



Annual reporting in 2019/20: From intent to action

September 2020 | Seventh edition



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EY UK Head of Corporate Governance

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Introduction

2019/20 annual reports and accounts (ARAs) were set to be characterised by first-time implementation of the revised UK Corporate Governance Code (the 2018 Code) and by compliance with the new Companies (Miscellaneous Reporting) Regulations 2018 (MRR). These place significant new requirements on companies, and their repercussions stretch beyond just reporting: in order to report meaningfully under these, companies had to revise their underlying processes.

Then came the COVID-19 outbreak, introducing an extra, unexpected dimension which has tested corporate governance and reporting frameworks in new ways. It has forced companies into action, bringing purpose, culture and stakeholders – all new aspects of the 2018 Code – to the fore.

From intent to action

From our review this year, FTSE 350 companies have made a good start at implementing the changes, but more is needed to turn the dial from intent to action. Florence Nightingale thought that “feelings waste themselves in words; they ought all to be distilled into actions which bring results”. I find this particularly poignant at the current time. It not only resonates with the global response to the pandemic, but also aligns with our view that reporting should not be solely focused on the processes a company has in place or its good intentions: it needs to give real insight into the actions taken, as evidenced by the outcomes that have been achieved.

UK companies began feeling the impact of the pandemic by early March, just as the December 2019 year-end reporters were starting to publish their ARAs. Our review of FTSE 350 reporting this year therefore includes a number of March and April 2020 ARAs, to provide insight on how companies were initially responding to the crisis. The crisis has tested, for example, how boards have been discharging their duties under section 172 of the Companies Act 2006

(s172) at a time when many have faced difficult decisions involving trade-offs between competing interests – the impact on their stakeholders, long-term success and reputation. Companies are already being judged on their actions. If they can report now in a transparent and balanced way, this will stand them in good stead during any post-COVID-19 analysis.

We see such transparent and balanced corporate reporting as a vital cog – alongside governance and stewardship – in the accountability framework needed to build and maintain trust in business. It is one of the key mechanisms by which investors and significant stakeholders hold directors to account. The ARA remains a pivotal document to enable this.

Stakeholder dimensions and the need for comparability

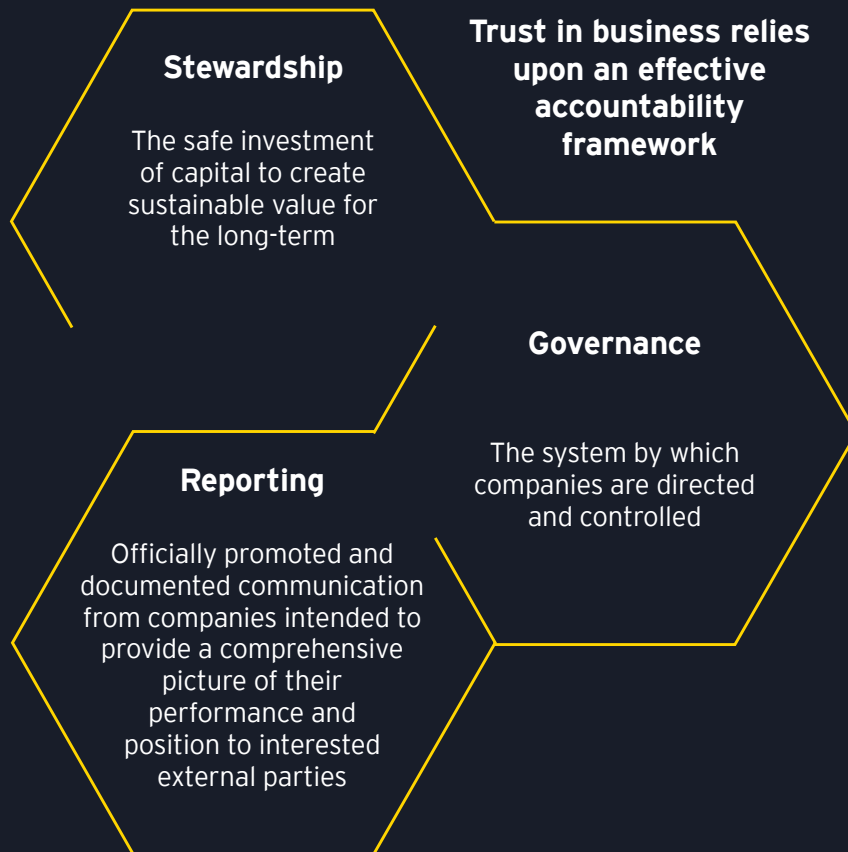
As well as investors, other stakeholders are seeking increased corporate accountability too. The tragic events leading up to the Black Lives Matter movement have shaken up the social and business landscape. Employees want their companies to be candid about their current diversity status and to take concrete actions to improve it. Public reporting – and the ability to hold companies to account based on that reporting – is important for achieving momentum and progress, as demonstrated by the substantial strides made in improving gender diversity on boards.



The report and accounts provide fundamental assured information which underpins the contract between the shareholders and the directors of a company – the importance of which is evidenced by a formal vote of approval at the General Meeting.

As asset owners, asset managers and society at large turn their attention to a wider definition of long-term sustainability, the role of the ARA will become more vital than ever. The report will need to adapt to provide a compelling narrative which can inform a genuine understanding of purpose and sustainability that extends beyond financial characteristics.”

Andy Griffiths, Executive Director, The Investor Forum



The demand for multi-stakeholder, non-financial reporting creates a new challenge – the need for clear, comparable metrics. At present, the environmental, social and governance (ESG) reporting arena is supported by numerous – sometimes competing – frameworks. Greater comparability would help users of reports to understand a company’s relative ESG performance better and hold boards to account. I hope there will be some settlement on commonly accepted frameworks, as has happened in climate change reporting through the Task Force on Climate-related Financial Disclosures (TCFD). This is why the World Economic Forum’s International Business Council project on developing core metrics related to the UN Sustainable Development Goals (SDGs), which EY is part of, is so important (see more on page 57).

Change ahead

The Financial Reporting Council’s (FRC) Future of Corporate Reporting Project may also drive change in this area. In the report due to be published for consultation in the autumn, the FRC is seeking to present a new corporate reporting model that moves away from the focus on a single user – the shareholder – and a single document such as the ARA, in order to meet the information needs of a wider variety of stakeholders via a network of reports. Given this likely direction of travel, our view is that the importance of the s172 statement will only grow. It has the potential to be the cornerstone of reporting – providing an opportunity for a company to distil its key messages and to highlight the connectivity within its network of reports.

Various regulatory reforms still in play may bring yet further enhancements. The Brydon Review's proposal¹ for directors to publish an annual public interest statement couldn't be more timely: COVID-19 has been a real test case for what it means for companies to act in the public interest.

It also proposes a resilience statement to replace the current going concern and viability statements. While much criticism has been levelled at viability statements, COVID-19 has resulted in companies including welcome detail about scenarios and stress testing. In our view, this has created a new benchmark from which to build any new frameworks to report a resilience statement.

Change in the governance and reporting arena and adapting to it seems to be set as a constant fixture for some years to come. But there is also benefit in regulators adopting a cohesive and phased approach to allow companies to emerge from the aftermath of COVID-19, learn from the existing round of reporting and, where appropriate, co-develop the new requirements to allow for meaningful, outcome-oriented reporting.

I hope that those involved in preparing ARAs will find this publication useful in achieving this objective. In line with previous years, we have kept it practical by including insights and guidance not only on disclosure requirements, but also on underlying governance processes. Your feedback is welcome.



Mala Shah-Coulon, EY UK,
Head of Corporate Governance

¹ *Assess, assure and inform improving audit quality and effectiveness, report of the independent review into the quality and effectiveness of audit*, Sir Donald Brydon CBE, December 2019.



Acid test

Our acid test – created six years ago and regularly updated – is a practical tool for preparers and boards looking to ensure the narrative within the ARA covers the key qualitative aspects of leading practice. In light of the COVID-19 crisis, we supplemented it to cover matters that we believe boards and management should address in the narrative within their ARA to explain the impact of the crisis on the company and its response. Points related to COVID-19 have been highlighted by yellow side bars.

Throughout this publication we provide further insight to a number of these topics.

Purpose, strategy and culture

- ▶ What is the company's purpose? Does it explain why the company exists and how it contributes to wider society?
- ▶ How are some of the difficult decisions the board has made/will make aligned to the company's purpose? Are there any that may challenge the company's purpose in the long term?
- ▶ Has the company's purpose remained relevant or has this pandemic indicated that the board may need to reconsider it?
- ▶ Does the company's purpose clearly inform its strategy?
- ▶ What are the company's strategic objectives? Are they clear and measurable?
- ▶ How has (or will) the pandemic impacted the company's strategic direction? What do you expect the longer-term impact of COVID-19 to be on your business?
- ▶ How does the board make decisions regarding how capital is allocated across the short and long-term priorities? For example, capital investments, research & development (R&D), pensions and shareholder distributions.
- ▶ How are decisions around capital allocation being impacted by COVID-19? Have you articulated the longer-term consequences of these decisions?

- ▶ Which aspects of the company's culture are critical to the operation of the business model and/or the delivery of its strategy?
- ▶ How does the board measure and monitor the extent to which the culture is embedded?
How has the board adapted its approach to such monitoring given remote working?

Business model

- ▶ How does the company make money?
- ▶ What are the company's key inputs, processes and outputs (for shareholders and other stakeholders)?
- ▶ What are the company's competitive advantages and how are these sustained over time?
- ▶ How are the company's key tangible and intangible assets engaged in the process of value creation?
- ▶ How does the business model help deliver the strategy and how is it different from others in the sector?
- ▶ How is the company adapting its normal ways of operating to ensure it remains solvent in the short term and viable and sustainable in the medium to long term?
- ▶ How are customer needs and priorities changing in light of COVID-19 and how is the company responding? Have new upside opportunities arisen as a result of COVID-19 (e.g., e-commerce growth) and how has management capitalised on these?

- ▶ How are the company's competitive advantages being impacted by COVID-19? How is the competitive landscape changing?

Key performance indicators (KPIs)

- ▶ What are the key metrics the board uses to measure progress against its strategic objectives? Are these leading indicators which truly measure performance against strategy over the long term rather than just output measures?
- ▶ How has the company performed against its metrics over time and how has this influenced the remuneration of senior executives?
- ▶ Are alternative performance measures (APMs) and exceptional items clearly defined and explained? Is the audit committee satisfied that they have been used in a manner that reflects a fair and balanced view of the performance and position of the business?
- ▶ Which new metrics (if any) have been established to assess performance during this crisis?
- ▶ Where costs have been apportioned to a COVID-19 related exceptional item, is this objective and reliable?

Risk appetite and principal risks

- ▶ What levels of risk is the board willing to take in pursuit of its strategy and how is this monitored by the board?
- ▶ Has the board's risk appetite for certain principal risks reduced as a result of COVID-19? If so, what additional mitigating measures are being taken?
- ▶ What are the principal risks to the successful delivery of the strategy and operation of the business model?
How has the board's assessment of principal risks evolved in light of COVID-19?
- ▶ What are the risks that pose the greatest threat to the viability of the company i.e., solvency and liquidity risks?
- ▶ How, specifically might these manifest in the company as opposed to generically in the sector?

Risk management and internal control disclosures

- ▶ How are the principal and emerging risks mitigated and controlled by the company's systems of internal controls and risks management and how does the board monitor these controls?
- ▶ What did the board's review of the effectiveness of these systems and controls encompass and what were the findings?
- ▶ Has the board identified significant failings or weaknesses and is it clear what actions have been or will be taken to address these failings or weaknesses?
- ▶ What has the current crisis taught management about its risk identification and management processes? What adaptations have been made e.g., seeking additional assurance, increasing scope of monitoring etc.?
- ▶ What enhancements and changes have been made (or will be) in internal controls resulting from the pandemic and new ways of working? Consider the resilience and security of the IT environment in particular.

Viability statement

- ▶ Over what timeframe has the board considered the viability of the company and why? How has the period been rationalised especially where the company is making investment decisions over longer periods?
- ▶ How confident is the board on maintaining the previous timeframe to assess the viability of the company? Is the level of uncertainty so high, that the period should be reduced?
- ▶ What process did the board use to assess viability? Given the pandemic, how did the board's involvement in the assessment process change?
- ▶ Does the board understand which, if any, severe but plausible risks (or combination of risks) would threaten the viability of the company and has appropriate disclosure been provided?
- ▶ What specific scenario and sensitivity testing has been performed on the model(s) supporting the viability statement and what was the outcome of this testing?
How have the viability scenarios from previous years changed to reflect COVID-19?
- ▶ What assurance did the board obtain over relevant elements (e.g., stress testing)?
- ▶ What assumptions and caveats did the board use in reaching its conclusion, for example around expected operational restrictions, ability to meet debt covenants or assumed duration of COVID-19 crisis etc.?

- ▶ What is the board's view of the longer-term prospects of the company beyond the period of the viability statement?

Stakeholder engagement and s172

- ▶ Are the key stakeholders of the company clearly identified?
- ▶ How did the board seek to understand the views of and seek input from both shareholders and stakeholders during the year?
How are management and the board adapting their engagement strategy in light of the crisis?
- ▶ How is the board engaging with the workforce during the period of remote working?
- ▶ Does the board articulate the feedback received from such interactions and any actions taken?
How has the board had regard to these groups in the principal decisions they made?
- ▶ How is COVID-19 influencing the views/priorities of key stakeholders and how is the board factoring these in to its approach on decision making, its consideration of stakeholder outcomes and its efforts to mitigate/minimise adverse consequences for stakeholders?

Governance

- ▶ What did the board and its committees actually do in the year to govern the company – what specific governance issues arose and how were they addressed?
 - What issues have taken precedence given the crisis?
 - ▶ What, if any, changes were made to governance arrangements during the year and why?
 - How has the board adapted its way of working to govern and communicate effectively in the year?
 - ▶ How is the board being kept updated on both the changing regulatory framework as well as the various temporary measures and relaxations that regulators have extended so as to oversee and monitor the company's compliance with these?
 - ▶ What areas for improvement were identified from the board and committee evaluations and what progress was made against actions from the previous evaluations?
 - ▶ What additional work has the audit committee done to address the key areas of judgement (in light of COVID-19) in the financial statements e.g., impairment, valuations, going concern?
- ▶ How is board committee composition and succession planning being managed, giving due regard to the evolving strategy of the company, skills, experience, diversity and tenure?
 - ▶ Have any lessons been learnt regarding the different skill sets required to govern effectively through the crisis? How is the nomination committee considering these in future succession planning?
 - ▶ How is the board considering the potential impact of COVID-19 on the implementation of remuneration policies and executive remuneration in the year?



Key themes

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Meaningful reporting

Page 11

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Purpose

Page 24

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Culture

Page 31

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Managing risk and viability

Page 40

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Climate change and the UN Sustainable Development Goals

Page 49

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Stakeholder engagement and s172

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Workforce engagement and diversity

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1

Meaningful reporting

From intent to action

Making balanced and transparent disclosures and using the ARA as a pivotal document to make commitments and track the progress against those over time is key.

1

Follow up on commitments made in the previous year's ARA. Set and use financial and non-financial targets and metrics to measure progress against the commitments made.

2

Shift the focus of disclosures from process towards outcomes.

3

Challenge whether the ARA is fair, balanced and understandable (FBU) based on your experience as a board member or member of the management team. Does it paint the same picture of the company you discussed in the boardroom? Be open about what did not go according to plan, as well as what did.

Reminder – The 2018 Code (page 2) emphasises the importance of reporting meaningfully, avoiding boilerplate statements and instead disclosing how the Principles have been applied, the action that has been taken and the resulting outcomes using signposting and cross-referencing where relevant. This should help investors to evaluate a company's governance practices.

What do we mean by meaningful reporting?

Meaningful reporting cuts to the heart of the concept of 'from intent to action'. It is about following up on commitments – demonstrating that they were more than signals of good intentions and have been carried forward throughout the year. It links to the concept of FBU in encouraging an open and honest account of

the year in review. It reflects the reporting journey companies have been on – moving from process descriptions towards more outcome-orientated disclosures.

This year presented a good opportunity for companies to rethink their reporting in light of the 2018 Code and the MRR. Some companies did take that opportunity. We particularly noticed some improvements in the reporting of KPIs and examples of thoughtful reporting, such as the inclusion of relevant and linked case studies within the narrative.

In 2020/21, reporters will face a further challenge of having to discuss the impact of COVID-19 at a time when the full impact is not yet known. The FRC has been clear that this is not a reason to avoid reporting on it. According to the FRC's Chief Executive, Sir Jon Thompson: "Reporting where outcomes are uncertain is difficult, but we expect companies to rise to the challenge to avoid situations where helpful information could have been in the public domain and was not."² Even where previous commitments cannot be met or are no longer feasible, it is important for companies to be consistent and refer to them with an adequate rationale for any new approach e.g., dividend decisions that don't align with a previously disclosed dividend policy or changes to the business model or strategy.

Compliance with the 2018 Code

When it published the 2018 Code, the FRC was keen to re-emphasise the requirement within the 2018 Code and the Listing Rules to **apply the Principles** of the 2018 Code rather than simply comply with its Provisions alone in a strict 'tick box' manner.

Most companies provide little evidence of how they applied the Principles – perhaps in part due to the conceptual and behavioural nature of some of them. In the absence of illustrative disclosures or worked examples, companies find it challenging to report in a manner that would enable shareholders to evaluate how these Principles have been applied. As a result, companies end up repeating the Principles as statements of fact. Examples of Principles that are challenging to report against include the following:

- ▶ Principle A – A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.
- ▶ Principle B (second sentence) – All directors must act with integrity, lead by example and promote the desired culture.
- ▶ Principle F (second sentence) – They (the chair) should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate.



² COVID-19 - Resources, action, the future: Reporting in times of uncertainty, Financial Reporting Lab, FRC, June 2020.

Figure 1: Derwent London plc, ARA 2019, page 102

CORPORATE GOVERNANCE STATEMENT

Structure of the Governance section
The Governance section has been organised to follow the structure and Principles (A to R) of the 2018 UK Corporate Governance Code (the 'Code') and illustrates how we have applied the Code Principles and complied with the Provisions. Further information on the Code and our compliance is on page 96.

BOARD LEADERSHIP AND COMPANY PURPOSE

Effective Board
Our Board is composed of highly skilled professionals who bring a range of skills, perspectives and corporate experience to our boardroom (see pages 98, 99 and 111). In accordance with the Code, the role of the Board is to promote the long-term sustainable success of the Company, generate value for shareholders and contribute to wider society.

On an annual basis, the Board conducts a detailed annual review of our strategy (including our purpose, and strategic objectives). This year's review took place on 21 June 2019 and included high-level exploratory discussions to challenge whether the strategy remains fit for purpose and responsive enough to our ever-changing environment.

Through its review, the Board is able to assess and identify changing or emerging risks that could impact on the Group in the short and medium term (further information on our emerging risks is on page 45). As we generate value through the core activities identified in our business model (see page 20), the flexibility of the business model is also assessed by the Board to ensure it remains 'future ready'.

Some of the key aspects discussed by the Board during its strategy discussions included:

- changes to the London office market and investment market (see pages 12 to 15);
- our development pipeline in respect to its replenishment and future potential (see pages 28 to 29);
- review of the five-year plan;
- our employees, their wellbeing and developing our talent pipeline (see pages 84 to 85);
- emerging occupier trends;
- responsibility matters including our net zero carbon emissions strategy (see pages 80 to 83); and
- investor relations and corporate communications.

To ensure sufficient time for discussion, the Board utilises its five principal committees to effectively manage its time. At each Board meeting, the agenda ensures sufficient time for the committee chairs to report on the contents of discussions, any recommendations to the Board which require approval and the actions taken. Further information on the activities of the principal committees can be found on pages 116 to 165.

Purposes, values and culture
Our purpose, values and culture are disclosed on page 01.

PURPOSE

Why we do what we do

→

VALUES

The qualities we embody

→

CULTURE

How we work together

Our purpose communicates the Group's strategic direction and intentions to our employees, occupiers and wider stakeholders. Due to its importance, it is reconfirmed on an annual basis to ensure it continues to reflect the Board's strategy, values and desired culture.

| | |
|--|----------------|
| 1. Board leadership and Company purpose | p.102 to p.107 |
| A Effective Board (page 102) | |
| B Purposes, values and culture (page 102) | |
| C Governance framework and Board resources (page 103) | |
| D Stakeholder engagement (page 104) | |
| E Workforce policies and practices (page 109) | |
| 2. Division of responsibilities | p.108 to p.110 |
| F Board roles (page 108) | |
| G Independence (page 109) | |
| H External commitments and conflicts of interest (page 110) | |
| I Key activities of the Board in 2019 (page 114) | |
| 3. Composition, succession and evaluation | p.111 to p.121 |
| J Appointments to the Board (page 111) | |
| K Board skills, experience and knowledge (page 111) | |
| L Annual Board evaluation (page 112) | |
| 4. Audit, risk and internal control | p.122 to p.139 |
| M Financial reporting (page 123) External Auditor & Internal audit (pages 124 to 126) | |
| N Review of the 2019 Annual Report (page 127) | |
| O Internal financial controls (page 126) Risk management (page 129) | |
| 5. Remuneration | p.140 to p.166 |
| P Linking remuneration with purpose and strategy (page 140) | |
| Q Remuneration Policy review (page 140) Changes to policy and summary of process (page 146) | |
| R Performance outcomes in 2019 (page 156) Strategic targets (page 157) | |

Some companies, such as Derwent London plc (Figure 1), indicate how they have applied the Principles by using the 2018 Code to structure their ARA's governance section, and by linking the Code's Principles to the relevant parts of the governance section and the Strategic Report. **InterContinental Hotels Group plc** (ARA 2019, page 94) provides a clear overview and uses signposting to demonstrate where disclosures relating to each Principle are located within the report.

