CO-OPERATIVES UK

Consultation Response

Consultation on Proposed Revisions to the UK Corporate Governance Code

February 2018

About Co-operatives UK

Co-operatives UK is the network for Britain's thousands of co-operatives. We work to promote, develop and unite member owned businesses across the economy.

Governance has been high on the agenda for the co-operative sector in recent years. From high street retailers to community owned pubs, fan owned football clubs to farmer controlled businesses, co-operatives together are worth £34 billion to the British economy.

Internationally, there are 2.9 million co-operative enterprises. The world's largest 300 co-ops have a combined turnover of $2.16 trillion, while co-ops worldwide are owned by 1.2 billion members and sustain 280 million livelihoods, equivalent to 10% of the world's employed population.

Co-operatives and the Code

Although there is a general understanding that the way an organisation operates is important, there is no universally applicable definition of the word "governance". It is used and understood differently in different contexts. This is to be expected and in fact it is welcome. The UK Corporate Governance Code (the Code) is a living document which has developed to meet the changing context in which UK PLCs operate and to deal with new challenges thrown up by experience.

Co-operatives are not listed companies and are not therefore the focus of or bound by the provisions of the Code. In a roundtable on mutual governance, co-organised with and hosted kindly by the Financial Reporting Council (FRC) in 2016, the Code was recognised as an authoritative point of reference, while not appropriate in every respect and additional principles outside of the Code appeared relevant for member-owned businesses: on values and purpose, accounting for performance on member value and member engagement. The first of these - a more explicit concern for purpose, values and culture - is now included in the draft Code.

So, while recognising the differences, we welcome changes that we see as bringing PLCs closer to the priorities of co-operative and mutual enterprises. Co-operatives UK is pleased to be represented on the Stakeholder Advisory Panel for the FRC and as the Code also continues to be an important reference point for large co-operative businesses, and for governance codes beyond, we are pleased to respond to this consultation.

Differences between corporate and co-operative governance

Good governance in co-operatives and mutuals is based on similar underlying principles as for other organisations but there are differences. There are distinct drivers of accountability and success in a co-operative. The economist Tushaar Shah characterises these as the extent to which the business is "member-centred", explaining that "*the success of a co-operative… depends upon how effectively it serves the purposes central to its user member; and how effectively the co-operative does this depends critically on how well it gets designed to do so."*

A focus on expertise has been a key theme in recent work on co-operative governance. Having a Board with the relevant skills to oversee executive managers in the interests of members is what representative structures are intended to lead to. But there can be a tension between member control and expertise needed for governance **-** the key is appropriate governance design.[1] Recent work by Professor Johnston Birchall, in line with the focus on 'member-centred' governance, reviewing the approach of large co-operatives worldwide, suggests that governance design will look to find the optimal mix for the circumstances of a co-operative of three key components: **representation**; **expertise**; and **member voice**.[2]

Work on good governance in the co-operative sector

Co-operatives UK operates a number of quality standards, to guide co-operatives in relation to good governance. These include the Code of Governance for Consumer Co-operative Societies[3], the Worker Co-operative Code of Governance and a Code of Governance for Agricultural Co-operatives. The Co-operative Governance Expert Reference Panel was established in 2015 by Co-operatives UK reflecting a need for an independent and authoritative voice across the co-operative sector for best practice in governance.

To define what quality looks like in terms of co-operative governance at a Board level, the Panel has published the Co-operative Governance Wheel.

