluded as the format of their annual reports could not be processed.

Figure 15 presents the mean scores of the three readability scales. On average, the corporate governance statements of the companies analysed presented low readability scores on all three scales used. However, these scores are similar to those reported for other sections of UK companies' annual reports, such as the remuneration report,[17] the risk report[18] and the management commentary.[19] Applying the six Principles requires technical (and often complex) corporate governance arrangements. As a consequence, narratives discussing those arrangements were likely to exhibit low readability scores. As Figure 15 shows, the score for the Flesch–Kincaid Grade Level is around 14, indicating that understanding this sample of corporate governance statements would require 14 years of formal education. Such scores are indicative of texts that are difficult to read. Only three companies recorded a Flesch–Kincaid Grade Level lower than 10, indicating that they produced corporate governance statements that could be classified as easy to read. The other two readability metrics used paint a similar picture. Specifically, the average score of the Gunning Fog Index is found to be 16.5 (i.e. a reader would need 16.5 years of formal education to understand the content), whereas the average score of the SMOG index is found to be 17 (i.e. a reader would need 17 years of formal education to understand the content). Based on the above findings, it is inferred that the text of the average corporate governance statement analysed is difficult to read.[20]

Figure 15: Average levels of the readability rates of the corporate governance statements across industries



The analysis of the corporate governance statements' readability per industry reveals that there was no significant variation in the level of readability, measured using three readability indices, across the different industries studied.

17 Hooghiemstra, R., Kuang, Y. F., & Qin, B. (2017).
18 Linsley, P. M., & Lawrence, M. J. (2007).
19 Athanasakou, V., Eugster, F., Schleicher, T., & Walker, M. (2020).
20 See methodology section for more details on readability metrics.

8. Conclusions

This report provides evidence on (i) the adoption of the Wates Principles and other codes by the companies within the scope of the Companies (Miscellaneous Reporting) Regulations 2018, and (ii) for those companies that applied the Wates Principles, the application of each Principle and the quality of their corporate governance disclosure.

It was encouraging to see that the Wates Principles are widely adopted, with 348 companies applying them. Companies used different ways to signal their adherance to the Wates Principles. Although not all companies provided explicit statements to indicate a substantive adoption of the Wates Principles, explanations demonstrating an application of the Wates Principles were quite common.

Analysis suggests that disclosure practices are still in their infancy.

Our analysis suggests that disclosure practices are still in their infancy. This report has shown there is a wide variety of disclosure practices and has also highlighted that, while there were some companies that did report specific information, most of them limited their disclosures to generic statements about their corporate governance arrangements in relation to the six Principles. Most companies gave general commentary relating to individual Principles. These often lacked specific detail about how each Principle had been applied. However, this is less true for disclosures about corporate governance practices that have matured over the years; for example, the structure and composition of committees, the role of independent directors, and lines of accountability for directors. This could indicate that companies are still in a learning phase, and they may be developing their disclosure practice as their corporate governance arrangements evolve.

We would like to emphasise that we designed our disclosure index to measure the extent of disclosure by following the guidance contained in the Wates Principles. Hence, our analysis is limited to this type of information and may not capture additional disclosures that were not included in the coding scheme. Notwithstanding, we observed that companies provide good disclosures in terms of general information about their formal policies, for example in relation to remuneration policies or management of opportunities, but those disclosures were relatively absent in terms of explanations as to how they would apply these formal policies in practice.

Even though this report has found some good examples of reporting, there is still room for improvement.

In conclusion, our research project has outlined some positive aspects related to the first year of adoption of the Wates Principles; however, we have also indicated that there is much room for improvement. In particular, we would suggest that companies need to:

1. disclose more detailed information in relation to the application of the six Principles to provide readers with a comprehensive understanding of the corporate governance arrangements in place and how these are mapped to the respective Principles;

2. discuss more instances and/or circumstances relating to a given corporate governance practice to evidence how they have applied the Principles; and

3. use more cross-references, as in several cases the disclosure of some items could be found in other sections of the annual reports, but these were difficult to track down without the provision of cross-references.

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Appendix 1: Research Methodology

This research project was divided into two parts:

- Part A identified: a) the presence of a corporate governance statement within the annual report, b) the application of a known corporate governance code and c) any alternative corporate governance arrangements adopted.

- Part B focused on the companies that used the Wates Principles to guide their corporate governance practices with the aim of evaluating their adherence to the requirements of each of the Principles and the quality of their reporting, evaluated in terms of the extent of disclosures, examples of good practices and readability.

The research method adopted in these two parts was primarily based on the use of content analysis, that is, the systematic and replicable analysis of text, involving the collection and codification of a piece of writing into various categories.[21] The following sections detail how the content analysis methodology was applied in these two parts and how the readability of disclosures was measured.