Compliance with the Provisions

Compliance with the 2018 Code

61%

comply with every Provision of the 2018 Code

80%

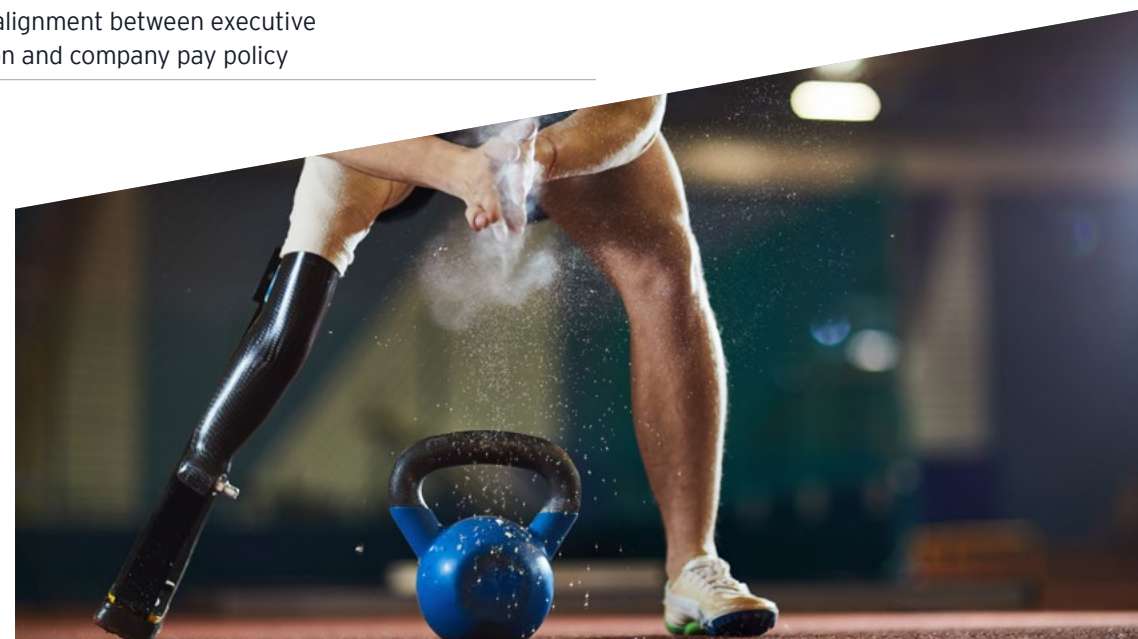
comply with all but one Provision



When the FRC published the 2018 Code, it recognised that companies had largely been trying to comply with all the Provisions in a tick-box manner, rather than face the challenge of explaining their rationale for any non-compliance. This was partially driven by proxies and the behaviour of some investors, who have been criticised in the past for automatically penalising companies that didn't comply with every Provision. Companies still seem largely focused on meeting all the Provisions of the 2018 Code: 80% of our sample complied with all but one of the Provisions. This seems high in the first year of applying the 2018 Code's new requirements, especially when these involve not just changes to reporting, but most importantly implementing the underlying governance mechanisms and processes as a basis upon which to report. As shown in Table 1, most of the Provisions that companies did not comply with were newly introduced in the 2018 Code, with companies explaining their plans for compliance in the following year.

Table 1: Rate of non-compliance with 2018 Code Provisions

| Provision | Description | % of companies that do not comply |
|-----------|--|-----------------------------------|
| 38 | Pension contribution rates aligned with those available to the workforce | 9 |
| 19 | Chair tenure | 8 |
| 11 | At least half the board should be independent | 6 |
| 32 | Remuneration committee independence | 6 |
| 9 | Chair not independent upon appointment | 6 |
| 36 | Remuneration schemes promoting long-term shareholdings | 5 |
| 41 | Engagement with the workforce to explain the alignment between executive remuneration and company pay policy | 4 |



However, it is important to remember that full compliance with the Provisions has never been the objective of UK corporate governance codes. Since its publication, the FRC has been reminding companies that: "Full strict compliance has never been the aim, nor has it reflected the spirit, of the Code due to the 'comply or explain' approach on the Provisions. Detailed and comprehensive explanations offer the reader a greater insight into how the company operates."³

DS Smith plc (ARA 2020, page 65) shows understanding of the FRC's approach in a section called 'Governance in action'. It states: "In the introduction to the Code the FRC recognises that high-quality reporting on the Provisions of the Code may include an explanation of how the spirit of the Principles has been applied, which in some cases may be by a different route from that suggested in the Code's Provisions... in three specific instances, our approach to the Provisions differs from the Code's."

We also observed some good explanations for specific cases of non-compliance. For example, **Rolls Royce Holdings plc** (Figure 2) provides a convincing and detailed explanation, giving readers clear insight into the situation at hand and the reasons behind the actions taken.

Figure 2: Rolls Royce Holdings plc, ARA 2019, pages 59 and 60

Board developments

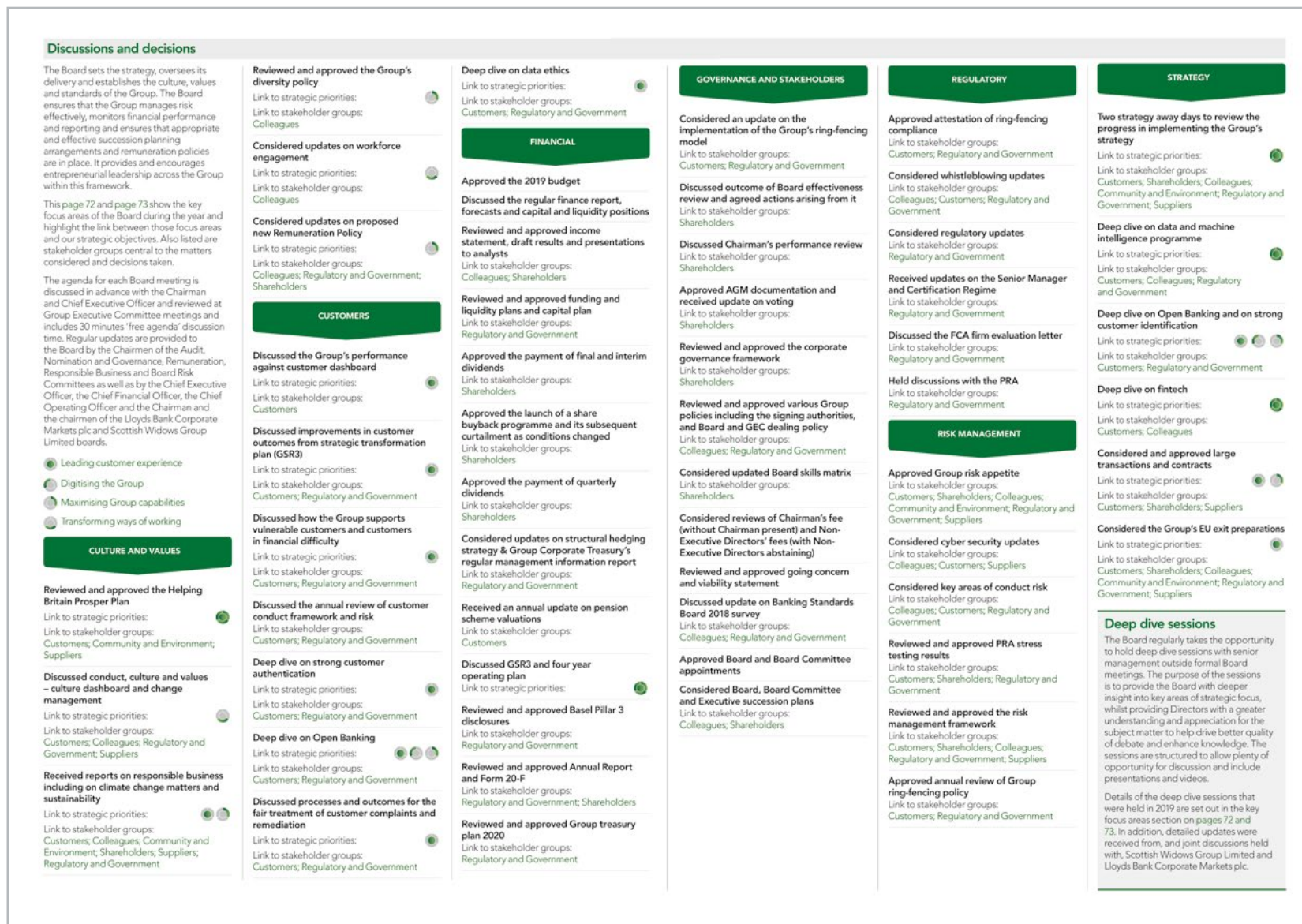
We are very sorry that Ruth Cairnie stepped down from the Board at the end of 2019 to allow her more time to focus on her other commitments, following her appointment as chair of Babcock International Group PLC. Following Ruth's departure, Irene Dorner was appointed as Chairman of the Remuneration Committee, with effect from 1 January 2020. While we note the Code requirement that remuneration committee chairs should have served on a remuneration committee for at least 12 months prior to their appointment, we have every confidence that Irene has the appropriate experience and skills to carry out the role. She formally joined the Remuneration Committee on 1 August 2019. Irene is Employee Champion on the Board, a role she has held for three years. Her role on the Audit Committee over the last four years gives her excellent insights into the financial performance measures and targets for the long and short-term incentive schemes. She has also attended six Remuneration Committee meetings since

joining the Board and is therefore familiar with the discussions and workings of the Committee. Irene also has experience of HR in her executive career having spent two years as general manager, human resources for a UK unionised workforce of 55,000 at HSBC. Irene joined Ruth to consult with shareholders on the remuneration policy that will be voted on by shareholders at the 2020 AGM and both attended the joint briefing during the year on wider workforce engagement (see page 86). Irene stepped down from the Audit Committee in December 2019.

Ruth's unexpected departure from the Board temporarily left us short of our own Board diversity targets. However, I am pleased that we have recently announced the appointment of Dame Angela Strank, currently chief scientist and head of downstream technology at BP and a member of their executive management team. Dame Angela will join our Board on 1 May 2020.

³ Annual review of the UK Corporate Governance Code, FRC, January 2020.

Figure 3: Lloyds Banking Group plc, ARA 2019, pages 72 and 73



Bringing governance to life through reporting

Promisingly, we observed many companies making improvements to and innovating in their reporting this year. However, while progress continues to be made in the strategic report, governance reporting mostly remains 'boilerplate' and the area most ripe for improvement. This seems like a missed opportunity. Applying the new requirements of the 2018 Code could have led to more thoughtful reporting.

A good way to do this is by removing many of the boilerplate process descriptions and replacing them with details about the actions taken in the year by the board (as outlined in the **Derwent London plc** example earlier). Information required by law can be moved to the back of the governance section so as not to interrupt the narrative. **Lloyds Banking Group plc** (Figure 3) provides a really clear overview of the board's focus in the year. It demonstrates the breadth of the board's role, the topics discussed and how they link to stakeholders and the strategy.

Bunzl plc (ARA 2019, pages 70 and 71) uses case studies to illustrate 'The board in action', including coverage of the board's overseas trips and the new CFO's induction. When used appropriately, case studies can be a great way of shifting focus from intent to action by bringing descriptions of what happened to life. However, there has to be substance over form – case studies need to be

used in a meaningful way to add detail and colour to reporting topics. **BP plc** (ARA 2019, pages 25-31) does this with case studies linked to each of its strategic priorities. **Drax Group plc** (ARA 2019, pages 22, 46 and 70) uses case studies across a range of areas such as strategy, diversity and board activity. Throughout its ARA, **The Vitec Group plc** includes short quotes from various employees relevant to the specific section.

Fair, balanced and understandable

In the ARAs we reviewed, FBU statements tend to be process orientated. Some provide interesting detail on how the board made its assessment, such as **Aggreko plc** (ARA 2019, page 60): "Full draft provided to the Committee and Board seven days prior to the February 2020 meetings to enable time for review and comment and to provide a final opinion".

Few companies go beyond a process statement to give more detail as to what the board or audit committee looked at, what challenges were raised and how these were addressed or what changes were made to the ARA. In a year full of change in all respects – regulatory as well as macro-economic as a result of the pandemic – we would expect more such detail. For example, **Derwent London plc** (ARA 2019, page 127) provides an insight into the approach taken in reviewing the ARA to ensure it was FBU, as well as an

overview of the changes made to the ARA in the year. **HSBC Holdings plc** (ARA 2019, page 174) gives an overview of the areas of focus of the FBU assessment at a high level: "In particular, the Committee gave careful consideration to the key performance metrics relating to the strategic priorities to ensure transparency and consistency throughout the financial reporting disclosures."

Encouragingly, we feel that companies have improved their KPI disclosures, with many now including more non-financial metrics. This is important progress towards disclosing some of the value not reflected in financial metrics that give an indication into aspects such as brand loyalty, employee sentiment and customer service, showing stakeholder outcomes more clearly.

Barclays plc (Figure 4) is unique in that it presents its KPIs split by stakeholder group and includes a wide range of internal and external financial and non-financial measures to assess performance. **Rentokil Initial plc** (Figure 5) provides rich KPI disclosure across many metrics – both non-financial and financial. For each, the company includes an assessment of the progress made, a five-year trend, the link to strategy and remuneration and a detailed overview of the performance.

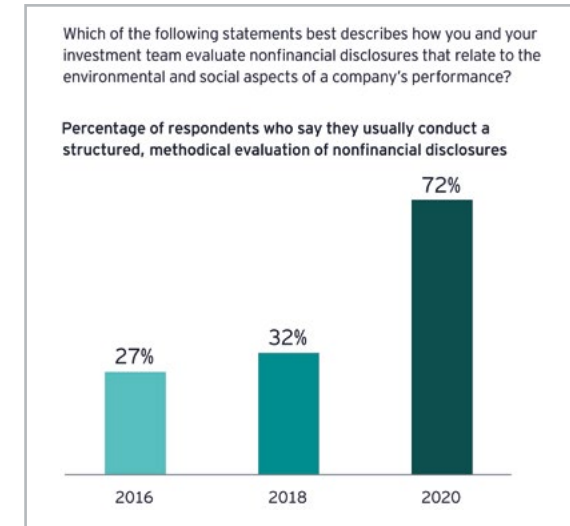
Figure 4: Barclays plc, ARA 2019, pages 18 and 19



Figure 5: Rentokil Initial plc, ARA 2019, pages 12-15



Figure 6: EY's July 2020 report, *How will ESG performance shape your future?*, page 9



EY's July 2020 report, *How will ESG performance shape your future?* found that the number of investors embracing structured reviews of non-financial disclosures has gone up significantly – to 72% from 32% in 2018 and 27% in 2016.

However, only two companies in our ARA analysis mention that they have reviewed KPI disclosures as part of the FBU assessment. Given the investor interest in such non-financial metrics and the likely direction of travel of the Brydon Review, we recommend that more boards, as part of their overall FBU assessment, consider whether their KPIs provide the right snapshot for measuring stakeholder outcomes and describe the progress to be made in key areas.

A number of FBU statements did reference a review of APMs, but only at a high level, explaining little more than that they were an area of focus. **IMI plc** (ARA 2019, page 73) provides more detail, as follows: “The Committee’s review included in particular the consideration of alternative performance measures and the classification and presentation of adjusting items in accordance with the Group accounting policy. The Committee received a detailed account of the restructuring costs disclosed as adjusting items and was satisfied that these were appropriately categorised given the nature, scale and purpose of the relevant projects.”

“

The lockdown has had a profound impact on social behaviours and mindsets and this will not be fully reversed when society normalises. Company disclosures need to evidence that they are on top of these trends such as stakeholder management, technology, and adjustment to business practices.”

Nathan Leclercq, Head of Corporate Governance, Aviva Investors

Response to COVID-19

It is imperative that companies report on COVID-19 in an open and honest way, as its impact likely permeates throughout the ARA and tests many of the commitments made. In addition, boards will typically have played a large role in overseeing and guiding their companies’ responses during these challenging times, and this should be reflected in governance disclosures.

We have observed some good disclosures from March and April 2020 year-end reporters. For example, **Marks and Spencer Group plc** (Figure 7) provides a detailed overview of the company’s response to COVID-19 alongside an event timeline and specific detail about the board’s involvement. **DS Smith plc** (Figure 8) uses a CEO interview in a Q&A format to draw out lessons from COVID-19 which it links effectively to the company’s purpose, as well as other pertinent issues.



Figure 7: Marks and Spencer Group plc, ARA 2020, pages 51-53

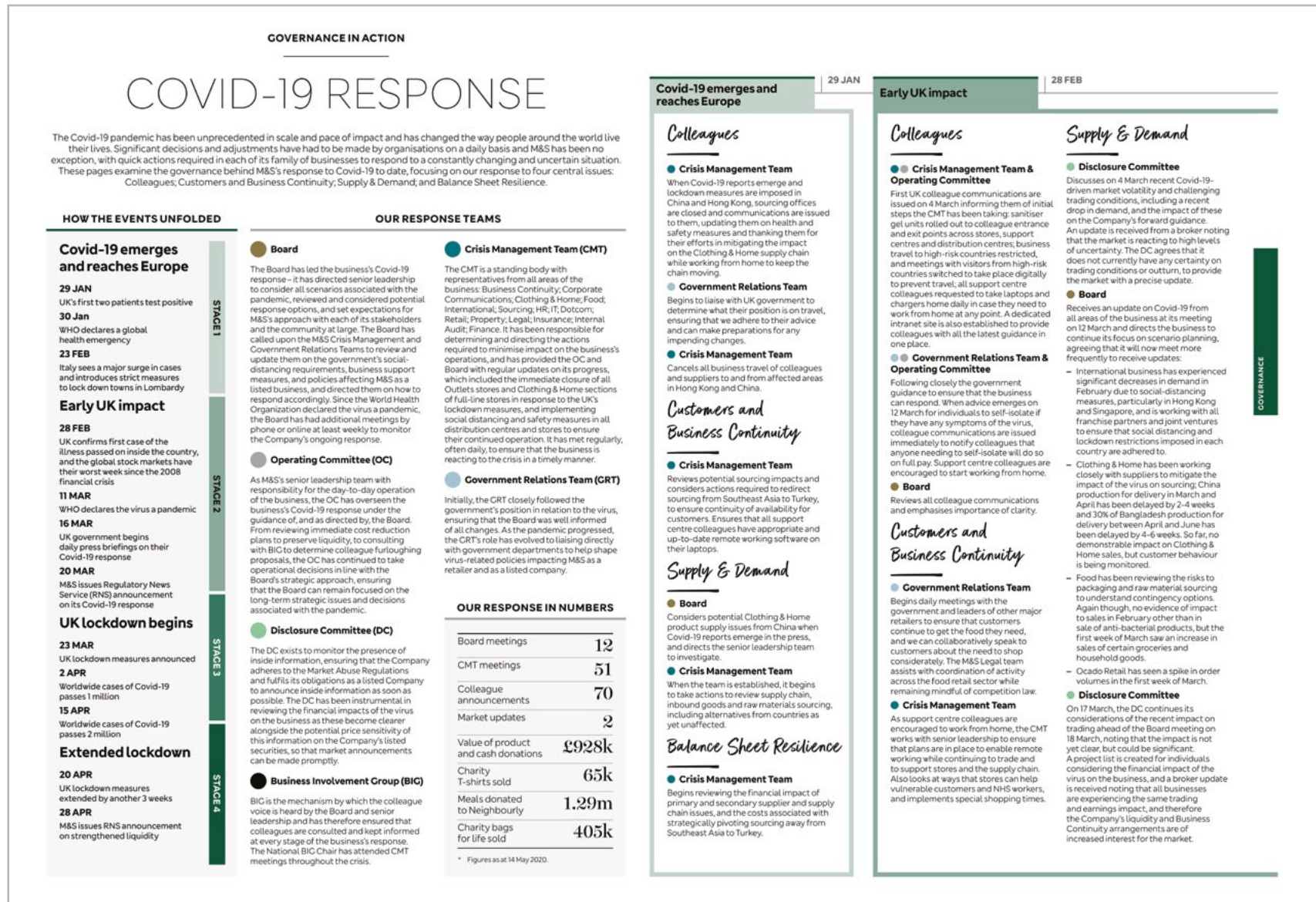


Figure 8: DS Smith plc, ARA 2020, page 20

GROUP CHIEF EXECUTIVE'S INTERVIEW

Q&A: Driving circularity



Q. How has DS Smith responded to Covid-19?

As we continue to respond to the global Covid-19 pandemic, I am immensely proud of our people who have remained steadfast in these challenging times. Their continued health and wellbeing is my priority and we have put in place stringent health and safety measures across all of our sites. I also recognise the critical role DS Smith and the wider packaging industry has right across global, national and regional supply chains. Our packaging is predominantly used to transport and protect food and personal care items or to deliver goods to people's homes through e-commerce. We also serve the vitally important pharmaceutical sector.

It is the continued production of paper and packaging that allows these goods to get to where they are most needed and that is why our teams continue to go to work every day to run these operations and support our customers' businesses. I am very appreciative of the way in which they responded to this challenge. While we have not faced significant disruption, our sites are working together to support each other, to transfer orders and ensure we do not let our customers down. This is a testament to the values we have embedded right across the business.

Q. How important are the communities in which you operate?

Our communities sit at the heart of our Purpose and over the course of 2019/20, we have engaged with 100 per cent of our local communities where we have sites with over 50 employees, covering a range of activities from community litter picks and school visits to cardboard boat races. Meanwhile, our Charitable Foundation continues to make a significant impact in the local communities we operate in, focusing its support on responding to Covid-19 through donations and innovative packaging for vulnerable citizens, alongside sustainability or education-focused community initiatives around the world.