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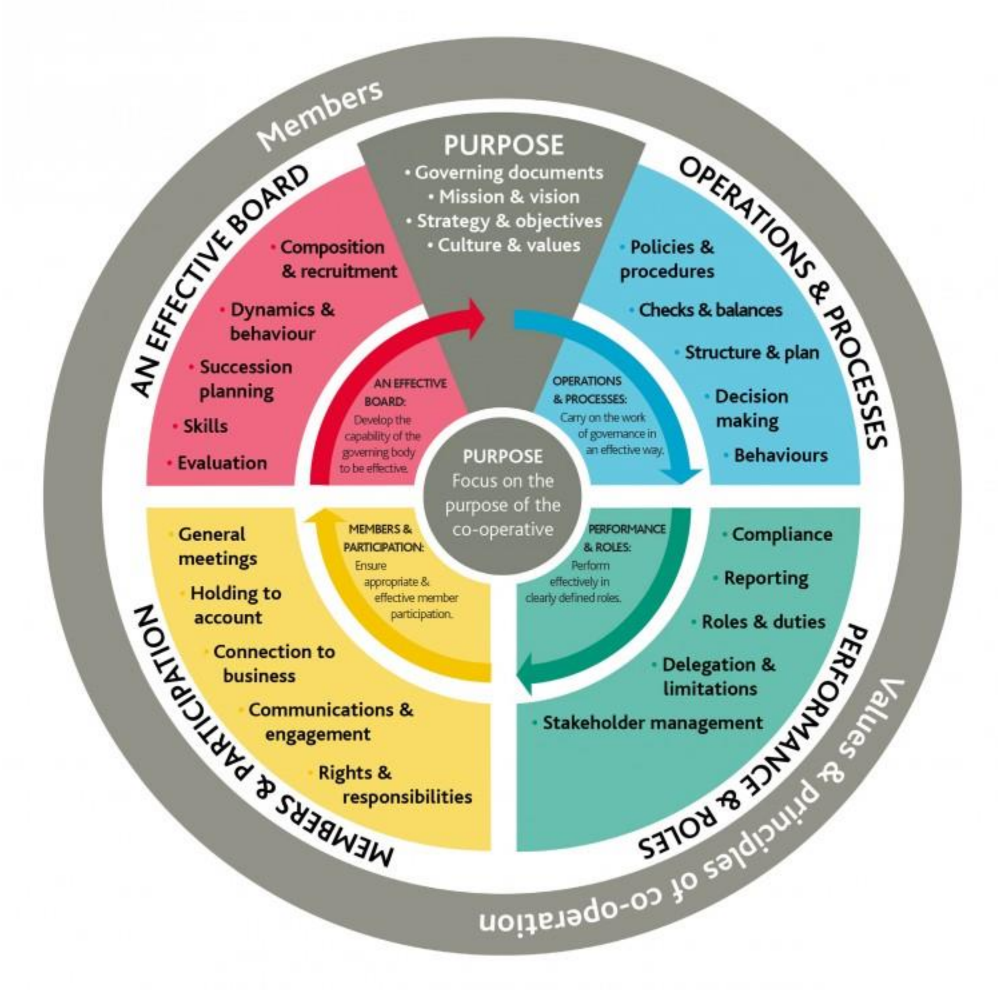
[1] For an overview of this, see https://www.youtube.com/watch?v=-IqieupiNUs

[2] This is the second edition, comprehensively revised, of a research study by Professor Johnston Birchall, reviewing the governance of 60 of the world's 60 largest co-operatives.

[3] The Code of Governance for Consumer Co-operative Societies is a self-regulation quality standard intended to ensure that co-operative businesses are well run and meet their members' needs. The code was first launched by Co-operatives UK (then the Co-operative Union) in 1996. This code was comprehensively revised in 2014, after a period of open consultation in the co-operative sector.



Responses to questions on the draft Corporate Code

Q1. Do you have any concerns in relation to the proposed Code application date?

We do not have any concerns.

Q2. Do you have any comments on the revised Guidance?

The revised Guidance is a substantive and helpful resource.

In terms of prompts around values and culture, it may be helpful to consider adding content drawing on work that we have compiled, published by Routledge in the book Values by Ed Mayo. These are:

Checklist on Values in Business

Articulating values Does the organisation have an agreed statement of shared values? Are these values published and available? Are the values translated into expectations around everyday behaviour?

Leadership on values Is the strategy and direction of the organisation informed by its values? Do those with responsibility lead by example?

Governance on values Does the board consider values and track performance and risk in relation to them? Does the board consider external assurance and stakeholder feedback in relation to the values of the organisation? Are values integrated in the framework of policies approved by the board for the business?

The values fit Are the values in line with the core purpose or founding story of the organisation? Are the values the right ones, in terms of their fit with the wider market and society within which the organisation operates?

Ownership and awareness of values Do those involved in the business know what the values are? Do those in the business believe that the values are ones that they care about? Do the values inform the conversations, communication and planning of those within the business?

Integration of values Are values integrated in human resource management – such as performance review, learning and development and colleague recruitment and induction? Are values integrated into commercial relationships – such as buying decisions, supply chain management, and partnerships? Are values integrated into marketing – such as communication, product and service design and innovation?

Accountability on values Do values form part of the accountability framework of the business to its ultimate owners, for example in dialogue or in the articles of association? Do values form any part of what the business reports on or discloses externally? Are the interests and perspectives of stakeholders considered in the way that values are handled?

Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

We suggest that the draft text is missing a reference to the role of self-organising among workers, whether through trade unions, professional bodies or the new field of what has been termed, in the Taylor Review of modern employment practices, ‘worker tech’. The latter is of particular reference to freelancers and contractors, and so it is welcome in our view that the text makes reference to workforce rather than employees more narrowly.