Part A – Content analysis coding process

The first step was to look at the Directors' and Strategic reports, within the annual report, to identify the presence of a corporate governance statement. A corporate governance statement was defined as a specific section within the Directors' Report or the Strategic Report where the company discusses its corporate governance arrangements. Each company was scored as 1 if a corporate governance statement was found, and 0 otherwise. The corporate governance statements were then analysed to identify whether companies had adopted a recognised corporate governance code and, if they did, which one. Finally, if a company did not disclose the adoption of any known corporate governance code, its corporate governance statement was analysed to identify disclosures related to alternative corporate governance arrangements. A score of 1 was assigned if the company provided some information about the corporate governance practices adopted, and 0 otherwise.

The coding for Part A was performed by three research assistants with the use of the software package Nvivo 12. To ensure the consistency of coding, three research assistants and a senior member of the research team analysed the same sample of 50 reports independently. Any discrepancies found were discussed and agreed upon. The remaining reports were split among the three research assistants and analysed individually. Periodically, a randomly selected sample of these reports was checked by a member of the research team to ensure accuracy.

Part B – Content analysis coding process

Part B focused on the companies that used the Wates Principles to define their corporate governance practices. For this part, content analysis was used to evaluate the reporting by these companies against the requirements of the Wates Principles.

We checked to see if those companies that stated they had adopted the Wates Principles also explained how the Principles were applied. For this, we relied on a set of binary variables for each of the six Principles and assigned a company a score of 1 if the company provided some explanation in relation to a specific Principle, and 0 if it did not.

21 Krippendorff, K. (2018).

To evaluate the extent of disclosures, a disclosure checklist for each of the six Wates Principles was constructed following the supporting guidance provided by the Wates Principles[22] (see Appendix 2 for some examples of these checklists) and the inputs received from the FRC and the Wates Coalition. The disclosure checklist for each of the Principles was divided into sub-main areas based on the guidance provided by the Wates Principles. For example, Principle One includes three main areas: purpose, values and culture and strategy, whereas Principle Two includes four main areas: chair of the board, balance and diversity of the board, size and structure of the board and effectiveness of the board requirements. Each of these areas includes a different number of items, which can be distinguished into two types: Q1 items, used to evaluate the presence of some general information about the specific area analysed (there is only one Q1 item per area); and Q2 items, used to identify specific disclosures related to these areas (the number of these items depends on the specific information researched). For example, the area related to opportunities within Principle Four includes the following four items:

Q1. Does the company disclose information about its opportunities?
Q2. Does the company discuss:
   a. what processes the company has in place to identify future opportunities?
   b. how the board is involved in considering and assessing how the company creates value over the long term?
   c. examples of opportunities discussed at board level?

The use of these two types of items allows for a numerical evaluation of the extent of disclosure provided, both in terms of general information (through the analysis of Q1 items) and of more specific disclosure (through the analysis of Q2 items). While companies may not necessarily address every sub-item within the Principles, this method ensures rigour in identifying evidence as to which principles/areas companies have preferred to address compared to other principles/areas.

We used the dichotomous method to code the items in the disclosure checklist either as 1, in the case of disclosure, or 0, in the case of non-disclosure. The method used, however, is not strictly dichotomous, because some of the items included in our disclosure checklist might not be applicable to some of the companies analysed. In such cases, these companies were scored as 'not applicable'.[23] For example, the following items are included in the first area of Principle Two related to the chair of the board:

Q1. Does the company provide general information about the chair?
Q2. Does the company discuss:
   a. what the role and responsibilities of the chair are?
   b. how the chair promotes open debate and facilitates constructive discussion?
   c. whether the chair is also the CEO?

Q2 items are not applicable to those companies that do not have a chair. Therefore, in the cases of companies stating that no chair has been appointed, these items were scored as not-applicable (NA) and excluded from the calculation of the overall disclosure scores.

For each company and each Principle, we then calculated the disclosure index as the ratio between the total number of items disclosed by the company and the maximum possible score obtainable (i.e. the total number of items that were applicable to a company).

To ensure the reliability of the coding scheme developed, a pilot study of 10 companies was conducted to test the coding scheme developed for the six Wates Principles and aligned it between the different coders (inter-coder reliability). Each member independently analysed 10 reports to ensure that the classification criteria were standardised. The results of the individual classifications were then compared and any misalignment was identified, reanalysed and resolved through discussion between the coders. The revised coding scheme was then tested by the three research assistants on the same 10 reports. Each research assistant worked individually on two Principles with the support of one member of the research team. The coding of the research assistants for the six Principles was matched with the coding agreed by the research team. Any misalignment was discussed and explained to ensure that the research assistants' coding was in line with the

22 Financial Reporting Council (2018), p. 11–22.
23 Cooke, T. E. (1992).

coding of the research team. Further reports were analysed by the research assistants and one member of the research team until discrepancies were reduced as much as possible. The remaining reports were then analysed individually by the research assistants for the Principles assigned to them. These reports were periodically randomly checked by the members of the research team to ensure the quality/consistency of the analysis. All the reports were coded with the use of the software package Nvivo 12.