Q. Consumer engagement in the challenges of sustainable packaging is increasing. How is DS Smith responding?

Our sustainable, fibre-based strategy has positioned us at the forefront of this trend and we continue to partner with our customers to lead the response across all industries. In particular, our fast moving consumer goods (FMCG) and e-commerce customers are facing increasing calls from their own consumers to decrease the amount of unnecessary packaging and move away from materials like single-use plastic. Many have set ambitious goals to ensure their packaging is reusable or recyclable within the next five years. As their partner, we are constantly innovating to support them to do this.

Our 'Circular Design Principles', alongside our approach to 'right-sized' and inclusive packaging, are a few of many examples of our response.

Q. You launched your Purpose, 'Redefining Packaging for a Changing World', in 2018/19. How has this been embedded in your business over the past year?

Following the launch of our Purpose, we have worked hard to ensure it sits at the very heart of our business model. It informs our strategic decisions and strengthens our operations to ensure our business is ready to meet the challenges of a changing world. It helps us to identify key growth drivers and delight our customers with the innovation needed to meet them, including responding to Covid-19, leading plastic replacement and reusable e-commerce solutions.

Through a continuous programme of engagement, our Purpose has been deeply embedded across our global workforce, driving pride and ownership, while allowing us to grow closer to our communities as we support them to meet the challenges presented by Covid-19.

“Our business is inherently circular and with the support of our Purpose, we are well positioned for today's and tomorrow's changing world.”

– Miles Roberts, Group Chief Executive

Our review of March 2020 reporters found little reference being made to boards' consideration of COVID-19 exceptional items as part of their overall FBU assessment. We expect increased disclosure in 2020/21 reports given the subjectivity of such items, their potential materiality and the likelihood that they will come under more scrutiny by regulators and stakeholders at large.⁴ It is important for companies to explain whether the pandemic represented a blind spot that the board had not considered or whether it manifested in the way the board had previously discussed when modelling black swan events in relation to the viability statement.

As we have seen with previous corporate governance code updates, it usually takes about three reporting cycles for best practice to evolve. Overall, in our view companies have made a good start with the 2018 Code but we expect to see further improvements and evolution of reporting in the coming years.

⁴ "Company Guidance (Updated 20 May 2020) (COVID-19)", FRC, May 2020.

Spotlight on the ARA process

More than words, the ARA is a point-in-time snapshot of a company's underlying processes and progress. In today's ARA, almost every topic is linked or co-related, so how can a meaningful ARA be put together?

Top five considerations

1

Hold a debriefing session to assess last year's process soon after publishing the ARA. Include a review of last year's ARA to identify opportunities for removing redundant or repetitive content and for 'moving the narrative on' to focus on outcomes from the year, rather than processes.

2

Appoint one owner to coordinate the ARA process. The role should involve more than project management and keeping to deadlines. Such process owners need to draw on their understanding of the company and its business in order to orchestrate how the ARA is put together, clarify its key messages and achieve consistency between sections and authors.

3

Start early: reporting relies on robust underlying policies and processes (e.g., stakeholder engagement), which may need adjusting early in the year if the ARA is to include meaningful narrative on progress and outcomes.

4

Get audit committee and senior leadership buy-in for aspects such as the strategic narrative and the governance report.

5

Ensure sufficient collaboration between relevant teams e.g., ESG or sustainability, finance, investor relations and company secretarial. Given the linkages between sections, build peer reviews (performed by someone other than the author) into the timeline.



2 Purpose

From intent to action

Most companies now disclose a purpose statement and, in some form, refer to having a purpose-led strategy and culture. However, more needs to be done to evidence this – to show that organisations have really moved from intent to action.

1

Discuss your purpose and beliefs in a way that an outsider can understand and provide tangible examples of your purpose in action.

2

Succinctly explain the alignment between purpose and strategic objectives.

3

Set targets and KPIs that will indicate how successful you are in realising your purpose.

Reminder – The 2018 Code introduced the requirement for boards to establish the company's purpose and ensure it is aligned to the values, strategy and culture.

- ▶ Purpose is the 'why?' Why does the company exist? What value is created and for whom?
 - ▶ Vision articulates what the company will look like or where it is heading.
 - ▶ A company's strategy should outline a plan for achieving its vision, in line with the company's purpose.
-

Number of companies disclosing their purpose



The importance of purpose

The importance of organisational purpose has been rapidly gaining pace in recent years. Organisational context and purpose are the first steps in EY's Long Term Value framework, while 'governing purpose' is the first theme in the consultation on common metrics issued by the World Economic Forum (WEF).⁵ Professor Alex Edmans notes: "The studies find that... it is purpose that leads to profit, rather than profit allowing a company to pursue purpose."⁶ It is therefore hardly surprising that the number of companies articulating a purpose has increased to 86%, up from 41% in our

2016/17 review. This is despite the fact that, strictly speaking, the 2018 Code does not require such disclosure: read literally, it requires companies only to have a purpose.

Confidence in the assertion that purposeful companies perform better comes through most strongly in the narratives of those companies that either articulated their purpose for the first time this year or revisited their previous purpose. It is encouraging to read the level of employee consultation and involvement in establishing and articulating purpose by companies such as **Burberry plc** (ARA 2019/20, pages 15-19, summarised in Figure 9), **Croda International plc** (ARA 2019, page 10) and **Informa plc** (ARA 2019, pages 30-37).

⁵ *Toward Common Metrics and Consistent Reporting of Sustainable Value Creation*, World Economic Forum. January 2020.

⁶ Professor Alex Edmans, "Pursuing purpose, not profit, could help businesses grow a bigger pie for all of us", *CITY A.M.*, 27 March 2020.

Figure 9: Articulating Burberry's purpose (ARA 2019/20, pages 15-19)

- ▶ Burberry explains its journey in the year to articulate its purpose statement 'Creativity Opens Spaces' based on the beliefs that have guided the business from its early days under its founder, Thomas Burberry.
- ▶ The etymology of the statement 'Creativity Opens Spaces' is explained and linked back to the manifesto of Thomas Burberry in which he set out his vision for the brand and shared early customer testimonials. The meaning of the succinct statement is unpicked so that its ethos can be understood by the reader.
- ▶ Details of the activities undertaken to arrive at the purpose statement are set out, including the following:
 - The company combined traditional methods e.g., researching archives, running surveys and holding focus groups with more creative ones e.g., creating a doodle wall. Almost half of the organisation's employees offered their opinion.
 - A Purpose Box – a letterbox where employees could 'post' their thoughts about the purpose – travelled around Burberry locations and collected 2,000 handwritten note cards. Board members also submitted cards to the box based on an early discussion on purpose.
 - Experts, long-standing partners, industry luminaries and customers were consulted.
 - Feedback on findings was shared regularly.
 - Senior executives and the board took part in an immersive working session, reviewing the global findings and shaping the final output.
- ▶ Learnings are shared, including how the journey to articulate purpose led to the identification of four values introduced alongside purpose.

Implementing and embedding purpose

To an outsider, many purpose statements can read like a marketing slogan that is interchangeable between companies and industries. Few companies translate their purpose statement into something that is truly relatable. Although much time is spent (anecdotally) on crafting purpose statements, arguably the wording is less important than the ability to demonstrate how the purpose has been implemented. To this end, we are encouraged by the work of the Enacting Purpose Initiative – a multi-institution partnership led by the Saïd Business School at the University of Oxford – which recently published guidance to help boards and senior executives to put purpose intent into practice.



Investors are concerned by the possibility of ‘purpose-washing’ by companies, i.e., defining a purpose as a mere marketing slogan, a façade to hide behind. In other words, companies will need to ‘walk the talk’ regarding their purpose as their shareholders expect consistent disclosure regarding how the purpose has been fulfilled and reviewed by the board.”

Ali Saribas, Partner, SquareWell Partners Ltd⁷

To evidence the veracity of their commitment, some companies have started making the purpose narrative an integral part of their story: **Lloyds Banking Group plc** (ARA 2019, page 27) includes an upfront summary of its contribution to Britain; **Greggs plc** (ARA 2019, pages 2-3) explains what it does for society as part of its business model disclosure; **Tate & Lyle plc** (ARA 2020, pages 16-17) discloses targets and commitments for each of the three pillars supporting its purpose. Some companies that changed their purpose in 2019 were clear that this meant their strategy also had to change: **Reckitt Benckiser plc** (ARA 2019, pages 6-19) redefined its purpose and overhauled its strategy, as well as establishing a new set of KPIs that clearly link back to purpose. **The Weir Group plc** (ARA 2019, pages 2-5) put sustainability at the heart of its new purpose and adapted its strategy to match.

Linkages between purpose and strategic objectives form a fundamental aspect of a company’s equity story. However, articulating these in a clear and succinct manner remains a challenge and the alignment often only becomes clear on more in-depth reading. For readers who dip in and out of ARAs, making this connection can prove onerous. To avoid this, **National Express Group plc** (Figure 10) not only provides an overview of its purpose in the context of its vision, belief and strategic objectives, but also states how it will judge success in realising it.

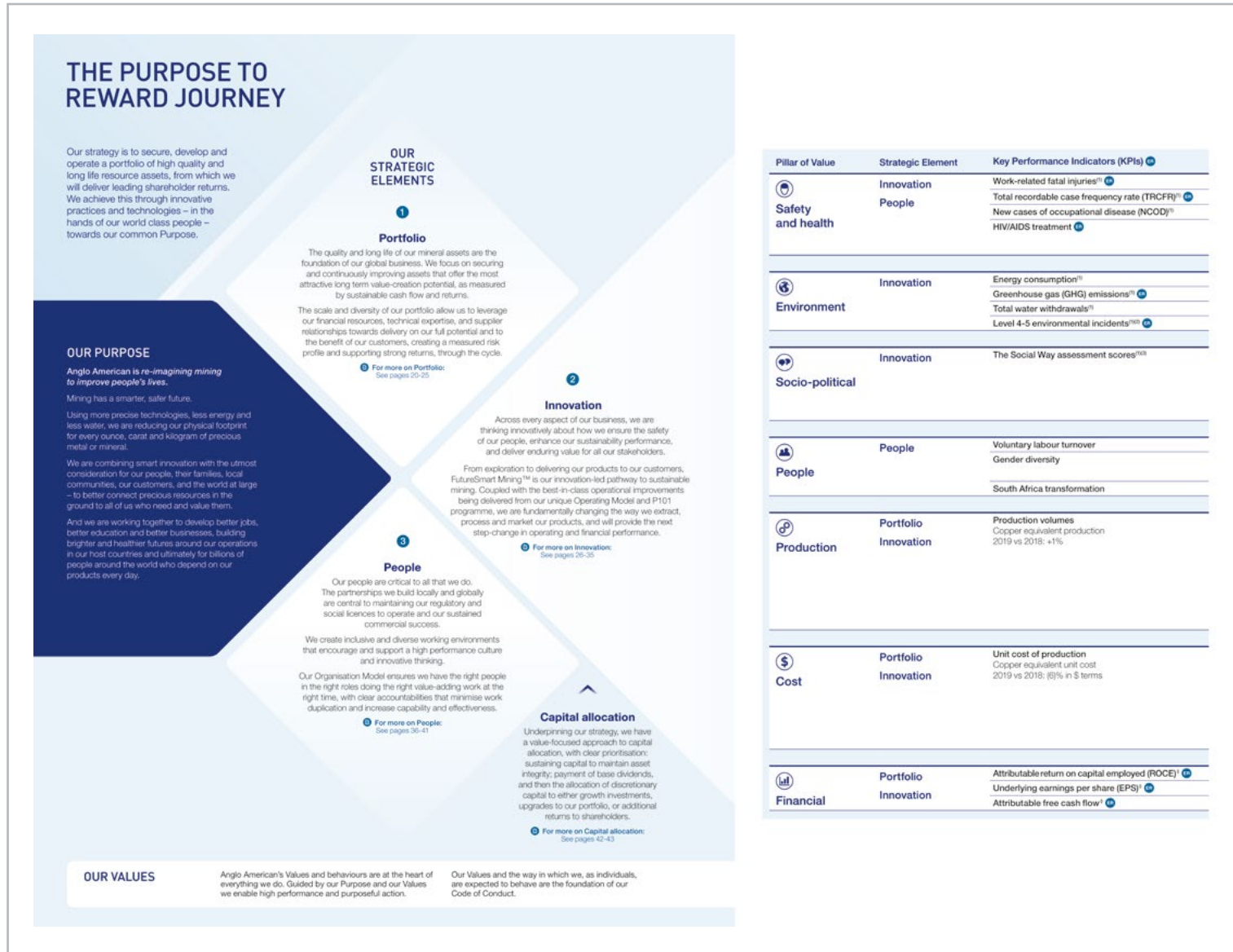
Anglo American plc (Figure 11) explains the alignment using a one-page graphic, supported by narrative in the CEO’s statement. The purpose statement uses the term “re-imagining” – suggesting new ways of thinking – which intuitively maps to the “innovation” element of its strategy. It also mentions “improving people’s lives”, which clearly links to the “people” element of strategy.

⁷ SquareWell Partners surveyed investors representing US\$22.1 trillion assets under management on their views about corporate purpose – *Making Corporate Purpose Tangible*, June 2020.

Figure 10: National Express Group plc, ARA 2019, page 69

| Purpose | |
|--|---|
| <p>During the year under review, the Board reviewed and articulated the Company's Purpose to ensure that it reflects the Board's current view of the Company's role in society. Such Purpose is best articulated when put into the context of the Company's Vision and Belief, its approach to achieving its Purpose and its view of how it will succeed in achieving its Purpose, as set out below:</p> | |
| Our Vision is: | to be the world's premier mass transit operator with services offering leading safety, reliability and environmental standards that customers trust and value |
| This Vision is rooted in a Belief that: | driving modal shift from cars to high quality mass transit is fundamental to a safe, green and prosperous future |
| Our Purpose therefore is: | to help lead this modal shift by making mass transit an increasingly attractive option for all our customers whether they are individuals, transport authorities, school boards or businesses. We seek to do this by earning our customers' loyalty by providing safe, reliable and great value multi-modal services on clean and green vehicles |
| We will achieve this through an Approach: | that seeks social and environmental leadership to ensure we are a good employer and partner, while using technology to make our services increasingly easier to access, safe and efficient. It is this model of progressive partnership that: delivers industry-leading services for our customers and communities; secures rewarding careers for our people; and generates sustainable returns for our shareholders |
| We judge Success as: | being seen by 2030 as the world's premier mass transit partner, with a reputation for industry-leading safety, reliability and value for money across a portfolio of easily accessible multi-modal services. At the forefront of technological innovation, National Express will lead the transition to zero emission vehicles, maintain its safety leadership and pioneer new ways to access transport. Our staff will see us as an employer of choice and customers will rely on us as an operator they can trust, with services that help meet their needs while also having a positive impact on their communities. This will, in turn, drive strong, consistent returns for our shareholders |

Figure 11: Anglo American plc, ARA 2019, pages 14-15



Beyond shareholder value

Principle A of the 2018 Code refers to a company's contribution to wider society, giving a clear indication that boards should look beyond just financial shareholder value when establishing a company's purpose. The expectation that a company's purpose should benefit all its key stakeholders has now become mainstream. This view was given a strong impetus by the Business Roundtable (BRT) statement which, in August 2019, announced a move away from stakeholder primacy.⁸

“

Stocks that 'make the world a better place' were already on decent valuations benefiting from positive legislation drivers but they have now started to re-rate further as more money is flowing into ESG funds.”

Andrew Neville, Fund Manager,
Allianz Global Investors

Rather more quickly than expected, COVID-19 became a test case not just for the BRT signatories but for any company that made a bold statement about 'doing the right thing'. In light of the global crisis, intent had to be turned into action, or lip service risked being exposed for what it was.

Many businesses held true to their word. As lockdowns progressed, the narrative on how companies were realising their purpose for the benefit of society evolved: it began to shift from explaining how companies earmarked funds to support the plight caused by COVID-19, to detailing how they were contributing to fighting the virus in the context of

their business. This was already the case in the 31 March and 30 June interim reports of many companies and in a number of the ARAs of 31 March 2020 year-end reporters, such as **Burberry plc** (Figure 12).

Albert Camus wrote: “What is true of all the evils in the world is true of plague as well. It helps men to rise above themselves.”⁹ We hope that in years to come, society will look back at the COVID-19 pandemic and see it as a pivotal moment that cemented the belief that a “company serves not only its shareholders, but all its stakeholders – employees, customers, suppliers, local communities and society at large.”¹⁰

Figure 12: Burberry plc, ARA 2019/20, pages 56-57

Bringing people together

Alongside our external commitments, many of our employees around the world looked to Burberry for guidance on how they could help the COVID-19 relief efforts. Burberry teams around the world volunteered their time generously, mobilising to help local communities and charities by preparing care packages, delivering meals, stocking food banks and supporting vulnerable neighbours. In a short space of time, The Burberry Foundation also launched a global COVID-19 community appeal, which offered employees a way of supporting emergency response efforts by donating to the community fund. All funds raised by The Burberry Foundation's COVID-19 community fund appeal are supporting emergency response efforts, including the procurement and distribution of personal protective equipment (PPE) and other medical materials, contributions to foodbanks, donations to healthcare charities and additional support for those working to tackle the pandemic.

SUPPORTING MEDICAL AND CARE WORKERS

We retooled our trench coat factory in Castleford to manufacture non-surgical gowns for medical and care workers and sourced surgical masks through our global supply chain. By the end of May, we had donated more than 150,000 pieces of personal protective equipment to the UK's National Health Service and healthcare charities, and this number has continued to grow.

PROVIDING RESOURCES FOR OTHER COMPANIES TO HELP WITH PPE PROCUREMENT AND PRODUCTION

Burberry engaged with industry and governmental organisations on coordinated responses to the pandemic. In support of the UK Government, we also produced a document, which provided information on adapting operations to procure and/or manufacture PPE. This document was designed to be shared with companies across sectors looking to respond to the COVID-19 pandemic.

⁸ Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans', *The Business Roundtable*, August 2019.

⁹ Albert Camus, *The Plague*.

¹⁰ “Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution”, *World Economic Forum website*, August 2020.

Case study: EY's long-term value framework in action

Navigating the shift from shareholder to stakeholder value

Leading purpose-driven companies are taking long term value to the heart of their organisations, making it a genuine focus of the c-suite. Over the past year we have worked with organisations in different industries intent on revisiting their strategy to ground it firmly in a purpose that creates value for all stakeholders, not just shareholders. This can be achieved through focussing on better stakeholder outcomes, be that accelerating the energy transition, achieving improved health outcomes, or giving communities improved access to prosperity through upskilling of talent, digital connectivity or access to basic utilities.

Using our Long-term Value framework, we have helped these companies to look closely at how what they do creates positive outcomes for stakeholders, and how that impact can best be monitored. New metrics are then reflected in management reporting, performance and capital allocation frameworks, going beyond margin and traditional return on capital measures towards other indicators of value, such as employee engagement and diversity, consumer trust and societal and environmental impacts.

We also see increased interest from companies in outcome measurement¹¹. Some are developing measurement frameworks to quantify their impact on society in financial terms, thus providing

greater insight on the intangible value they create. Novartis, for example, measures their social impact at \$67bn based on the estimated value of health benefits to patients.¹²

“

The metrics which a business selects to monitor and demonstrate success in today's stakeholder centric environment are frequently non-financial. They must be closely linked to intended outcomes if they are to demonstrate contribution to long-term value. Unfortunately, a strong linkage between strategy, intended stakeholder outcomes, and relevant metrics is rarely made in ARAs. Given the interest in non-financial value and investors' new responsibilities under the FRC's Stewardship Code this is likely to become an increasingly important narrative.”



Rebecca Farmer, Partner,
EY Long Term Value Lead

¹¹ *How do you value your social and human capital?* EY, August 2019.

¹² *Novartis in Society – ESG Report 2019, Novartis website.*

3

Culture

From intent to action

Culture was already the watchword of the corporate and regulatory world in 2015, when fewer than 10% of companies attempted to discuss how they measured it. Four years on, the majority of companies make some reference in their ARA to how culture is monitored, but very few discuss exactly how they do this or the resulting actions. To progress what has been done, companies should:

1

Explain why the desired behaviours are critical to the achievement of strategic objectives.

2

Lift the bonnet and be transparent about the metrics used to assess the actual culture.

3

Articulate the actions that need to be taken to close any identified gaps and report on progress.

Reminder – Provision 2 of the 2018 Code introduced a requirement for the board to assess and monitor culture, and to ensure it is aligned to the company's purpose, values and strategy, as well as to the approach taken to reward.

- ▶ Purpose informs the desired values.
 - ▶ The desired values are translated into behaviours.
 - ▶ The behaviours support the achievement of strategic objectives.
-

Culture matters

The conviction that culture is fundamental to creating and protecting long-term value is widespread. The right organisational culture should help to ensure that employees follow the North Star of purpose and their behaviours support the achievement of strategic objectives, even when policies and procedures can't keep up with the pace of change. The COVID-19 pandemic is a real test for culture – control frameworks, especially those more heavily dependent

on manual controls, have been disrupted and regular engagement structures have ceased to exist. Time will tell whether companies with the right culture were able to withstand the crisis and adapt better and more quickly to their changed work environments. Furthermore, the actions that companies are taking in response to COVID-19 will not only impact culture temporarily, but also shape it for years to come. These actions need to be aligned to the stated values and desired behaviours – or the narrative in the ARA simply won't ring true.

It may be that COVID-19 becomes a catalyst for companies to raise their game on culture reporting.