The provision does not address the issue of engagement with wider stakeholders, envisaged in Principle C, and text to encourage *“methods of stakeholder engagement that are: open and consistent over time; relevant in terms of addressing issues that are material; and based on two-way communication”* would be a welcome addition.

Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

The co-operative sector has welcomed the United Nations (UN) Sustainable Development Goals and the Secretary General of the UN has commented that “co-operative enterprises are in a unique position to help promote the 2030 Agenda. They are natural vehicles to deliver the collaborative partnership and the people-centered and integrated approach required to attain the 17 Sustainable Development Goals.”

We are therefore very supportive of the Goals being cited as one specific reference point in the Code and in the accompanying Guidance. We recognise that there is a wealth of voluntary good practice and principles across a wide range of stakeholder concerns that is simply too voluminous to make reference to. The status of the Goals, with backing across governments around the world, gives a natural privileged status and reference to these is helpful and important.

Q5. Do you agree that 20 per cent is ‘significant’ and that an update should be published no later than six months after the vote?

This seems reasonable and a helpful addition in terms of accountability.

Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

If this removal proceeds, there will be a benefit in monitoring the results through research, to ensure that independent assurance may continue play a role in good governance where needed.

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

The nine year period is widely cited – included in co-operative sector codes - and is therefore a good foundation to build upon. But we caution against this being used in a mechanistic way, because it is a proxy for independence not a guarantee of it, and we are not convinced that the Chair should necessarily be designated as independent.

As co-operatives are enterprises owned by members, people that are involved in the business, we find that independence is a concept that has to be treated in a distinct way in order to reflect the benefit of attracting directors from those members. The importance of independence at Board level is to ensure that directors are able to offer effective and impartial scrutiny of the business on behalf of the owners. This is about culture and people as much as it is mechanisms of terms or designations of independence, while recognising that these may play a role.

Co-operative boards will include in their formation a sufficient line of representation and accountability to members. To the extent that directors use knowledge that they have as members themselves, where appropriate, there can even be an advantage. As Shann Turnbull has argued, in stakeholder models of governance, directors can be involved and informed on the business, rather than independent and ignorant – or rather reliant on information channelled through the executive.

In a worker co-operative, for example, all directors may typically drawn from the workforce, prompting guidelines on how to fulfil this role and with terms of office therefore primarily intended to ensure renewal and diversity over time. Co-operatives will often appoint Chairs from within the current Board membership, meaning that they may spend time on the Board before taking the role of Chair

Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?

Yes. We are open to the reasons set out in the consultation paper not to provide a maximum tenure.

Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

A recognition of diversity is welcome and a growing feature of commentary on business governance. However, the principles in this section are weaker than would be ideal in that diversity is cited in Principle K as something <u>to consider</u>, but not in Section I as something to aim <u>to achieve</u>. We would encourage a clearer wording in Section I, along these lines.

While the voice of young people is not cited in the draft Code and Guidance, we believe that the diversity agenda can be of relevance in encouraging this. Working with our members, Co-operatives UK helped to open up membership of co-operative societies to all ages, with a change in the legislation that now permits members under the age of sixteen. We have published a guide to societies on young member engagement and pointed to best practice models around the engagement of young people, including in governance, across the co- operative sector.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

We are supportive of extending the recommendation. Research by Co-operatives UK shows that, while there is a long way further to go, co-operative models of governance do compare well in terms of gender equality in business. Across the co-operative sector, 37% of directorships are held by women, compared to 20% among leading PLCs.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

We are supportive of greater transparency around diversity in employment and governance.

Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

No comment.

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

Yes.

Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

We are supportive of efforts by the FRC to increase scrutiny and accountability of PLC executive pay, recognising that this is an unhelpful driver for inequality, a contributor to lower public trust in business and an uncertain formula for business success.

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

The risks of short-term distortion appear to be associated in particular with share options held by senior executives, even if these were introduced in order to do the opposite, to link pay to performance as measured by market valuations of the company. In the co-operative sector, because there are no offers of share options to top managers as part of their remuneration package, the opportunities for inappropriate incentives or abuse are more limited.

We suggest that the most effective way to drive long-term performance is to encourage a culture within which purpose is strong and compensation aligned to the values of the business, consistent across staff from top to bottom and where senior executive pay is variable against performance, it should be indexed against what are considered or proven over time to be the key drivers for long-term success.

Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

We encourage early review of this particular aspect of the Code, to test whether it is providing a meaningful impetus.

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Contact on this submission: Ed Mayo, Secretary General or James Wright, Policy Officer

James.wright@uk.coop

Co-operatives UK

Holyoake House

Hanover Street

Manchester M60 0AS

www.uk.coop