Part B – Readability

Readability is defined as the ease of understanding a text due to the style of writing. We analysed the readability of the corporate governance statements produced by the companies that have adopted the Wates Principles. Since these statements were obtained from annual reports downloaded from the Companies House website, which stores annual reports as scanned copies, we first converted them into txt files and analysed only the statements that could be converted into usable txt files. These corporate governance statements were analysed using ReadablePro software to calculate the three main readability scales used in the accounting literature, with a view to measuring how difficult the statements were to understand for adult readers.[24] These scales are the Flesch–Kincaid Grade Level, the Gunning Fog index and the SMOG index.

The Flesch–Kincaid Grade Level shows the level of education needed to be able to understand a text, based on the US grade level of education.[25] A lower score indicates that the text is easy to understand. A text is considered to be easy to read when the Flesch–Kincaid Grade Level scores 8/9, as it indicates that the text can be understood by 13 to 15-year-olds. The Gunning Fog Index indicates the number of years of formal education that are necessary for a reader to read and understand the text.[26] It ranges between 0 and 20. Again, a lower score indicates that the text is easy to understand. A level of 8 is indicative of a text that can be understood by the public. Texts that score 17 or above are considered to be at graduate level. The SMOG index estimates the years of education that an average person needs to understand any piece of writing.[27] As for the previous indices, a lower score indicates that the text is easy to understand.

24 Guay, W., Samuels, D., & Taylor, D. (2016).

25 The Flesch–Kincaid Grade Level is calculated as follows:

$$\text{Flesch–Kincaid Grade Level} = 0.39 \times \frac{\textit{number of words}}{\textit{number of sentences}} + 11.8 \times \frac{\textit{number of syllables}}{\textit{number of words}} - 15.59$$

26 The Gunning Fog Index is calculated as follows:

$$\text{Gunning Fog Index} = 0.4 \times \frac{\textit{number of words}}{\textit{number of sentences}} + 100 \times \frac{\textit{number of words with more than two syllables}}{\textit{number of words}}$$

27 The SMOG Index is calculated as follows:

SMOG Index= $3+\sqrt{\textit{number of words with more than two syllables}}$

Appendix 2: Example of Coding Scheme for Principles 1 and 4 of the six Wates Principles.

Principle One

A. Purpose

Q1. Does the company disclose its purpose? (0/1)

Q2. Does the company discuss:

a. the link between behaviours and purpose? (0/1)
b. if its purpose is aligned with its business practices/business model? (0/1)
c. the processes that are in place for the board to obtain a clear understanding of shareholder views on the company's purpose? (0/1)
d. the processes that are in place for the board to build positive relationships with stakeholders by engaging in dialogue with them in relation to the company's purpose? (0/1)
e. the processes that are in place for the board to incorporate shareholders'/stakeholders' views into its decision-making process in relation to the company's purpose? (0/1)

B. Values and Culture

Q1. Does the company disclose its culture? (0/1)

Q2. Does the company:

a. identify its values (i.e. a list of values)? (0/1)
b. explain what its values mean? (0/1)
c. explain how values guide decision-making at the board level? (0/1)
d. discuss its attitudes and/or behaviours? (0/1)
e. discuss the process in place to ensure that behaviours are aligned with culture? (0/1)
f. discuss who is involved in the management of culture? (0/1)
g. discuss how information relating to culture is passed to the board? (0/1)
h. discuss how the board monitors the company's culture? (0/1)

C. Strategy

Q1. Does the company disclose its strategy? (0/1)

Q2. Does the company discuss:

a. how it implements its strategy throughout the organisation? (0/1)
b. the connection between its strategy and its purpose? (0/1)
c. the connection between its strategy and its culture? (0/1)

Principle Four

A. Opportunity

Q1. Does the company disclose information about its opportunities? (0/1)

Q2. Does the company discuss:

a. what processes the company has in place to identify future opportunities? (0/1)
b. how the board is involved in considering and assessing how the company creates value over the long term? (0/1)
c. examples of opportunities discussed at board level? (0/1)

B. Risk and responsibilities

Q1. Does the company disclose information about its risk management?

Q2. Does the company discuss:

a. its material/principal risks? (0/1)
b. the use of a scenario analysis in its risk assessment? (0/1)
c. its role and responsibility in relation to developing the company's risk management systems? (0/1)
d. its role and responsibility in relation to determining the nature and extent of the company's principal risks? (0/1)
e. its role and responsibility in relation to determining its 'risk appetite'? (0/1)
f. its internal communication channels on risk information? (0/1)
g. its external communication channels on risk information? (0/1)
h. its role and responsibility in relation to agreeing a monitoring and review process? (0/1)

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