The do's and don'ts of describing culture

There is no perfect formula to describe a company's culture in a compelling way. The vast majority of companies attempt this by setting out their values, but too often these read like slogans and the description of the 'unique culture' quickly becomes boilerplate. The challenge is to bring values to life using tangible examples and explain how the related behaviours guide decision making in the context of the organisation: 'always doing the right thing' will mean something different for a mining company than for a

professional services firm. **Smith & Nephew plc** (ARA 2019, pages 24 and 25) achieves this by including a double-page spread explaining what its culture pillars of care, collaboration and courage mean in practice, both at the top and cascading down across all ranks of the organisation. **Land Securities Group plc** (ARA 2020, pages 68 and 69) explains its culture through four themes, with examples of relevant activities undertaken during the year and supporting indicators.

It is equally important to articulate how culture supports strategy and creates a competitive advantage. Despite culture being discussed in the risk section rather than as part of the broader cultural narrative, companies have been making progress in explaining how culture helps to protect value. However, they continue to struggle to articulate how culture supports the achievement of their strategic objectives.



While leaders want their company to be great at everything, a company's strategy will call for a specific orientation in the market (e.g., the innovator, the best brand, the most efficient), and the culture should be intentionally designed by management in the context of that orientation. Doing so will help shape decisions and behaviours, e.g., what kind of people are hired, what workplace policies and processes are put in place, what behaviours are rewarded. Research shows that companies generally fall into one of five culture archetypes that defines who they are: innovation, brand, customer, efficiency and quality.”

EY US Centre for Board Matters¹³

¹³ Stephen Klemash & Joe Dettmann, PhD, “Five ways to enhance board oversight of culture”, EY US Center for Board Matters.


One company that has done this well is **Rentokil Initial plc** (Figure 13). It includes an interview with the CEO focused on the importance of innovation, expressing views on what sets Rentokil

apart from other industry players that also claim to be highly innovative. There are cross-references to innovation case studies and the broader culture narrative. The employee

survey includes a specific question as to whether employees (colleagues) agree that the company is innovative, and the results are reported. This question is clearly linked to one of Rentokil's strategic priorities set out on page 28.

Figure 13: Rentokil Initial plc, ARA 2019, pages 4, 5 and 28

Q&A with Andy Ransom, Chief Executive
Innovation is embedded within our culture



> **Deploy innovation consistently, targeted at key pest sectors and with potential for new non-toxic solutions.**

We will continue to invest in product and service innovation to support our profitable growth and industry leadership and have an extensive pipeline of activities in place to support growth in 2020 and beyond. In 2020, we will focus on completing the roll-out of Lumnia across all our markets and will further expand the product range.

In 2020, we will develop and launch Global Bait Box, an innovative, flexible, technology-enabled rodent solution which addresses 57 different needs and market requirements. We will also continue to develop non-toxic pest control solutions (biological and physical methods in place of synthetic chemical products and pesticides) in response to regulatory changes and customer preferences.

“

Absent meeting people from within an organisation, can reporting fully bring a company's culture to life? Potentially not, but disclosures would be more helpful if instead of relying only on irrefutable concepts and words like integrity, excellence, honesty, transparency they focused on outcomes and treated culture as an asset. Boards should explain why the culture is right for what the company intends to achieve and how it contributed to the success (or not) of the business in a given year.”

Freddie Woolfe, Global Equities,
Jupiter Asset Management

Measuring and monitoring culture

As required by the 2018 Code, culture monitoring has moved up the board's agenda. **Glencore plc** (ARA 2019, pages 96 and 105) established a new ethics, compliance and culture committee in order to

focus on culture and stakeholder engagement, along with ethical and compliance matters. It is therefore not surprising that the accompanying narrative is relatively extensive this year compared to last. **Balfour Beatty plc** (Figure 14) sets out the actions taken by each director to monitor culture and explains how these contributed to delivering insights on culture.

Figure 14: Balfour Beatty, ARA 2019, page 94

| HOW THE BOARD MONITORED CULTURE IN 2019 | |
|--|--|
| ACTION TAKEN | LINK TO CULTURE |
| Each Director undertook visits to sites and employee events | ▶ Provided direct insights into workforce working environments, their behaviours and practices, their attitudes and approaches to other stakeholders, and the practical application of policies and standards |
| Each Director provided verbal feedback on visits to sites and employee events to the rest of the Board | ▶ Sharing experiences of visits and discussing these as a Board assisted in creating a broader exposure for each Director than would otherwise be possible due to the range and scale of the Group's operations across different sectors and geographies |
| Reviewed whistleblowing statistics, details of cases raised through the Speak Up provision and related independent investigations | ▶ Provided a perspective on the nature of employee concerns and trends in the behaviours of the workforce generally |
| Updated on a broad range of business integrity matters including approaches to combating modern slavery | ▶ Provided the Board with a broad understanding of practices and behaviours and how these align with the purpose, values, vision and strategy of the Group |
| Reviewed results and updates from employee engagement surveys | ▶ Identified high-level trends in employee satisfaction and understanding of Group policies and practices |
| Reviewed regular updates on reporting against the Prompt Payment Code in the UK | ▶ Provided an understanding of the Group's approach to supply chain partners |
| Reviewed statistics and trends of lost time injury rates across the UK, US and Gammon | ▶ Enabled Directors to assess the effectiveness of safety practices and behaviours |
| Reviewed metrics on safety observations reported by employees | ▶ Allowed a further insight into safety behaviours by evidencing the extent of individual responsibility taken by employees with regard to proactively reporting safety concerns |
| Reviewed details of the outcomes of internal audits judged to be less than satisfactory (undertaken by the Audit & Risk Committee with details available to all Board members) | ▶ Supplied the Board with a direct view of areas of practice, policy and behaviours that were not at the desired standard and provided details of the corrective action being taken |



Tesco plc (Figure 15) takes a unique approach to discussing how the board monitors culture – using each of its three values as a lens and at the same time explaining the link between that value and the strategy.

In 2017, only 9% of companies indicated how their board measured culture. Although most companies now state that they do measure it – unsurprisingly, as it is required by the 2018 Code – they appear to be keeping their cards close to their chests, and do not voluntarily reveal concrete data points.

Where disclosed, the more common metrics to measure culture include whistleblowing cases, training completion rates, safety metrics and, to a lesser extent, turnover or resignation rates. Without concrete metrics, it is difficult to identify underlying issues or drive actions by incentivising the management team via its executive remuneration.

To this end, **Rio Tinto plc's** (ARA 2019, page 22) disclosure is informative, as it sets out the company's direction of travel. The ARA explains that “non-financial metrics for measuring the people strategic pillar have been developed, including the development in 2019 of a culture and values scorecard” and states that in 2020 the company will consider “which of these internal metrics will be used as published KPIs in future annual reports”.

Some companies are silent on whether metrics have been established or identified and their narrative on culture monitoring focuses instead on the review of policies and procedures. Although important, this is limited to assessing only the desired culture, not the actual one.

Generally, companies are more transparent about employee survey results. This is useful, but survey results may not give the full picture. For example, a high employee engagement score coupled with a rising turnover rate tells a different story than the high engagement score alone. See our ‘Spotlight on employee surveys’ on page 38 for more analysis.

A balanced approach that takes into account internal metrics, survey results and external data points is fundamental to effective monitoring.

AstraZeneca plc (ARA 2019, page 107) introduced a new workforce trends report, which is reviewed by the board twice a year.

It contains a summary metrics dashboard compiled from data across the global workforce, including scores from employee surveys and promotion and resignation rates, as well as references to other relevant reports. **Taylor Wimpey plc** (Figure 16) demonstrates a balanced approach to culture monitoring, which includes a survey, internal metrics, external data points and compliance initiatives, and sets out the actions undertaken by the board as a result.



Figure 15: Tesco plc, ARA 2020, page 26


| | | |
|-------------------------|--|---|
| <i>Our values</i> | We treat people how they want to be treated. | |
| <i>Link to strategy</i> | We know that looking after our colleagues with respect and compassion is essential to building a culture of trust, a necessary component to the success of Tesco. We focus on ensuring that our business is a place where colleagues feel recognised and rewarded for the work they do together, where they have the opportunity to get on and where they are supported in their development as they move through their careers in the business. | |
| <i>Board oversight</i> | <p>We employ more than 400,000 colleagues globally and the Board aims to ensure that every one of them has the opportunity to get on.</p> <p>The Board recognises that getting on means different things to different colleagues. For some, it's about enabling them to be themselves, flexibility that allows them to fit work around their lives and being supported in leading a healthy lifestyle. For others, it means developing the skills they need now and in the future, choices to move roles and opportunities to gain experience. Whatever it is colleagues want to achieve, the Board's aim is to help</p> | <p>them succeed by providing them with the flexibility, skills and reward to get on.</p> <p>Customers are at the heart of everything we do and every decision we make to ensure we offer customers the value, quality and service that they expect and it is delivered in the right way for them. In support of this, members of the Board have spent time engaging with customers, colleagues and a wide range of stakeholders. Through customer, colleague and supplier surveys the Board receives insight into how Tesco is perceived, what our stakeholders want and how they want to be treated.</p> |

Figure 16: Taylor Wimpey plc, ARA 2019, pages 69 and 71

How our Board monitors culture

The Board sets the culture of the Group, as described on pages 2, 61 and 69, and uses a number of indicators to inform its regular assessment of whether the culture continues to be appropriate and whether there are any further actions that are necessary.


These indicators cover a range of in-house and independent monitors, as set out below:



Employee survey

The Employee Survey is conducted every two years and the results for 2019, in which over two-thirds of employees participated, showed over 90% considered that:


- Their work gave them active engagement in the Group's performance and prospects.
- They understood, supported and actively promoted the Group's strategy.
- They understood, supported and actively promoted in their day to day work the key strategic direction of improved attention to customers' needs.



Glassdoor list of best places to work

The results of the Employee Survey (above) are further borne out by the annual Glassdoor list of best places to work which is an independent survey across UK businesses of employees' perception of the Company for which they work.


The 2019 list, ranking the best places to work during 2020, showed the Company had maintained its top fifty ranking for the third successive year and continued to be the highest-ranked of the major UK Housebuilding companies.



Employee retention


The Board receives an update on HR matters at each meeting.

Our employees offer one of our greatest competitive advantages and retaining their services is a key element of our strategy. Voluntary employee turnover of 12.9% is lower than for 2018 and is aligned to a strong level of engagement with the Company's strategy.



Health and safety

The Company maintains an absolute, non-negotiable commitment to maintaining a healthy and safe place of work for all stakeholders, as described elsewhere in this Annual Report on pages 15, 23 and 28. The Employee Survey described above found that 97% of employees understood their role in advancing this commitment in their day to day work.



Compliance

The Group has robust policies, regularly reviewed, concerning key governance areas including anti-bribery; anti-corruption; anti-money laundering; and anti-slavery and human trafficking. These policies are actively promoted through online training; checks for successful completion of initial and updated training and guidance; and annual sign-offs by senior management across the business.

These processes and checks are underpinned by a robust Internal Audit Department, whose work is monitored by the Audit Committee as described on pages 103-104, and an independent whistleblowing process monitored by the Board as described on page 75.

The Company's approach is described in more detail on page 71. The Board is led in these respects by the Chair, who ensures the Board operates correctly, setting its own culture and, by extension, that of the Company in its operations and its dealings with all stakeholders. The observance of that culture throughout business operations is led by the Chief Executive with the assistance of the other Executive Directors and the Group Management Team.

During the course of 2019 and into 2020, the Board actively reviewed and monitored several key areas that it considers are important indicators of the Company culture, including health, safety and environmental matters (as set out on pages 28 and 37), customer service, land, risk strategy, and diversity and inclusivity.

Spotlight on employee surveys – a measure of culture?

Employee engagement is a useful output measure of an organisation's culture, in the same way as attrition rate or a customer satisfaction score. However, a typical employee engagement survey does not provide information on values and behaviours.

Encouragingly, an increasing number of companies present the results of their engagement surveys, including historical trends. For example, **InterContinental Hotels Group plc** (ARA 2019, page 45) includes the bi-annual employee engagement survey score as a KPI, provides five

years of data, and shares conclusions drawn in the form of next year's priorities.

However, it is only by measuring values and behaviours, the cultural 'inputs', that an organisation can truly understand what is driving its culture. An example of a company that transparently shares insights obtained through a culture survey is **Polymetal International plc** (Figure 17).

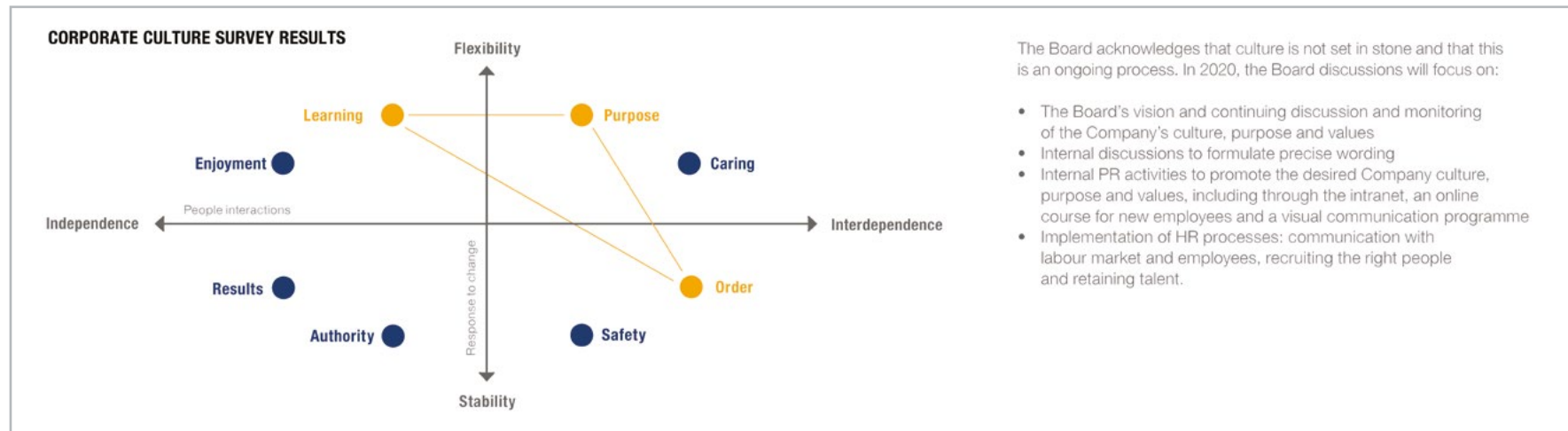
EY has been working with companies across different sectors to develop their approach to

assessing and monitoring culture, moving their focus away from a traditional employee engagement survey to one that provides better evidence of the values and behaviours that are both driving performance and reducing risk.



Simon Manterfield, EY Culture, Diversity & Inclusion

Figure 17: Polymetal International plc, ARA 2019, page 99



Fewer than 20% of companies in our sample referred to the role of internal audit in monitoring culture, and even fewer indicated that specific culture audits may have been conducted. This implies that the main unfiltered source of culture insights available to the board is through direct workforce engagement – even further amplifying its importance. Many boards were only starting to think about their approach to monitoring culture prior to COVID-19. Now they will have to adapt to doing this in the current remote working environment.

“

My role complements our internal work on improving culture. Following a cultural survey, my engagement is used to probe deeper into certain questions with the workforce — getting to understand what the issues are behind the survey data.”

Designated Non-Executive Director, mutual financial institution

Outcomes and actions

The way that companies identify gaps between the desired and actual culture and explain the actions taken to close them could be improved.

Many companies acknowledge the 2018 Code requirements by stating that, where the board had concerns, it asked management to undertake remedial action. Few, however, are transparent about what these concerns were or the actions needed to address them. **HSBC Holdings plc** (ARA 2019, page 176) refers to the need to improve the ‘speak-up’ culture in order to develop and maintain a culture where employees can raise issues and concerns without fear of punishment,

embarrassment or rejection. **Taylor Wimpey plc** (ARA 2019, page 69 and see earlier example) summarises the initiatives to be undertaken, while **Polymetal International plc** (ARA 2019, page 99 and see earlier examples) sets out the board’s focus areas for the following year. Even fewer companies, if any, explain what targets have been set and how the board will monitor the efficacy of actions taken to improve culture.

Clarity on tracking progress and action monitoring is especially important for companies that have outlined initiatives to change or transform culture or introduce new values. It is difficult to articulate progress in a credible way if no targets have been set.

4 Managing risk and viability

From intent to action: risk

Although the 2018 Code requirement seems to have led many companies to increase their focus on emerging risks, more insight needs to be provided to evidence that a company has proper risk management procedures in place to identify and manage emerging risks.

1

Explain how the risk management processes were adapted to identify emerging risks – or what is already in place to identify them.

2

Describe how emerging risks are monitored through the organisation.

From intent to action: viability

1

Give an overview of the changes made to viability scenarios in light of COVID-19 (and any other significant events or challenges faced in the year) and disclose the results of the scenario testing in a quantitative manner.

2

Disclose the interconnectivity between principal and emerging risks when assessing the company's long-term prospects.

3

Provide insight into any changes in the company's risk appetite and explain how changes in appetite today will help you remain competitive over the long term.

Reminder –

- ▶ Provision 28 requires companies to complete a robust assessment of the company's emerging and principal risks, describe what procedures are in place to identify emerging risks and explain how these are being managed or mitigated.
 - ▶ The 2018 Code does not define emerging risks. Companies are not required to disclose their definition, nor what emerging risks have been identified.
 - ▶ In our view, emerging risks are those that are likely to materialise or have an impact over a longer timeframe. This timeframe can vary, although we recommend it should be no less than three years. Emerging risks generally do not have much of a 'track record' or previous known experience against which their impact or probability can be considered. Therefore, it is likely that different 'scales' such as vulnerability, velocity and preparedness may need to be used to help assess, track and monitor them.
-

The growing importance of emerging risks

The COVID-19 crisis has tested organisations' risk management processes and led to enhancements. The pandemic is proof of how threats that may have been seen as distant or 'off the radar' can rapidly evolve and affect almost every aspect of a company's business. It has really brought home the requirements introduced by the 2018 Code regarding emerging risks.

As noted in last year's ARA review, boards should first define what an emerging risk is and ensure that the term is understood throughout the organisation.¹⁴ Companies' ARAs should then explain clearly what procedures are in place to identify emerging risks and be transparent about the frequency of assessment.

Emerging risks

In line with Provision 28 of the 2018 Code, some December 2019 reporters have meaningfully explained the changes they made to their risk assessment processes in order to identify emerging risks. For example, **Fresnillo plc** (ARA 2019, page 88) summarises the activities undertaken to strengthen its risk management process: it has defined the emerging risk concept, deployed effective monitoring mechanisms, carried out horizon scanning (including

the use of third party information from global risk reports and academic publications) to consider disruptive scenarios, and implemented mitigating control actions. The company has also enhanced its risk awareness culture. **Balfour Beatty plc** (Figure 18) explains that the new requirement has been embedded within the group's risk management reporting process. It describes its treatment of emerging risks, explaining that these risks are subject to discussion between the group, the strategic business unit and the enabling function. Relevant emerging risks are escalated to the Executive Risks Steering Group for further analysis and validation.

Disappointingly, the vast majority of companies only make generic references to emerging risks when describing their risk management processes. They provide little insight into whether existing risk management processes were sufficient to identify emerging risks or whether they had to flex or amend these processes to do so. They give little information about how emerging risks, once identified, are treated and monitored.

Where companies clearly explain changes made from a process perspective to identify emerging risks, there are references to workshops, meetings, surveys, third party information and – in the case of **Rolls Royce Holdings plc** (ARA 2019, page 50) – the use of an app to collect insights from a diverse stakeholder group.

¹⁴ *Annual reporting in 2018/19: engaging stakeholders, restoring trust*, EY, 2019.

Figure 18: Balfour Beatty plc, ARA 2019, page 75

Emerging risks

As part of the July 2018 update to the UK Corporate Governance Code listed companies are required to identify the procedures they have in place to identify emerging risks faced by the business and an explanation of how these are being managed or mitigated.

This requirement has been adopted and embedded within the Group's risk management reporting process and, in parallel with the day-to-day management of risk, each Strategic Business Unit (SBU) and Enabling Function (EF) includes specific reference to its emerging risks in its half year and full year risk submission. These risks form part of the discussion between the Group and the SBU or EF and relevant emerging risks are escalated to the Executive Risk Steering Group for further analysis and validation.

Within Balfour Beatty, emerging risks are considered in the context of longer-term impact and shorter-term risk velocity and are viewed in context with its Viability statement. The Group has therefore defined emerging risks as those risks captured on a risk register that:

- are likely to be of significant scale beyond a three-year timeframe; or
- have the velocity to significantly increase in severity within the three-year period.

Relevant emerging risks are discussed below:

| RISK EVENT | IMPACT | CONTROLS | TIMESCALE |
|---|--|--|-----------|
| Climate change Failure to adapt to climate change pressures, regulatory change (i.e. Task Force for Climate Related Financial Disclosures) and client expectations. | <ul style="list-style-type: none"> ➤ Exposure to fines, defects, project delays and reputational harm amongst stakeholders. ➤ Climate change also presents several opportunities to the Group (flood defences, improving utility infrastructure, etc). | <ul style="list-style-type: none"> ➤ Climate change clauses built in to contracts, ongoing review of reporting and operational regulations and use of up-to-date weather data in project planning. ➤ The Group is actively working with its customer base to showcase its infrastructure capabilities. | >3 YEARS |
| Net Zero Carbon Failure to adapt to increased social awareness and client expectations. | <ul style="list-style-type: none"> ➤ Reduction in future work including including with strategic clients and within frameworks. | <ul style="list-style-type: none"> ➤ The Group maintains strong relationships with its customer base to understand expectations and share potential limitations. ➤ The Group has demonstrable capability in delivering innovative and sustainable solutions. | <3 YEARS |
| Uptake of new technologies Failure to embrace innovative technologies to deliver efficiencies to the Group and its customers. | <ul style="list-style-type: none"> ➤ Inability to deliver better for less resulting in a loss of competitive advantage within the marketplace and an inability to secure further work. | <ul style="list-style-type: none"> ➤ The Group continues to drive innovation through adoption of improved project management tools such as Field360 and is working with industry-leading external advisers to embed creative thinking. This is reinforced by the appointment of a Chief Technology Officer to lead the accelerated delivery of change and innovation. | <3 YEARS |

Defining emerging risks

Although not required by the 2018 Code, an increasing number of companies disclose what they consider to be emerging risks in the context of their organisation. When doing so, companies often refer to them as unpredictable events and explain that those risks could have a material impact on their business, strategy or financial strength.

Not all companies refer to a timeframe. Those that do, such as **Reckitt Benckiser Group plc** (ARA 2019, page 75) and **Balfour Beatty plc** (Figure 18), tend to consider a range between two and five years.

Reckitt Benckiser Group plc (ARA 2019, page 75) defines emerging risks as: “an event that has the potential to significantly impact RB’s financial position, competitiveness and reputation, specifically;

- ▶ When the nature and value of the impact is not yet fully known or understood, giving the emerging nature of the risks; and/or
- ▶ With an increasing impact and probability over a longer time horizon (i.e., 5+ years)”

Emerging risks disclosures – climate change

This year, an increasing number of companies disclose the specific emerging risks they have identified. The most common ones relate to environmental and technology issues, followed by geopolitical issues. Companies that refer to technology issues often focus on the risk of being unable to embrace new technology, which may put them at a competitive disadvantage.

Spotlight on resilience statements – the link with emerging risks?

The Brydon Review of December 2019 recommends that “the board should make a Resilience Statement that incorporates, enhances and builds on the Going Concern and Viability Statements”. This resilience statement would be broken into three sections: short term resilience, medium term resilience and long-term resilience.

When addressing long term resilience, paragraph 8.1.3.3 of the report states that “... directors would reference the sorts of threats that the company may face – climate change may provide a particularly good example – and describe either why they believe the company is resilient in the face of such threats or what processes are in place to enable the company to plan its reaction to these threats.”

We therefore see a natural link between emerging risks and the proposed resilience statement. We encourage boards to start thinking about the alignment between their emerging risk timeframe and the extant requirement to consider and disclose “long term prospects” (as part of the viability statement), and also potentially in future resilience statements.

Some companies disclose climate change as both a principal and an emerging risk. This might be because it is such a broad term, with some aspects that are well known and understood – leading to its inclusion as a principal risk, and others that are still unknown – hence an emerging risk to the company.

National Grid plc (Figure 19) has elevated climate change from an emerging risk to a principal risk. It makes effective use of a case study to illustrate its approach and conclusion that, this year, climate change is a principal risk.

Companies will be affected by climate change in different ways and their approach to considering climate-related challenges will also vary, depending on organisational context. However, there is an expectation that companies will at least describe how they have assessed the impacts and are managing them.

“

In general, investors believe that more companies should be assessing climate change as a risk, or at least as an uncertainty, in their reporting of principal risks and uncertainties. However, investors are also interested in which risks companies have themselves identified. There is an expectation that how a company assessed the materiality of climate risk should be reported even where it has not been considered a principal risk.”

Climate-related corporate reporting: Where to next? Financial Reporting Lab, October 2019

An EY survey published in July 2020, *How will ESG performance shape your future?*, found that the number of investors dissatisfied with environmental risk disclosures has increased by 14% since 2018. 86% of the investors dissatisfied with the environmental risk information they receive say it is “critical” that disclosures in this area improve.

Further information on climate change can be found on page 49 of this report.

Figure 19: National Grid plc, ARA 2019/20, page 23



Case study on climate change moving from an emerging risk to a principal risk

Our risk registers typically include risks likely to manifest within the short to medium, rather than longer term. In the case of climate change, weather-related event risks previously featured, as did transition risks associated with the decarbonisation of heat and electricity and these were included as a threat in several of our existing principal risks (e.g. energy interruption, disruptive forces).

Over the last 12 to 18 months, facilitated workshops were held with each of the core businesses to ensure completeness of risk capture specifically relating to climate change and our net zero commitment, considering both physical and transitional risks.

Consideration was given to whether the individual or combined risks arising from increased variability in temperature, and/or greater wear and tear on assets under more extreme weather conditions such as flooding and higher temperatures, should feature more prominently. This was especially pertinent in the light of updates in climate science, observations of the changing weather such as increased intensity and frequency of storms on the US east coast, and wildfire ferocity in locations such as South America, California and Australia. We also understand the growing urgency to find a solution to decarbonise heat and the future of gas in a way that is fair, affordable and not overly disruptive to consumers.

As a result, a recommendation to develop a bespoke climate change risk was considered by the Executive Committee and Board, and discussed with US, UK and NGV executives and subject matter experts. The addition of a bespoke climate change principal risk was finalised in autumn 2019.

18%

of companies indicate their risk appetite for each specific principal risk identified

Risk appetite

Only 18% of companies indicate their risk appetite for each specific principal risk identified. This is unsurprising as the 2018 Code does not require any disclosures on risk appetite.

Provision 1 of the 2018 Code states: “The board should assess the basis on which the company generates and preserves value over the long-term. It should describe ... how opportunities and risks to the future success of the business have been considered and addressed, the sustainability of the company’s business model and how its governance contributes to the delivery of its strategy.”

Given this, in our view meaningful explanations on the level of risk companies are willing to take provide useful information on how the organisation will create a sustainable business over the long term. The pandemic will undoubtedly have changed the overall risk profile of many organisations and tested their risk appetite – and investors will clearly want to understand such impacts.¹⁵

It is therefore encouraging that some companies are providing meaningful risk appetite disclosures. For example, **The Weir Group plc** (Figure 20) includes a risk appetite statement using a tabular format explaining the risks it is willing to take in order to achieve its strategic priorities, and those that are deemed unacceptable.

We recommend that companies explain whether COVID-19 has led their board to reassess risk appetite and how changes in tolerance today will help the company remain competitive in the long term.

Figure 20: The Weir Group plc, ARA 2019, page 52

| RISK APPETITE STATEMENT | |
|---|---|
| The Weir Group is strategically positioned in markets with good long-term growth prospects. We will pursue ambitious growth targets, and we are willing to accept a higher level of risk to increase the likelihood of achieving or exceeding our strategic priorities, subject to the parameters below. | |
| Risk assertions | Risk parameters |
| 1. Organic growth We will rigorously pursue divisional organic growth strategies to meet our market growth objectives. | Investment of resources will be consistent with divisional strategies and expected divisional compound annual growth rates over five year plans. |
| 2. Mergers and acquisitions (M&A) We will actively pursue M&A opportunities that enhance our strategic platform subject to meeting investment criteria. | Post-tax returns should exceed our cost of capital within three years of the acquisition. |
| 3. Returns and profitability We will not pursue growth at all costs, however, we expect high margins, strong returns on capital and working capital discipline together with cash generation. | Short-term margin dilution is acceptable in gaining market entry but over the cycle we aim for top quartile operating margins and returns on capital. |
| 4. Capital allocation We will encourage capital expenditure in pursuit of our growth ambitions subject to Internal Rate of Return (IRR) hurdles and capital structure targets. | Local country cash flow projections for investment appraisal purposes discounted at country specific rates to account for risk weighted returns. |
| 5. Capital structure We are prepared to use leverage in pursuit of our growth agenda and will actively seek low cost debt to fund the Group but, recognising cyclical in our end markets, will maintain significant headroom against our financial covenants. | We will seek to maintain the ratio of net debt/EBITDA below two times (current financial covenants 3.5 times) and will retain adequate headroom within our debt facilities at all times. |
| 6. Reputation and stakeholders We will avoid/manage situations or actions that could have a negative impact on our reputation and stakeholders. We aim to be transparent with all of our stakeholders unless prejudicial to our collective interests. | No tolerance for breaches of: <ul style="list-style-type: none"> • Legislative/statutory requirements. • Weir Code of Conduct. • International sanctions. • Delegated authority levels. • Group and divisional policies. |
| 7. Safety, Health and Environment (SHE) We will not undertake or pursue activities that pose unacceptable hazard or risk to our people, the communities in which we operate, or the broader environment. | <ul style="list-style-type: none"> • No tolerance for breaches of Weir Group Safety, Health and Environment Charter. • Active community and environmental engagement is expected. • Target zero harm through continuous improvement. |
| 8. Country presence We are prepared to enter new countries which offer opportunities for growth consistent with our overall strategy. We will not enter, or will exit, countries which present a high risk of harm to our people, damage to our reputation, or breach of international sanctions. | No tolerance for breaches of: <ul style="list-style-type: none"> • Legislative/statutory requirements. • Weir Code of Conduct. • International sanctions. • Delegated authority levels. • Group and divisional policies. |
| 9. Innovation We will invest in technology, research and development to innovate our customer offering allowing us to maintain and expand our market share. | Target research and development spend of 2% of revenues. |

¹⁵ COVID-19 – Going concern, risk and viability, Financial Reporting Lab, FRC, June 2020.



Interdependencies between risks

Given that risks are unlikely to occur in isolation, assessing the correlation between risks is critical. A lesson from the current crisis is that, although a pandemic was reasonably foreseeable (it had been an emerging risk for over 10 years) and could have been well planned for, what was not predictable was the level of interconnected events, nor the depth and longevity of the crisis. Therefore, taking a more considered approach to risk interdependencies is essential for assessing enterprise risk.

The importance of interdependencies for risk management was already noted by the WEF in

2014: “To manage global risks effectively and build resilience to their impacts, better efforts are needed to understand, measure and foresee the evolution of interdependencies between risks, supplementing traditional risk-management tools with new concepts designed for uncertain environments.”¹⁶

Few companies voluntarily disclose the interconnectivity between their principal risks or the links between emerging and principal risks. Some exceptions include **Vodafone Group plc** (ARA 2020, page 63), which explains its collective risk landscape using a diagram. This exercise informs its scenario analysis, which is then used to prepare the viability statement. **Reckitt Benckiser Group plc** (ARA 2019, page 67) includes a graphic showing the interconnectivity between its principal and emerging risks.

“

COVID-19 acts as a reminder that significant disruptions require risk-based contingency planning. It is essential that companies consider interdependencies and plan for a range of scenarios. The way a board responds to these events — both during and after — will have a lasting impact on stakeholder confidence in the company’s brand and reputation.”



Emma Price, Associate Partner,
EY Enterprise Risk Services

¹⁶ *Global Risks 2014 Ninth Edition*, World Economic Forum, 2014.

With the advent of artificial intelligence and smart algorithms, companies should be able to understand more clearly the way in which different risks interact and correlate. They could then consider such interactions and correlations to model different plausible scenarios when assessing viability.

Responding to COVID-19

The WEF's Global Risk Report 2020 published in January 2020 included infectious diseases among the top 10 risks in terms of impact, but not in terms of likelihood.¹⁷ Despite this, COVID-19 has upended the entire global economy. Some organisations warned that countries were not prepared to handle an epidemic or a pandemic.

Although only a few December 2019 reporters refer to health epidemics or COVID-19 specifically

within their principal risk narrative, unsurprisingly a significantly higher proportion of March 2020 year-end reporters do so. In line with investors' expectations, companies have started to explain how COVID-19 impacted their risks and how management responded.¹⁸

Pennon Group plc (ARA 2020, pages 61 and 62) explains how COVID-19 has impacted its principal risks using a one-page graphic to show how its risks have evolved, including and excluding COVID-19. Its principal risk table provides detail and gives additional mitigating steps that have been taken in response to the pandemic. **Johnson Matthey plc** (ARA 2020, page 69, 70-74, Figure 21) describes how the company has responded to COVID-19. It explains its decision not to treat COVID-19 as a new principal risk, articulating its impact on each of the previously identified principal risks. The company also explains that it has

reassessed its risks in light of COVID-19, identifying which specific risks have been impacted.

This latter approach was generally favoured by most of the March 2020 year-end reporters in our sample and by the majority of companies that released their 30 June 2020 interim announcements by the first half of August.

Assessing how COVID-19 has impacted risks is a natural response. However, the pandemic should also cause companies to reflect on whether their risk management processes are adequate for spotting similarly disruptive events or risks in the future. It also underlines the importance of monitoring emerging risks more frequently. For some companies, COVID-19 seems to have acted as a wake-up call about the importance of having a robust risk management process in place.



Given the company specific nature of Covid-19, we expect companies to consider the specific resources, assets and relationships that are most under threat and the steps being taken to protect them when setting out their principal risks and uncertainties.”

Covid-19 Thematic Review: Review of financial reporting effects of Covid-19, FRC, July 2020.

¹⁷ *The Global Risks Report 2020*, World Economic Forum.

¹⁸ *COVID-19 – Going concern, risk and Viability*, Financial Reporting Lab, FRC, June 2020.

Figure 21: Johnson Matthey plc, ARA 2020, page 69

COVID-19

JM has been proactive in its response to COVID-19. The Group Incident Management Team has been swiftly deployed to manage the response to the current pandemic. While coordinated and closely overseen by GMC, the team has implemented several specific measures including a groupwide pandemic response plan, a groupwide alert level status matrix and a comprehensive site pandemic response measures playbook. These measures have ensured that operations are able to continue safely and in accordance with government policy and regional guidance. JM has also specifically focused actions in managing cash flow, reducing cost and working capital to ensure the group remains robust, with sufficient liquidity.

The board and GMC have further directed the updating of JM's principal risks to reflect the impact of this pandemic. In most instances, risk definitions have not been changed as the pandemic has not changed the longer term coverage of each risk. However, it should be noted that additional actions have

been defined and where appropriate implemented to reflect the impact of COVID-19. Consideration has also been given as to whether COVID-19 should be treated as an individual risk. The board agreed that the pandemic would be more effectively managed through articulating its impact within each of the existing principal risks rather than a stand alone item.

JM recognises that the current COVID-19 pandemic is an evolving situation and we will need to continue to be agile in managing this risk. Furthermore, we will continue to review and challenge the principal risks providing an ongoing consideration as to whether it needs to be recognised as a stand alone risk in the future.

The crisis has also accelerated our learnings on how differently we can use technology to connect, collaborate and engage with our customers, suppliers and employees across the globe. We intend to use these lessons, to ensure that as lockdown eases, we are embracing new habits and opportunities this change has created.

5 Climate change and the UN Sustainable Development Goals

From intent to action

There is significant and due stakeholder focus on how organisations address sustainability challenges through their strategy and operations. The majority of companies in sectors most affected by climate change now acknowledge that climate change forms a material risk or opportunity for their company, but there has been limited progress in improving the quality of climate-related disclosures.

1

Assess how climate change impacts your organisation and describe how it has been integrated or considered in your strategy.

2

Report back meaningfully on company-specific climate change targets, associated timelines and what actions have been taken to reach those targets.

Climate change: the urgency for action

Reminder – The expectations for companies to explain how they are considering climate change and its impact over the short, medium and long term, as well as how they seek to minimise their own negative impacts on the environment, have never been stronger. As last year, this has been evidenced by strengthened shareholder action and continued public interest.

- ▶ The Task Force on Climate-related Financial Disclosures (TCFD) provides a voluntary framework for reporting on climate-related risks and opportunities and is structured around four areas: governance, strategy, risk management, and metrics and targets.¹⁹

¹⁹ "Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017)", TCFD, 2017.

- ▶ Reporting in line with the framework indicates that a company has considered how climate change may impact the organisation and the implications of the low carbon transition.
- ▶ There is a strong possibility under the Government's Green Finance Strategy²⁰, with support from the FRC, the Prudential Regulatory Authority, the Financial Conduct Authority and the Pensions Regulator, that TCFD reporting will gain a mandatory footing and that listed companies and large asset owners will have to disclose in line with the TCFD recommendations by 2022.²¹
- ▶ Under the new Streamlined Energy and Carbon Reporting requirements (SECR) which apply for years beginning on or after 1 April 2019:
 - Quoted companies (as defined in the Companies Act 2006) must report on their global energy use in addition to greenhouse gas emissions in their directors' report.
 - Large unquoted companies and limited liability partnerships must disclose their annual energy use and greenhouse gas emissions and related information.

The Government's previously issued environmental reporting guidelines were updated in March 2020 to reflect SECR. Given the focus on climate change,

entities subject to SECR should demonstrate leadership by considering the new requirements holistically rather than as just another reporting requirement. For example, they could use the data points to gain a better understanding of their impact on climate change and capture the link between environmental and financial performance (e.g., via performance metrics to show the impact of lowering energy usage on costs).

The COVID-19 crisis has amplified the reality of natural threats and our vulnerability to them. In a similar vein, despite scientific warnings and political commitments, greenhouse gas emissions continue to rise. For the first time in the history of the WEF's Global Risk Perception Survey, environmental concerns dominate the top 10 risks in terms of likelihood and impact.²² There is increasing recognition of the need to integrate climate and environmental factors into decision making and strategy.

Investors are seeking a better understanding of how climate change may impact the company's business over the short, medium and long term. They also want to know about the company's planned response,

including how it may need to change its strategy. However, according to EY's July 2020 report '*How will ESG performance shape your future?*', based on a global institutional investor survey, companies are failing to meet investors' expectations on environmental, social and governance factors when compared with 2018.

“

We need to close the ‘commitment’ gap between what we say we will do and what we need to do to prevent dangerous levels of climate change. Governments cannot afford to wait. People and families cannot afford to wait. Economies must shift to a decarbonization pathway now.”

Emissions Gap Report 2019, UN Environment Programme, November 2019.

²⁰ *Green Finance Strategy. Transforming Finance for a Greener Future*, HM Government, July 2019.

²¹ In August 2020, the Department of Works and Pensions issued a consultation which (among other things) invites responses on proposals to disclose the assessment and management of climate risks and opportunities in line with the recommendations of TCFD.

²² *The Global Risks Report 2020*, World Economic Forum.

Companies need to enhance their disclosures on climate change and demonstrate they are moving from intent to action.

Based on our research, 41% of companies state that they adopt or partially adopt the TCFD framework. A few of these say they will seek to align their climate change disclosures to the TCFD framework by 2022. EY's 2019 Global Climate Risk Disclosure Barometer, which assessed the TCFD disclosures of the largest public companies in high-risk sectors, found "limited progress in addressing the quality of climate-related disclosures".²³ We are clearly in the early stages of this particular reporting journey.

“

As part of our climate change policy issued in January 2020, Brunel set ambitious expectations of our investment managers — they must demonstrate to us reduced exposure to climate risk and effective corporate engagement that puts companies and portfolios on a trajectory to align with a 2°C economy. Effective engagement by our investment managers is reliant on good quality corporate reporting. Companies must explain transparently how aligned their business is with the goals of achieving a net-zero carbon future, their supporting efforts to keep global temperature increase to well below 2°C, and on the actions they are taking to ensure this alignment. We also challenge them to explain how they are adapting their businesses to ensure they are resilient to the impacts of climate change. Such disclosure helps us, and our investment managers proactively engage with companies that are not delivering substantial progress in these areas.”

Faith Ward, Chief Responsible Investment Officer, Brunel Pension Partnership Ltd

²³ For further details on the methodology of this research, please see page 20 of the 2019 EY Barometer report.

41%

of companies state in their 2019 ARAs that they adopt or partially adopt the TCFD framework. Of this 41%:

27%

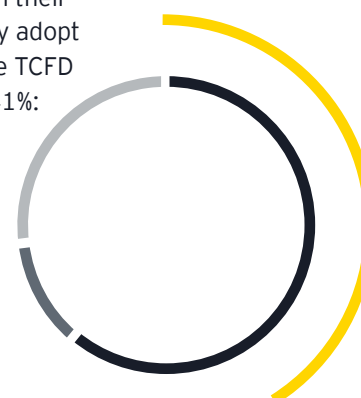
state that they have started implementing the TCFD framework in line with the UK Government's Green Finance Strategy and will seek to align their disclosures with the TCFD framework by 2022.

12%

state that they have fully adopted the TCFD framework, although this is disclosed in a separate report to the ARA.

61%

state that they have fully adopted the TCFD framework in their ARA.

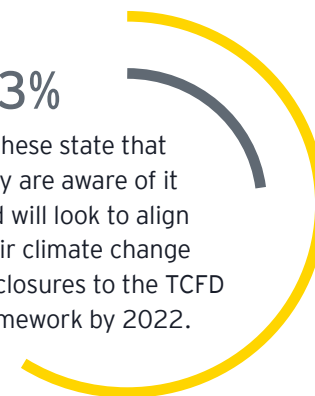


59%

of companies have not adopted the TCFD framework or are silent.

23%

of these state that they are aware of it and will look to align their climate change disclosures to the TCFD framework by 2022.



Spotlight on EY's work with Climate Action 100+

TCFD has elevated climate risk to one of the key risks facing many organisations, affecting business models. Companies need to assess how aspects such as the cost of carbon emissions and energy, exposure to extreme weather events and shifting demand resulting from climate change and environmental trends will influence their financial performance and longer-term prospects. They then need to transparently report on what they are doing to respond to these risks as well as to harness any opportunities. Based on EY's review of over 900 companies globally - including 30 in the UK - most organisations are not doing this particularly well. The findings are summarised in our recent publication - Climate Risk Disclosure Barometer 2020.

The TCFD has received significant support from a large number of governments, regulators and investors. For example, Climate Action 100+, an influential investor initiative, has highlighted that implementation of the recommendations is one of the strategic priorities to accelerate corporate action on climate change. Companies that are not able to articulate how climate change factors into their strategy are starting to look less credible in the eyes of investors.

“

In the first half of 2020, EY worked with Climate Action 100+ and a range of stakeholders to gain insight into how investors are engaging with the world's largest corporate emitters including in the energy, transportation and agriculture sectors. These insights have helped develop The Climate Action 100+ Net Zero Company Benchmark that clarifies investor expectations on climate change and the indicators which will be used by investors to evaluate company action and ambition demonstrated in tackling climate change. The new expectations were announced in September 2020²⁴ and companies should review these carefully ahead of their next reporting and annual general meeting cycle given the investor focus.”



Doug Johnston, Associate Partner, EY UK
Climate Change & Sustainability Services

²⁴ Climate Action 100+ calls for net-zero business strategies & sets out benchmark of largest corporate emitters, Climate Action 100+, September 2020.

The TCFD framework recommends that companies disclose the actual and potential impacts of climate-related risks and opportunities on strategy and financial planning where such information is material. Companies are encouraged to describe the resilience of the company's strategy considering different climate-related scenarios. However, according to EY's 2019 Global Climate Risk Disclosure Barometer, "10 or fewer of the companies assessed disclose the use of climate scenarios".

As noted by Mary Schapiro, Special Advisor to the TCFD Chair and Vice Chair for Global Public Policy at Bloomberg LP, in June 2019: "A company that communicates its climate resiliency to its investors will have a competitive advantage over those that don't."²⁵

The TCFD recommends disclosing metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material. Companies should explain the timeframes over which the targets apply, whether the targets are

absolute or intensity based, and the methodologies used to calculate targets. In this year's ARA review, we found that more than half of companies are disclosing targets related to climate change. We encourage companies to be transparent when disclosing these targets, in line with the TCFD recommendations.

Companies that are transparent include **Hammerson plc** (ARA 2019, pages 34 and 35), which provides detail on how it will reach its targets in phases and the progress made during the year is. **ITV plc** (Figure 23) provides granular detail on its targets and performance in reaching them. **International Airlines Group** (ARA 2019, pages 48, 50-54) uses a graphic to illustrate how the company intends to meet a clear 2050 target of net zero emissions (e.g., through new aircrafts, new types of fuel and offsets). It also explains how it calculates values and shows whether they have improved against their targets. **BP plc** (Figure 22) explains its three specific aims supporting its ambition to become net zero in 2050 or earlier.

Figure 22: BP plc, ARA 2019, page 40

Environment

Climate change and the energy transition

The world needs more energy to fuel prosperity and improve standards of living for a growing global population. This energy must be delivered in affordable and reliable ways, but it must also be lower carbon. BP's purpose is to reimagine energy for people and our planet. To deliver this, we have set out a new ambition to become a net zero* company by 2050 or sooner, and to help the world reach net zero.

Net zero aims

Aim 1: Net zero operations
We aim to be net zero across our entire operations on an absolute basis by 2050 or sooner. This aim relates to Scope 1 (direct) and Scope 2 (indirect) greenhouse gas (GHG) emissions.

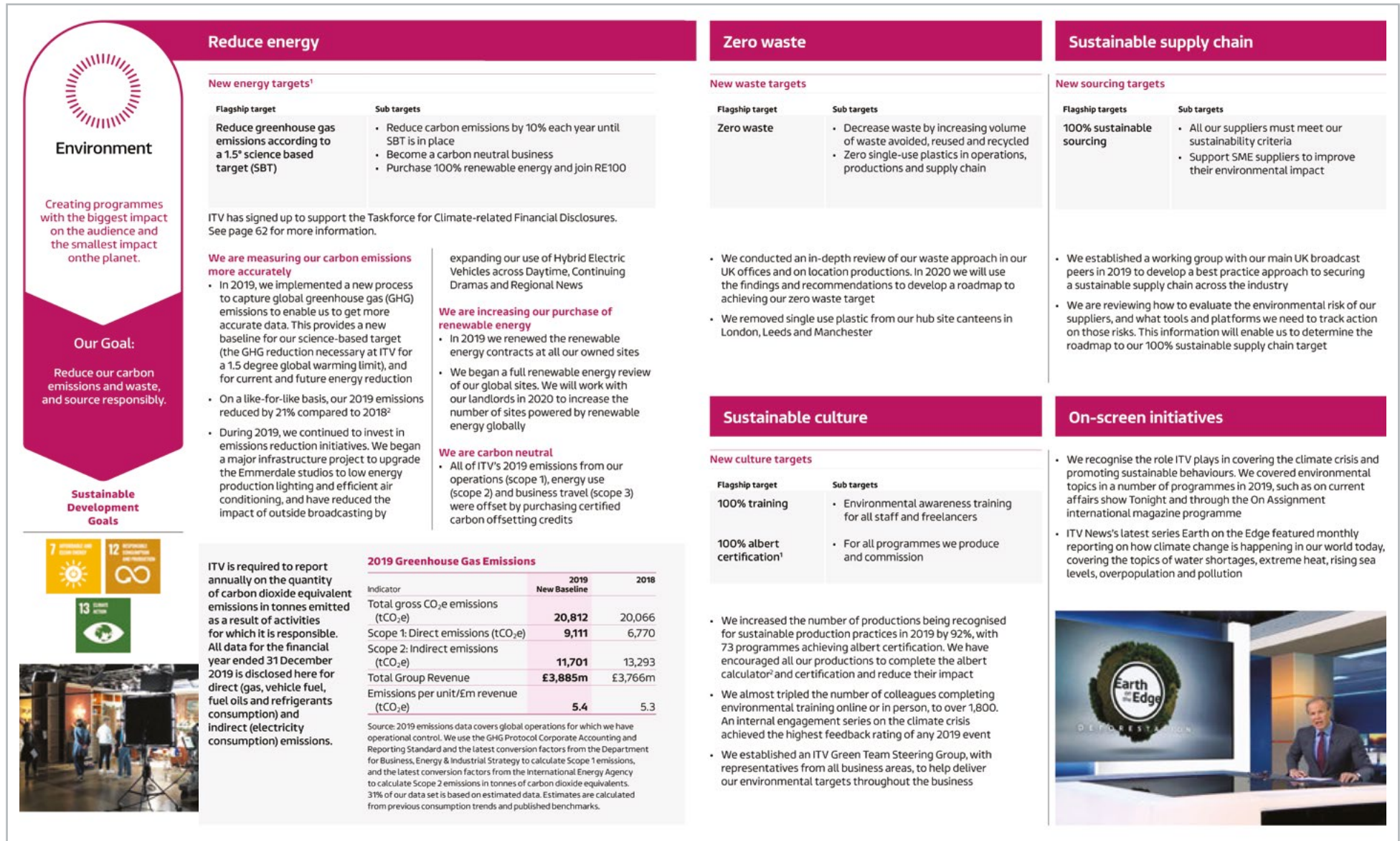
Aim 2: Net zero oil and gas
We aim to be net zero on an absolute basis across the carbon in our upstream oil and gas production by 2050 or sooner. This is our Scope 3 aim, and is on a BP equity share basis excluding Rosneft. This carbon was equivalent to 360MteCO₂e* of emissions in 2019.

Aim 3: Halving intensity
Our aim is to cut the carbon intensity of the products we sell by 50%, by 2050 or sooner. This is a lifecycle GHG emissions intensity approach, per unit of energy. It covers marketing sales of energy products and, potentially, in the future, certain other products, such as those associated with land carbon projects.

This metric also responds to the CA100+ resolution, which requires us to report the estimated carbon intensity of our energy products.

²⁵ Task Force on Climate-related Financial Disclosures: overview, TCFD, March 2020.

Figure 23: ITV plc, ARA 2019, pages 46 and 47



The TCFD framework also recommends that companies disclose their governance around climate change. Although companies increasingly recognise climate change as a principal or emerging risk, they often fail to explain how climate change is integrated within their governance framework. Those that do often explain that responsibilities have been assigned to a specific committee. This is frequently a sustainability committee, a corporate social responsibility committee or some equivalent, but increasingly the terms of reference of other existing committees, such as a risk committee, also now refer to climate change.

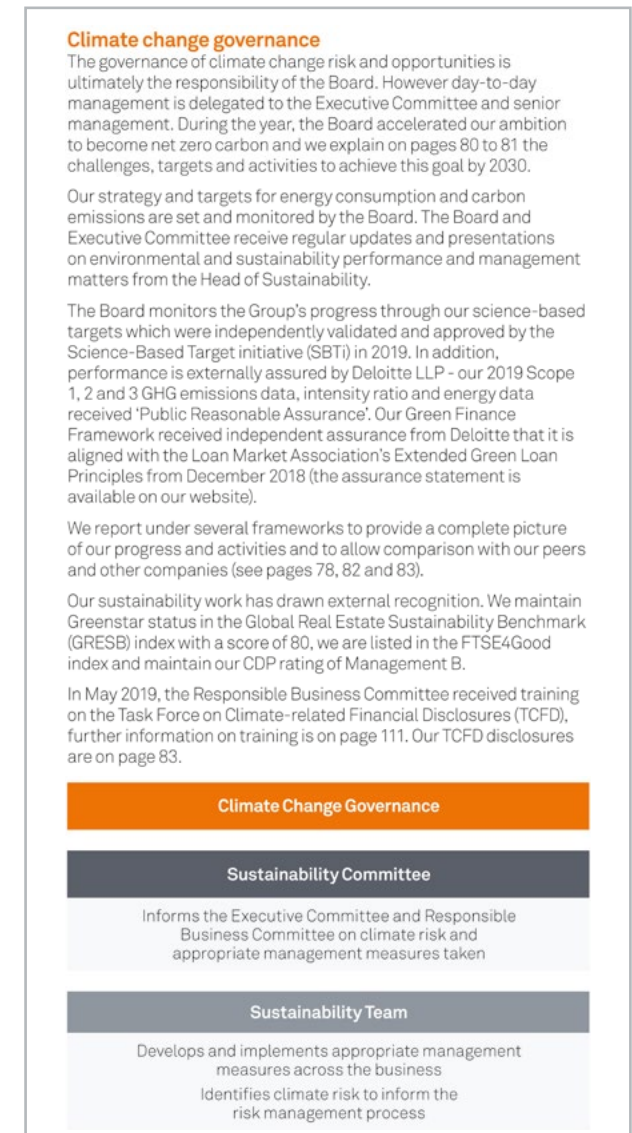
“

Expectations of institutional investors are shifting rapidly with respect to ESG risk and impact management. The 2020 Stewardship Code has set a much higher bar for investors. All of this is transforming investors’ interest in corporate ESG reporting. This year, COVID-19 has driven issues like public health and workforce resilience into greater focus for investors, but the interest in climate-related risks is here to stay. There are real opportunities to win loyal support from investors for companies that commit to high quality disclosures and actions that address material ESG issues in their businesses.”

Catherine Howarth, Chief Executive, ShareAction

Derwent London plc (Figure 24) clearly describes its climate change governance. It explains how climate change responsibilities have been delegated to its Sustainability Committee and the sustainability team, but also shows how the Responsible Business Committee is kept abreast of developments.

Figure 24: Derwent London plc, ARA 2019, page 90



From intent to action

Although the majority of companies now reference the UN SDGs, more needs to be done to evidence companies' progress in achieving the SDG targets.

- 1 Once you have identified SDGs relevant to your company, break them down into the underpinning SDG targets and set out quantitative metrics and qualitative ambitions to monitor and communicate progress.
- 2 Explain how the commitment to meet SDGs is integrated into the company's strategy and the governance system.
- 3 Show how the SDG targets have been incorporated into operations and values and explain what progress has been made towards reaching the identified targets over time.

UN Sustainable Development Goals

Reminder – In 2015, all United Nations member states adopted the 2030 Agenda for Sustainable Development – a global agreement to eradicate poverty and strengthen universal peace.²⁶

As part of this, there are 17 SDGs focused on addressing economic, environmental and social impacts and these are underpinned by 169 targets to help define progress.

Governments around the world have the ultimate responsibility for delivering on the goals and the UK is currently reviewing its progress towards the SDGs.

Progress towards meeting the targets by 2030 cannot, however, be made by governments alone – individual businesses must also play their part. Equally, the SDGs relate to much bigger issues than one company's sustainability efforts – some require industry and sector-wide collaboration and transformation.

We found that 56% of companies reference the SDGs in their ARAs. The most commonly referred SDGs are: Good health and well-being

(SDG 3) and decent work and economic growth (SDG 8), followed by climate action (SDG 13), gender equality (SDG 5) and responsible consumption and production (SDG 12). Unfortunately, not all companies that mention SDGs in their ARAs explain the actions they have taken or plan to take to meet their commitments.



²⁶ Resolution adopted by the General Assembly on 25 September 2015, General Assembly, United Nations, September 2015.

EY's July 2020 report '*How will ESG performance shape your future?*', found that that 59% of investors are making significant use of disclosures related to SDGs. However, one of the challenges is the lack of consistency by which organisations measure and report on SDGs. Such disclosures will only be valuable for investors if they are of high quality and if companies report on their progress on a consistent and comparable basis.

To this end, and in light of the demand for increased convergence in non-financial reporting, the WEF's International Business Council (IBC) coordinated a project – developed by EY and other firms – to identify a core set of metrics that are directly relevant to achieving the SDGs and are universal across industries.

The WEF IBC report issued in January 2020, *Toward Common Metrics and Consistent Reporting of Sustainable Value Creation*, consulted on a proposed baseline set of metrics. It also recommended disclosures that companies could use to align their mainstream reporting and, in so doing, reduce fragmentation and encourage faster progress towards a systemic solution. The consultation period has now closed, and an updated, refined set of both core and more progressive, expanded metrics is expected to be released shortly.

²⁷ Hywel Ball, "How changing the way we measure value helps companies focus on the long-term", EY website.

As EY's own Long Term Value framework demonstrates, societal value is a vitally important component of the holistic value that business delivers to its stakeholders.²⁷ Without a direct linkage to strategy, measurable ambitions, and a clear understanding of the value levers (financial, consumer, human and societal) that a business intends to use to deliver those outcomes, companies are vulnerable to accusations of green-washing or purpose-washing.

We therefore encourage companies that mention the SDGs to set out clear targets (either quantitative or qualitative) to monitor and communicate progress and disclose what specific actions they have taken towards achieving those goals. Companies already doing this include **Croda International plc** (Figure 25), which clearly sets out targets aligned to SDGs, **ITV Plc** (ARA 2019, pages 46 and 47) and **Polymetal International plc** (Figure 26).



Figure 25: Croda International plc, ARA 2019, page 30

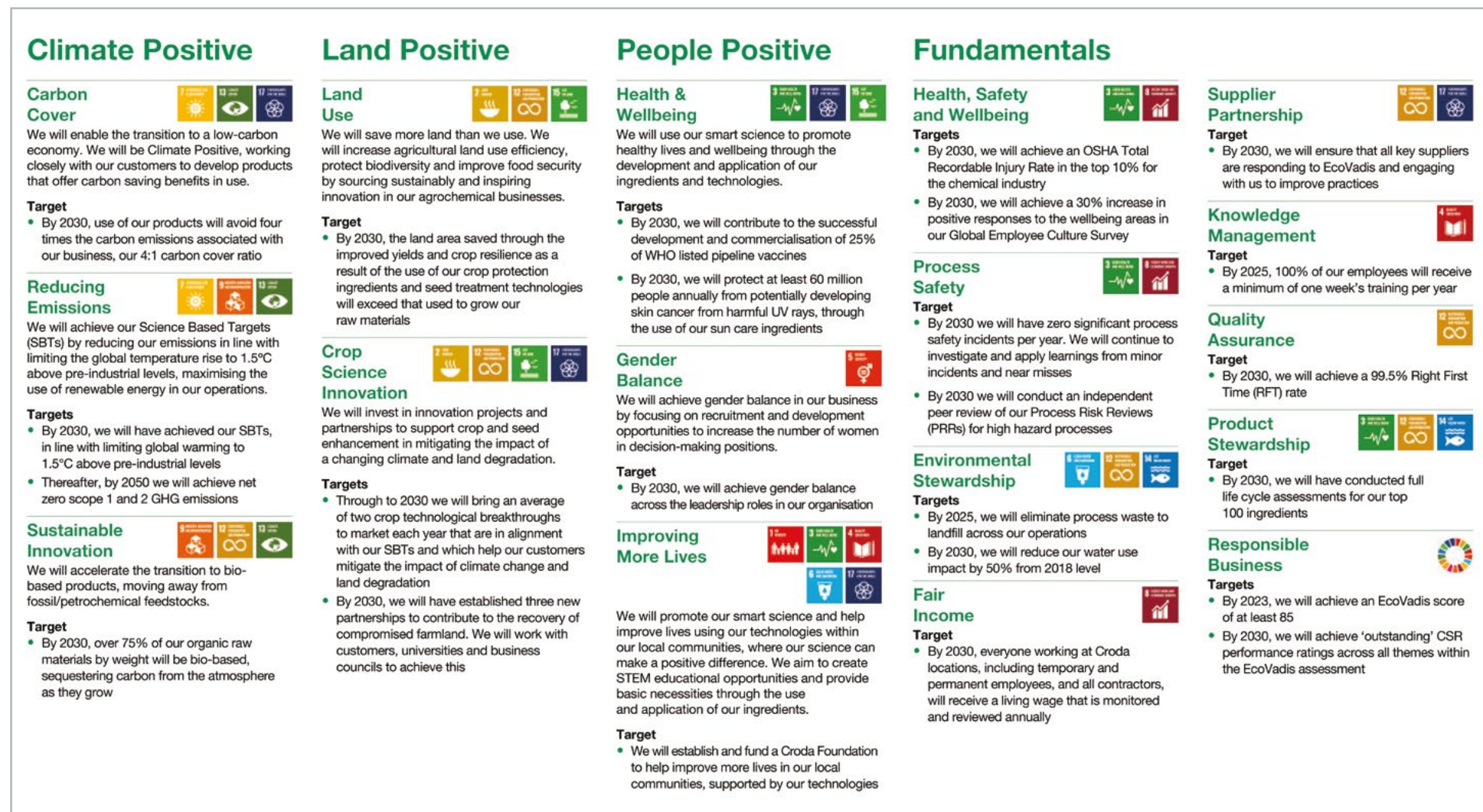
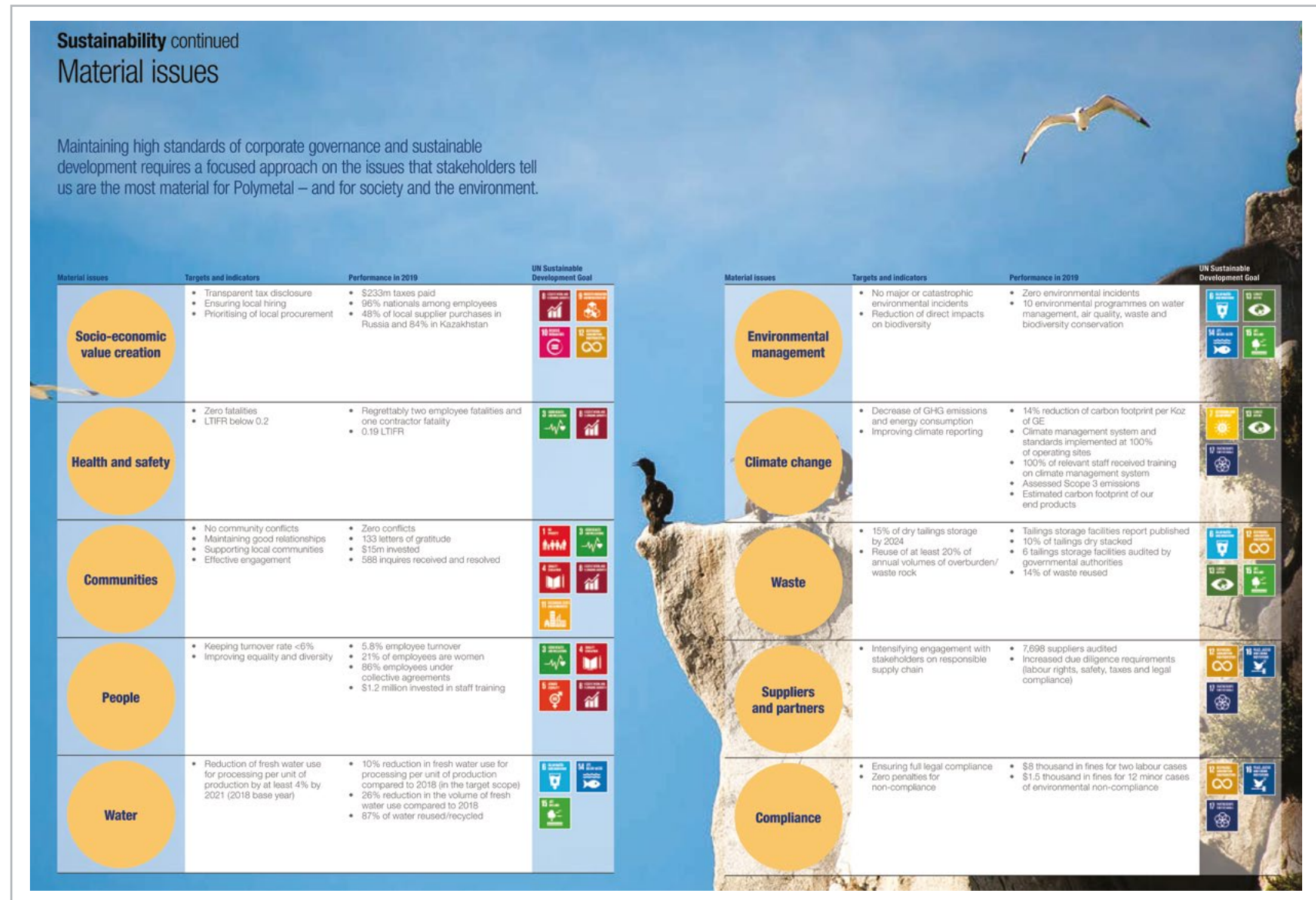


Figure 26, Polymetal International plc, ARA 2019, pages 56 and 57



6 Stakeholder engagement and s172

From intent to action

Now, more than ever, businesses need the trust of their stakeholders. Although most companies disclose their key stakeholders and the key engagement mechanisms at a high level, more insights are needed on how stakeholder engagement and other s172 matters are considered and influence the board's strategic thinking. This has been brought into sharp focus during the pandemic as board decisions face even more scrutiny by stakeholders, regulators and the public at large.

1

Explain how the board engaged with key stakeholders, on what topics and the decisions and actions taken in response to feedback received.

2

Provide a balanced view of the principal decisions and, in respect of each principal decision, explain how s172 matters have been considered.

3

Set out stakeholder outcomes²⁸ and the impact that engagement has had on changing them.

Reminder of key requirements

MRR

- ▶ Section 172(1) statement: A statement in the strategic report to explain how directors have had regard to the matters set out in s172(1) (a)-(f).
- ▶ Employee engagement: The directors' report must detail how directors have engaged with employees, and the effect of their regard for employee interests on principal decisions taken by the company.
- ▶ Other stakeholder interests: The directors' report must summarise how directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard on principal decisions taken by the company.

2018 Code

- ▶ Describe how key stakeholder interests and s172 matters have been considered in board discussions and decision making (Principle D and Provision 5).

²⁸ Stakeholder outcomes are the fundamental dimensions of performance that matter to different stakeholders and are therefore most material to the business.

How the board engaged

Most companies are not starting from scratch on stakeholder engagement. Previous years' disclosures placed a greater focus on the engagement activities undertaken by management – rather than by the board. However, given that the new requirements elevate the importance of s172 for boards, we expect that boards also have some direct engagement with material stakeholders (in addition to direct engagement with employees – which is already a requirement).

It is not easy to decipher from many of the disclosures whether the board was involved directly in engagement e.g., when a passive voice is used or the disclosure refers to 'we' rather than specifying who was involved.

However, some companies clearly explain who was involved with engagement. **Lloyds Banking Group plc** (ARA 2019, pages 20-27) differentiates between the board's direct and indirect engagement for each key stakeholder group. For example, in respect of customers, the chairman and a number of Non-Executive Directors (NEDs) attended monthly customer insight sessions (direct engagement) and reviewed customer complaints to understand areas for improvement (indirect engagement). **Rentokil Initial plc** (ARA 2019, pages 76 and 77) details

the information flow to the board and direct board engagement for each stakeholder group. For instance, in relation to suppliers, the information flow to the board included the review of payment practice reports.

Impact of stakeholder engagement

Some companies disclose more about the impact of stakeholder engagement. **Barclays plc** (ARA 2019, pages 16 and 17) outlines the feedback received from stakeholders e.g., that customers and clients would like to find Barclays easy to deal with. **HSBC Holdings plc** (ARA 2019, pages 17 and 18) provides examples of actions taken in response to feedback the company has received. For example, in response to customer

feedback around improving processes, the bank made it easier for international customers to secure a mortgage.

While many companies explain areas of concern and/or topics engaged on at a high level in respect of key stakeholders, few cover the impact of stakeholder engagement on board decisions, as required by the MRR and 2018 Code. Closing the feedback loop – reporting on the outcomes of matters raised as part of engagement – is key to building trust with stakeholders.

As encouraged by initiatives like the Embankment Project for Inclusive Capitalism (EPIC)²⁹, many companies include measures of value or impact for stakeholders e.g., customer satisfaction scores, employee turnover rates and amounts of community investment, such as **Pennon Group plc** (ARA 2020,



Reporting must cover the concerns raised by stakeholders, how companies have understood the issues, and how they have thought carefully about how these impact on the long-term success of the company.”

Annual Review of the UK Corporate Governance Code, FRC, January 2020.

²⁹ EPIC established metrics to help companies better articulate and illustrate their long-term non-financial value. Created by the Coalition for Inclusive Capitalism and EY, this project brought together a collection of participants, representing US\$30 trillion of assets under management and almost 2 million employees around the world.

pages 26-28) and **Taylor Wimpey plc** (ARA 2019, page 33). This is insightful and, in our view, the next step would be to disclose a correlation i.e., whether the engagement activities and resulting actions contributed to better stakeholder outcomes over time. For example, what impact did customer engagement have on customer satisfaction scores? This would allow boards to flex their approaches to stakeholder engagement over time.

Principal decisions

The MRR requires companies to explain **how** directors have had regard for stakeholders on principal decisions, as well as **how** s172 matters have been considered. Most companies disclose three or four principal decisions. However, 45% do not clearly identify principal decisions or provide any narrative e.g., by way of case studies, making it difficult to understand how stakeholder considerations impacted decisions and actions taken by the company.

The principal decisions most often identified relate to capital allocation (e.g., around dividend policy), board appointments, mergers, acquisitions and restructuring, remuneration policy changes, collaboration with business partners, approval of strategic business plans and budgets, refreshing company purpose, and a new ESG strategy.

Although companies take differing approaches to principal decision reporting, most focus on

stakeholder considerations. For example, when **Pearson plc** (Figure 27) explains its decision to acquire Lumerit Education, it includes detail on the board's consideration of the impact on stakeholders such as learners, shareholders and educational institutions.

We found few examples of companies addressing the broader s172 factors beyond stakeholders, such as the long-term consequences of decisions and their impact on a company's reputation and standing. However, **National Express Group plc** (Figure 28) is a good example of how this can be done, explaining holistically how s172 matters, including those beyond stakeholders, were considered in its principal decisions.

Unsurprisingly, most companies tend to focus on positive impacts of decisions. Companies need to be more balanced in their reporting by signalling potential adverse consequences of decisions on stakeholders and the long-term success of the company, as well as the relevant mitigating actions and strategies. This is especially relevant for 2020/21 reporting due to the pandemic.

Legal & General Group plc (ARA 2019, pages 62 and 63) explains its decision to sell its general insurance business, including the risks to key stakeholders and mitigating actions. It discloses that employees may be negatively impacted and how, as part of the deal negotiations, employees would be transferred to the purchaser with protection of their contractual terms and conditions and continuity of service.



Figure 27. Pearson plc (ARA 2019, page 61)

Board decision-making – Acquisition of Lumerit Education

This case study on Pearson’s recent acquisition of Lumerit Education provides an illustrative example of how the Board has regard to relevant stakeholders and their interests in its decision-making processes.

In October 2019, Pearson announced the acquisition of Lumerit Education, an ed-tech company that leverages technology to provide students with a customised path to earn up to three-quarters of their degree online and outside of a traditional college. It aims to address the rising problem of the lack of affordability of a degree, while trying to increase flexibility and reduce the time commitment required to complete a degree. Its clients include private-pay consumer students as well as corporations providing tuition assistance programmes for their employees. Lumerit Education uses data and analytics to match learner profiles to academic programmes to enable more people to prosper in their lives through learning. Pearson viewed the acquisition of Lumerit Education as an opportunity to strengthen and develop its strategic focus on employability and lifelong learning. With this acquisition, we will use the Lumerit Education technology to accelerate the growth of our Accelerated Pathways business, making education more affordable and accessible in all phases of life. Lumerit Education works with employers to deliver education programs that improve employees’ skills and knowledge, building a workforce that’s more competitive, engaged, and prepared for the future of work. As Pearson’s first acquisition for five years, Lumerit Education was an important milestone. The Board focussed on there being a strong strategic rationale, clear integration plans and achievable synergies.

As part of the consideration process for this acquisition, the Board received detailed updates from management, prepared by the internal advisory team (with key input from the business and external advisers) setting out the matters for evaluation, which included the anticipated synergies, due diligence findings, valuation and return impacts, stakeholder considerations and detailed post-acquisition integration plans. In its deliberations,

the Board also considered developing the capability in-house, deciding against that option due to the expected time to complete.

Through the decision-making process, the Board considered the impact on its key stakeholders, including:

Employers: The Board noted the potential role for Pearson as a ‘matchmaker’, leveraging our experience to provide educational options to organisations looking to recruit, retain, upskill and re-skill their employee base. Lumerit Education’s offering ensures better utilisation of costs already allocated to tuition reimbursement programmes, improves employee retention, course completion and helps to upskill employees.

Learners: Lumerit Education’s offering provides learners with flexibility, helping them find the most efficient way to earn a degree. The acquisition will enable Pearson to apply its expertise in courseware to the delivery of general education and gateway courses and to make an impact on student learning outcomes.

Educational Institutions and Educators: The ability to offer on-demand courses through Lumerit Education’s ‘Global Digital Classroom’ provides educational institutions and educators with the ability to offer any of the classes, at any time. The technology also allows partners access to a funnel of transfer students who want to complete their degree.

Employees: The Board considered the current employees of Lumerit Education in their deliberations, including how best to preserve the culture and sense of energy that the strong Lumerit Education leadership team had created and minimise the disruption to them while integrating the Lumerit Education team into the wider Pearson culture.

Shareholders: In evaluating the acquisition prospect, the Board considered the alignment of Lumerit Education with Pearson’s strategy, ensuring that it was a good fit and would bring synergies to the business.

For further examples and insights, see our emerging observations on s172 reporting based on a review of over 60 FTSE 350 companies with December 2019 year-ends.³⁰ This analysis follows on from our reporting framework outlined in a preceding EY report published in 2019, ‘Deconstructing the Section 172(1) statement’.



³⁰ Section 172(1) reporting: Emerging observations from December 2019 reporters, EY, April 2020.

Figure 28: National Express Group plc, ARA 2019, pages 66 and 68

| | |
|---|--|
| <p>In making decisions, the Company's Directors are cognisant of all their legal duties, including their duty under Section 172(1) of the Companies Act 2006 to act in the way that is most likely to promote the success of the Company for the benefit of its members as a whole and to have regard (among other matters) to the factors set out in Section 172(1)(a) to (f) of the Companies Act 2006. Examples of some of the principal decisions taken by the Board during the year and an explanation of which factors the Directors had regard to when reaching such decisions, including those set out in Section 172(1)(a) to (f) of the Companies Act 2006, are set out in the table below:</p> | |
| <p>Key of factors considered</p> <p> Financial impact Reputation Acting fairly between members Long-term impact Community & environment Fostering business relationships Employees </p> | |
| <p>Board decision</p> <p>Successful bid for and award to the Company's ALSA division of a 15-year contract to operate urban bus services in Casablanca, Morocco</p> | <p>Directors' consideration of factors in accordance with s.172(1)</p> <ul style="list-style-type: none"> The contract would generate revenues of c.€1 billion over its 15-year term and contribute to the delivery of the Company's growth strategy by further expanding the urban bus segment of the Company's ALSA business The Company's investment in a brand new urban bus fleet would improve both the safety of the bus operation and reduce its impact on the environment through newer vehicles emitting fewer harmful emissions The Company's commitment under the contract to redesign the urban bus network and introduce a new ticketing and payment system should enhance passengers' experience of urban buses for the benefit of the Casablanca community The contract award would mean the assumption by the Group of the incumbent operator's drivers who, through becoming part of the Group and being subject to the Group's Global Safety Policies, would benefit from risk profiling and being provided with further training or other actions to reduce risk profiles |
| <p>Board decision</p> <p>Acquisition by the Company's UK division of the business of providing Home to School and Ring and Ride services for vulnerable children and adults in the West Midlands (out of the administration of the previous provider)</p> | <p>Directors' consideration of factors in accordance with s.172(1)</p> <ul style="list-style-type: none"> The acquisition would enable the Company to access a new UK market, creating potential opportunity in the longer term for further growth in this market The acquisition would secure the continued provision in the West Midlands of these vital community services The acquisition would secure the employment of c.600 of the employees who worked for the seller companies in administration Improvement of the fleet to be carried out immediately post acquisition would improve the safety and reliability of these vital services and reduce harm to the environment through fewer emissions from the improved fleet The acquisition would result in all transferring employees being paid at the least the Real Living Wage and having access to wider employment opportunities within the National Express Group The acquisition would strengthen the Company's UK bus business' relationship with two of its key stakeholders: Transport for West Midlands and Birmingham City Council, which are invested in the continuation of these vital community services and keen to see the improvements in the services that the National Express Group is able to offer |
| <p>Acasablanca contract – having regard to other stakeholder interests</p> <p>Subsequent to the award of the Casablanca urban bus contract to the Company's ALSA division, the Casablanca transit authority requested ALSA to start providing services under a transitional contract in advance of commencement of the formal contract to secure the continued provision of services to the public. The Company had due regard to the authority's interest in acceding to such request.</p> | <p>Acquisition of West Midlands Home to School and Ring and Ride services business – having regard to other stakeholder interests</p> <p>One of the principal reasons for the Company's UK division's acquisition of the business of providing Home to School and Ring and Ride services out of the administration of the previous provider was to assist Transport for West Midlands – with whom the Company's UK bus business has been working in alliance to provide public transport services in the West Midlands over many years – in securing the continued provision of these vital services. The Company also had regard to Birmingham City Council's interest in securing these services in accordance with its statutory duty to do so.</p> |
| <p>Board decision</p> <p>Acquisition by the Company's North America division of WeDriveU, the premier corporate shuttle service provider in Silicon Valley, USA</p> | <p>Directors' consideration of factors in accordance with s.172(1)</p> <ul style="list-style-type: none"> The acquisition would deliver favourable financial returns against all three metrics which the Group uses to assess acquisitions and contribute to the delivery of the Company's growth strategy, both immediately by the entry into the large and fast-growing US corporate shuttle market and longer term through leveraging the combination of WeDriveU's brand and experience and the Group's base and quality of operations to grow the business across North America and beyond By providing an entry point into the US corporate shuttle market which, by its nature provides drivers with more regular and less seasonal work than the school bus business, the acquisition would create more employment opportunities for the Group's current employees working in school bus and, through growth of the Group's corporate shuttle segment, more employment opportunities generally The acquisition would enable the Company to foster new business relationships with WeDriveU's impressive customer base, which includes major blue-chip corporates The acquisition could potentially expose the Company to higher reputational risk as a result of the regulatory and legal claims environment in California, USA, where WeDriveU operates. This would be mitigated by WeDriveU's high operating standards as demonstrated through its safety record (as ascertained through due diligence), and through the Group's ability to enhance those standards further through implementation of the Group's Global Safety Policies The acquisition would enable the Company to serve the communities in which WeDriveU operates by providing commuter shuttle bus services connecting people with their work, and in a way that reduces the impact on the environment by reducing reliance on personal cars |
| <p>Board decision</p> <p>Refinancing of c.€650 million of maturing Euro notes, Sterling bonds and other debt facilities through the Company's debut US private placement of notes and the issue of notes under the Company's EMTN programme</p> | <p>Directors' consideration of factors in accordance with s.172(1)</p> <ul style="list-style-type: none"> The refinancing would secure the liquidity required for the Company to execute its long-term strategic plans over the 7-12 year blended tenor of the new debt The new debt would be secured on very favourable financial terms, both as regards coupon and having regard to delayed draw features (reducing double cost of carry) The refinancing would enable the Company to develop lending relationships with certain debt investors that were new to the Group, and build on those with debt investors that already lend to the Group The decision to secure debt rather than equity funding would help to ensure that shareholders, including small shareholders who may not be able to take up their rights in a rights issue, would benefit equally from the delivery of the Company's strategy funded by debt |
| <p>Acquisition of WeDriveU – having regard to employee interests</p> <p>The Board's regard to the importance of retaining and incentivising the management team of WeDriveU strongly influenced the structure of the acquisition, with the Company initially acquiring 60% of the equity, with put and call options over the remaining 40% equity which continues to be held by the management. The value of these options depends on the success of the WeDriveU business over the next three years aligning the Company's and such management's interests in maximising that value.</p> | <p>To ensure that the Company's Directors have regard to all factors that are relevant when taking decisions, the papers prepared by the Executive Directors, senior management and the Company Secretary which seek a decision from such Directors have always drawn attention to the relevant factors that should be taken into account.</p> <p>In the year under review, this practice has been enhanced by the inclusion in such papers of a dedicated appendix which collates the factors referred to in Section 172(1)(a) to (f) of the Companies Act 2006.</p> |
| <p>The minutes of the Company's Board and Committee meetings are also increasingly recording how relevant factors, including those referred to in Section 172(1)(a) to (f) of the Companies Act 2006, have been taken into account, allowing Directors to refer back and remind themselves of the rationale for decision-making as required, including when called upon to take similar or related decisions in future.</p> | |

COVID-19 considerations

As with purpose (see page 24), COVID-19 has served as a real test case in bringing stakeholder voice and boards' s172 duties to life – and some of this comes through in reporting.

“

... a short-term economic crisis such as the one induced by the coronavirus outbreak reveals which companies truly embodied the stakeholder model, and which only paid lip service to it [...]. The Covid-19 crisis is a litmus test that shows who has been 'swimming naked' while endorsing stakeholder capitalism.”

Klaus Schwab, WEF Founder and Executive Chairman

A number of reporters with year-ends on or after March 2020 explain how they engaged with and considered stakeholders who were hardest hit by

COVID-19. These included customers who struggled to pay or who were due refunds, as well as suppliers e.g., in relation to any delays in payment. Some companies comment on their contribution to society, particularly in fighting the virus.

For example, **British Land Company plc** (ARA 2020, page 97) describes its decision to release certain customers from their rental obligations for three months and to defer around £35m of rental payments for the quarter ended March 2020. **United Utilities Group plc** (ARA 2020, page 102) explains that it has been engaging with its supply chain to better understand their financial difficulties and is committed to temporarily altering payment terms with suppliers in the short term, paying them within seven days where possible to support their cash flow. **Vodafone Group plc** (ARA 2020, pages 54 and 55) describes its five-point plan to help communities e.g., by providing network capacity and services for critical government functions, facilitating working from home, helping small and micro businesses within its supply chain, and improving governments' insights in affected areas.

In addition, many companies refer to the principal decisions taken when dealing with COVID-19, such as capital allocation decisions (including whether to pay dividends) and changes to workforce terms and conditions. For example, **Royal Mail plc** (ARA 2020, pages 110 and 111) explains why a final dividend should not be recommended and discloses the

temporary enhanced sick pay terms for colleagues who experienced or showed symptoms of COVID-19 (even those with less than one year's service). It also reports that it is paying a recognition award of up to £200 to frontline colleagues who worked through the crisis since March. **Johnson Matthey plc** (ARA 2020, pages 9 and 33) describes the board's donation to the company's science education fund equal to 20% of board members' salaries and fees, and pledges to make no member of staff redundant and not to furlough staff until June.

As companies continue to grapple with and emerge from the crisis, we expect to see disclosures on how boards adapted their stakeholder engagement and considered s172 when making decisions.

“

40% of people have already convinced others to stop using a brand that they felt has not responded appropriately in response to the pandemic.”

Edelman Trust Barometer Special Report: Brand Trust in 2020

7 Workforce engagement and diversity

From intent to action:

The 2018 Code and related MRR heightened the focus on workforce engagement. Having completed the first cycle of implementing these changes, companies could further improve their reporting as they move from intent to action.

1

Communicate the importance of your workforce: if the workforce is considered a key strategic asset, explain how it underpins the operation of your business model and the delivery of your strategy.

2

Identify how the board engages with the workforce, the resulting feedback and input it has received and how this was considered in the boardroom.

3

Describe the feedback loop to the workforce, including an explanation of decisions or actions taken.

4

Disclose (using data and metrics where possible) whether workforce engagement mechanisms are effective, and the changes being considered to ensure that the voices of all significant parts of the workforce will be heard in a meaningful way.

5

Set targets for gender and ethnic representation at board and senior leadership levels. Establish plans to achieve these and report on progress at least annually.

Reminder –

Alongside the requirements introduced on stakeholder and employee engagement through the MRR, under the 2018 Code boards have to adopt one – or a combination – of the following mechanisms to engage with the workforce, or explain what alternative arrangements are in place:

- ▶ A director appointed from the workforce
- ▶ A formal workforce advisory panel
- ▶ A designated non-executive director (DNED)

The 2018 Code also requires the remuneration committee to engage with the workforce to explain how executive remuneration aligns with wider company pay policy.

Communicate the composition of your workforce and why it is a key strategic asset

Though many companies identify their people as a key strategic asset, there is often lack of follow through in the accompanying narrative as to why this i.e., how the workforce is essential to the operation of the business model or the delivery of strategy. Investors are keen to see expanded information on aspects such

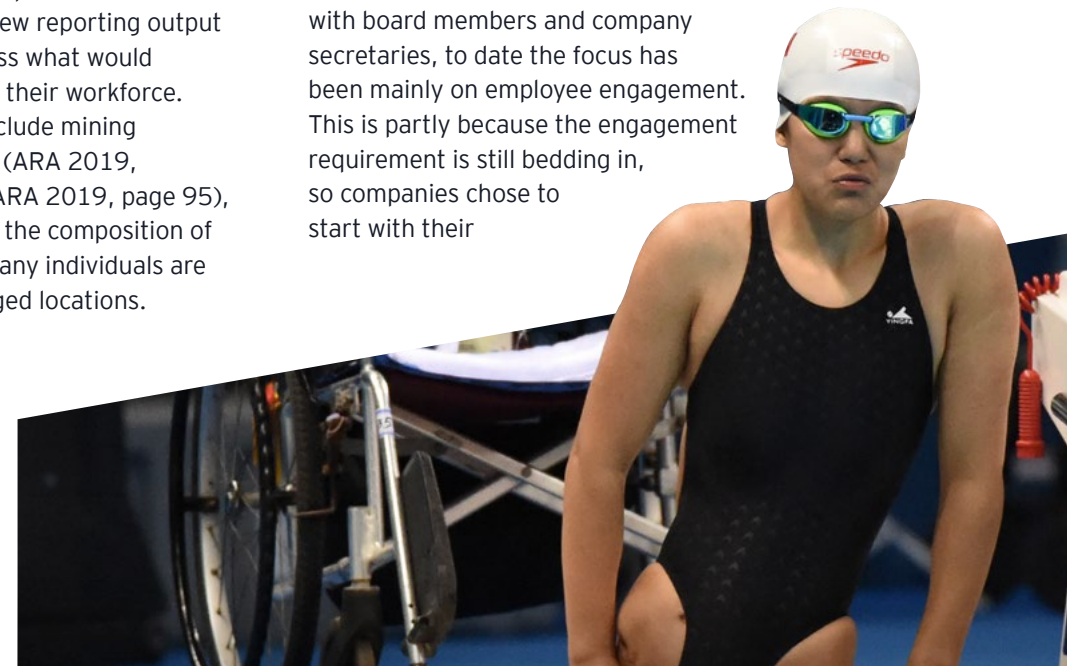
as risks and opportunities related to the workforce, how the business is investing in the workforce, what changes need to be made and how the company measures the contribution of its workforce.³¹

We encourage companies to explain who their workforce is through a mixture of quantitative and qualitative information. Quantitative data could include input metrics to describe the workforce e.g., on the basis of employment type, gender or nationality. It could also include output metrics that demonstrate the value of the workforce as a strategic asset or indicate the outcomes or value created for the workforce e.g., retention rates, investment in training or action on whistleblowing cases.

We found that most companies report a small selection of input metrics, with few reporting output metrics. Companies should assess what would enable readers to build a picture their workforce. Reporters showing specificity include mining companies, **Anglo American plc** (ARA 2019, page 50) and **Antofagasta plc** (ARA 2019, page 95), which provide granular detail on the composition of their workforces, such as how many individuals are from local mining or disadvantaged locations.

Who do you engage and how do you engage them?

The 2018 Code emphasises that boards should engage with the workforce rather than just a company's employees (which is a requirement of the MRR). The Code's reference to the workforce is a deliberate attempt to capture not only those on traditional employment contracts, but also a wider pool including contractors or those with alternative working arrangements. In our ARA review we found that some companies clearly define their workforce. Examples include **AstraZeneca plc** (ARA 2019, page 107) and **Reckitt Benckiser Group plc** (ARA 2019, page 47). However, from our discussions with board members and company secretaries, to date the focus has been mainly on employee engagement. This is partly because the engagement requirement is still bedding in, so companies chose to start with their



³¹ *Workforce-related corporate reporting*, Financial Reporting Lab, FRC, January 2020.

immediate employee pool; but it also reflects some anxiety around blurring the lines in terms of legal responsibilities for non-employees. It is likely to take a few iterations before boards land on a more final engagement approach, but companies with a large proportion of staff on arrangements other than standard employment contracts should consider this carefully.


In terms of how engagement has been approached, the DNED has been the most popular mechanism.³² In many cases this has been implemented in conjunction with existing mechanisms, such as employee forums. Employee engagement is not a new concept – s172 is a long-standing directors' duty – so companies have been keen not to reinvent the wheel. We advise companies to review existing engagement mechanisms and look to see how these can be improved or expanded. Companies that have provided a good explanation of their chosen engagement mechanism include **Prudential plc** (ARA 2019, page 99), **William Hill plc** (ARA 2019, page 65) and **BAE Systems plc** (ARA 2019, page 95).

Ensuring engagement is meaningful

Many disclosures concentrate on the processes around workforce engagement. However, it is more important for companies to give insights into the engagement outcomes and, crucially, the impact of those outcomes on board decisions. Participants at DNED roundtable

discussions we hosted in May 2020 acknowledged that the workforce feedback gathered to date has had limited impact on strategic board decisions, as it has often centred on more operational matters. This is largely because the mechanisms are new and also due to some initial scepticism from the workforce. Trust should build over time so that the issues raised provide more meaningful insights. Our 2020 paper, *Designated NEDs: The journey from scepticism to meaningful insights*, includes ideas to raise conversations up to a strategic level.

Some topics are particularly challenging in terms of achieving meaningful workforce engagement. This may be because they are complex, such as executive remuneration policy, or are not seen to be of direct relevance to the majority of the workforce. We encourage companies to think of alternative methods e.g., podcasts or internal newsletters, to explain and engage on these topics, as done by **Man Group plc** (ARA 2019, page 80) and **Prudential plc** (ARA 2019, page 164). There is a need to invest time and break down certain subjects to enable the



Designated NEDs: The journey from scepticism to meaningful insights

Insights on workforce engagement from discussion roundtables

EY
Building a better working world

This paper summarises the key themes and insights from our May 2020 roundtable discussions with DNEDs, company secretaries and HR directors on workforce engagement. It provides practical thoughts on how to approach it and aims to help DNEDs evolve and become more effective in their role.

³² Annual Review of The UK Corporate Governance Code, FRC, January 2020.

wider workforce to contribute to conversations. This could help the 4% of companies we found not to be complying with the 2018 Code's Provision 41, which requires the remuneration committee to engage with the workforce to explain the alignment between executive remuneration and wider company pay policy.

Reporting on what has been done

Insightful disclosures clearly explain the engagement mechanisms in place and why they were chosen. This is useful in the first year of reporting against any new governance requirement. Companies that report well in this area include **Aggreko plc** (ARA 2019, pages 50 and 55), **BP plc** (ARA 2019, pages 88 and 89) and **Elementis plc** (ARA 2019, page 63).

Given the often relatively informal nature of workforce engagement, the better disclosures include case studies or personal viewpoints from the DNED or participating board members e.g., **Reckitt Benckiser Group plc** (ARA 2019, page 47) and **Essentra plc** (Figure 29). These help to bring the engagement to life, giving colour to the disclosure. We suggest viewpoints could focus on the feedback heard and how it has been influencing board decision making.

The 'new normal' of working

The COVID-19 pandemic has resulted in extensive remote working and engagement, with the result that communication has never been more important. Companies such as **Taylor Wimpey plc** and **The Weir Group plc** have held regular employee pulse surveys and virtual townhalls to stay in touch with employees. We heard in our DNED roundtable discussions how virtual engagements have worked surprisingly well. With everyone engaging virtually, the playing field has been levelled, often leading to

better overall participation. Many DNEDs have been pleasantly surprised by such outcomes and hope to continue with some virtual engagement, even when social distancing restrictions are lifted.

As companies continue to adapt their engagement mechanisms and meet the challenges presented by the COVID-19 pandemic, we encourage reporting in the next cycle to be open about the changes that have had to be made and reflect on what has and has not worked.

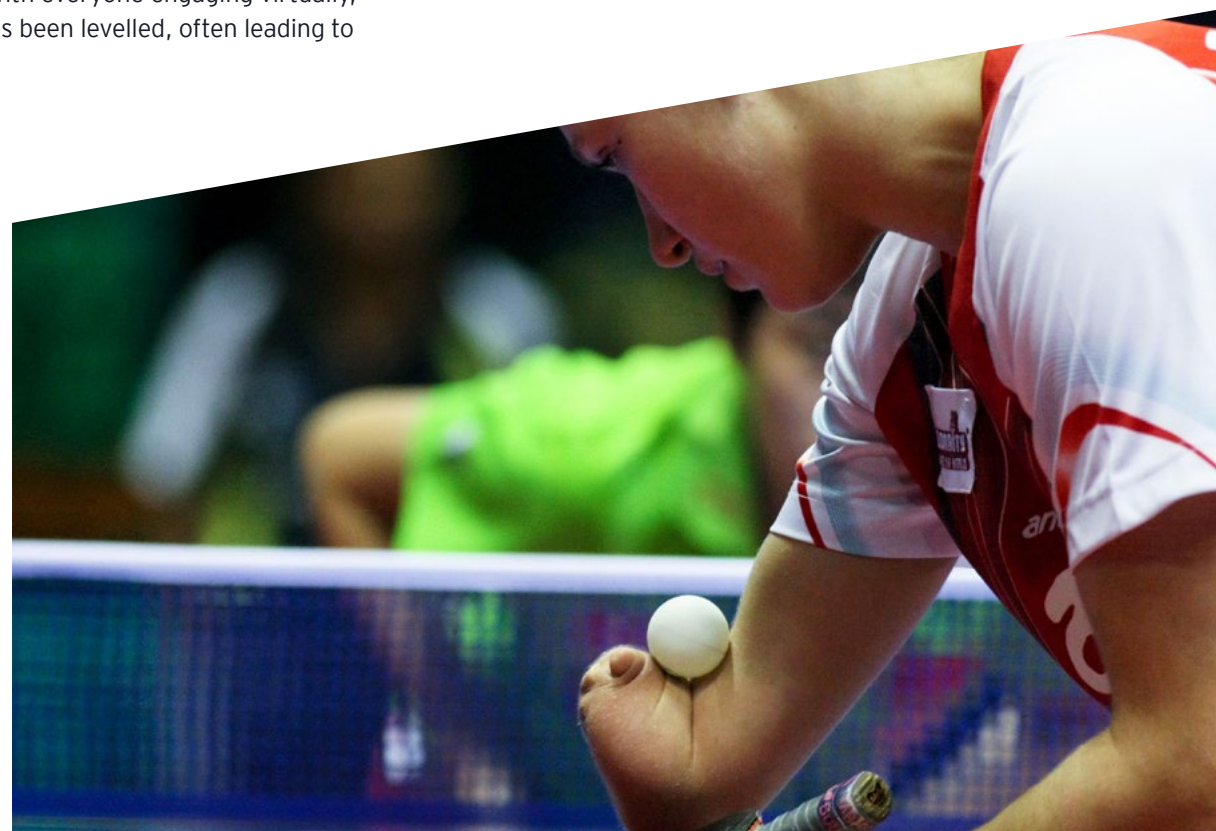


Figure 29: Essentra plc, ARA 2019, pages 76 and 77

Directors' Report
Corporate Governance Report continued

Q&A

Board engagement with employees
In January 2019 Mary Reilly was designated as Board Employee Champion. In this role Mary has travelled to sites around the world to meet employees, host town halls, learn about employee experiences and take back to the Board any feedback or questions. Given the importance the Board places on engagement and the desire to hear and understand even more, in November 2019 Ralf Wunderlich joined Mary in this role. In 2020 they will visit more Essentra sites – in Asia, Europe and the Americas – either alone or together.

Mary Reilly
Non-Executive Director



What have you enjoyed most about the role?
A I was initially attracted to the role because I'm naturally curious – said to be a good characteristic for a Board member – about how the Company makes money, the role employees play in that and what their perspectives are on the issues facing Essentra. Also on a human level I really enjoy meeting different people, so I've enjoyed getting to the grassroots of the organisation and meeting the people who make things happen for our customers and each other every day. The role has given me the opportunity to see the many different aspects of the organisation – regional differences, differences between our business divisions – as well as all the things our employees have in common.

What are the benefits of having this designated role on the Board?
A When creating this role the Board thought very carefully about how it should work. We have deliberately ensured that there is no agenda when I'm out and about meeting employees; it is simply about creating a genuine dialogue. What this means for employees is that I can explain what the Board is, how it works and describe what it is working on. It's particularly important for employees to understand that this is not an HR, Workers' Council or Union role, it is simply their opportunity to talk. For the Board I am able to relay perspectives and suggestions and these help build our understanding of the organisation, enrich our discussions and inform our broader decision-making.

What are the main themes coming out of your meetings with employees?
A It is definitely a theme. While the organisation has invested a lot in creating more stability in the IT infrastructure there is still some frustration felt on the front line. As expected HR issues come up quite frequently in terms of reward and recognition and this aligns with feedback coming out of the employee survey. Also as you might expect working environment also comes up a lot, this can be anything from the availability of toilets to investments in machinery etc. However, what has really struck me is that the vast majority of employees do feel invested in the Company's future and see that they have a role in making Essentra a great place to work.

Have there been any surprises?
A I have been genuinely surprised to meet so many employees with long tenures within the organisation and also the huge amount of pride that exists among the workforce. There's genuine care for management by front line staff – the amount of issues they have to grapple with and also some concern around the broader economic environment, eg Brexit.

What has been the reaction from employees to the role?
A The reaction has been really positive everywhere I've been. I have found employees are very happy to take time out of their shift to meet me. They are universally keen to understand the difference between the Board and the Group Management Committee ("GMC") and how both work in terms of decision-making at Essentra. Employees have also been really receptive to the confidential email inbox we have made available so that employees can contact me outside of the meetings.

What has been the reaction from the Board?
A The Board has really invested in making this role a success and is eager to hear the feedback from my visits, which I provide at each Board meeting.

How has the role influenced decision-making by the Board?
A In general terms feedback from the role has definitely helped create more robust dialogue about employees at the Board. It is interesting for the Board to see how the decisions we make carry through the organisation and impact on front line staff. I think we have all been surprised by how long it can take for some investments to impact the front line, for example in IT upgrade.

As a more specific example of how the role has influenced decision-making, I was fortunate enough to visit our Packaging site in Barcelona in April, around the same time that the Board was considering the potential acquisition of Nekicesa in Spain. Visiting the site, it was clear that our business has capacity issues which was leading to employee frustration. They are incredibly passionate and commercial and really wanted to maximise the opportunities as they saw them in the Spanish market. While not the deciding factor in the acquisition, this perspective certainly added to our decision-making process and the ultimate acquisition which completed in September.

What have been the challenges of the role and how do you see it developing?
A Making the time and then managing the trips has required more organisation than originally envisaged. In making this happen the Company has been a great support and clearly demonstrates its commitment in making the role a success.

Indeed because the Board wants to hear and understand even more from employees, I'm delighted that in November Ralf Wunderlich was also designated as a Board Employee Champion. We've already seen the benefit of having two Employee Champions, for example we went through the results of the recent employee survey together; having two perspectives was very useful. Ralf and I, together with the whole Board, are committed to supporting management in doing more to make our employees feel proud of and are looking forward to visiting a number of our sites during 2020 either alone or together.

What are you hoping to see evidence of during your visits of 2020?
A The Company is working hard to improve and change culture within the businesses, specifically in relation to compliance training and activities, and I shall be hoping to find evidence of this as I continue my tour of the Essentra facilities. I shall also be looking to hear from employees about the impact of the new HR strategy, particularly the introduction of the employee lifecycle.

Visits by the Non-Executive Directors and the Board Employee Champion



6 Visits made to the UK
5 Visits made to the USA
4 Visits made to Europe
1 Visit made to Asia

DIRECTORS' REPORT

Looking beyond gender diversity

Gender diversity has received due attention for the best part of the last decade. Although we cannot rest on our laurels just yet, much action, transparency and accountability has been driven by the Hampton-Alexander Review, and the statutory reporting of gender diversity and gender pay gap metrics. But what about diversity beyond gender?

It has always been a requirement of UK corporate governance codes for boards to consider diversity in its widest sense. There has also been a growing recognition of the benefits of a diverse workforce and its ability to drive competitive advantage. Even so, broader diversity issues have not received the same attention as gender until recently. There has been less accountability, resulting in fewer concrete actions. However, this year the sad events leading to the Black Lives Matter movement have sparked a drive to create real change. Companies can no longer ignore these social calls and must be both bold and transparent about the actions they are taking.

Reporting on board diversity: adding specificity and accountability

In this year's ARA review, 56% of companies report board diversity metrics around the composition of their board (beyond the requirement to report

the board's gender diversity). The most frequently reported metrics are nationality, tenure and age.

Surprisingly, only 12% of companies currently report the ethnic diversity of their board. More will need to be done to meet the recommendations of the Parker Review, including its aim to achieve 'One by 2021' in FTSE 100 companies (2024 for FTSE 250 companies). ARAs should describe the board's policy on diversity and the company's efforts to increase, among other things, ethnic diversity within its organisation,



The Black Lives Matter movement has sparked long-needed conversations about the roles all businesses play in creating change. Executives have woken up to the impact that staying silent can have on customer loyalty, brand, reputation and, in some cases, investor confidence.”



Arun Batra OBE, Partner, EY Culture, Diversity and Inclusion and CEO and founder of The National Equality Standard

Spotlight on UK National Equality Standard

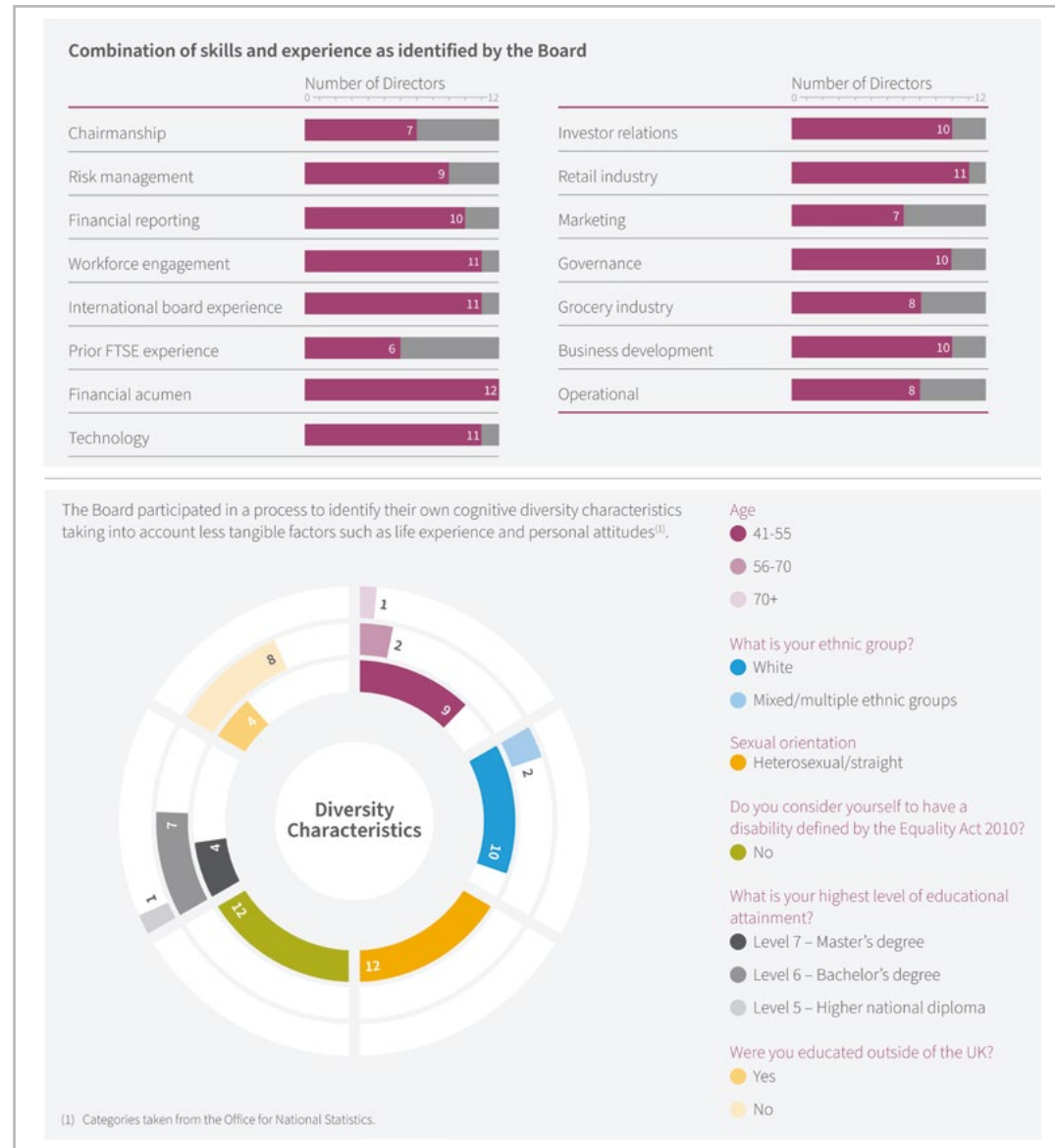
The National Equality Standard (NES) is the UK's leading diversity assessment framework. It enables organisations to measure diversity and inclusion (D&I) across their regions, business units and departments. The NES was founded by Arun Batra, EY Partner, in partnership with the UK Government and in collaboration with 20 public and private sector organisations that are market leaders in attracting, recruiting, developing and retaining diverse top talent.

The NES takes a holistic approach to incorporate all aspects of D&I into a single national standard. It addresses all nine protected characteristics and broader D&I considerations (e.g., social mobility).

Participation in NES assessment ensures long-term sustainable change and a beneficial impact on productivity and growth. It also provides a detailed roadmap with recommendations to help organisations improve their diversity.

To find out more on how EY can provide NES assessments visit: www.nationalequalitystandard.com

Figure 30: Ocado Group plc, ARA 2019, page 77



12%

Although companies are more openly discussing the challenges to increasing diversity, there isn't much accountability – only 12% report the ethnic diversity of their board.

including at board level.

Some companies disclose broader aspects of the diversity of their board, usually reported using tables or graphs. Examples include **British American Tobacco plc** (ARA 2019, page 81) and **Ocado Group plc** (Figure 30). Some such as **Standard Chartered plc** (ARA 2019, page 104) also report transparently on the board diversity policy, providing progress updates on the policy's objectives.

The 2018 Code introduced a requirement for the ARA to reflect how the board evaluation has or will influence board composition. Companies signal their positive intentions to improve diversity through future board appointments. However, this intent should be accompanied by detail on how it will be put into action.

In particular, companies should include:

- ▶ Measurable objectives for board diversity with a link to a commentary of performance against them.
- ▶ An explicit reference to the requirements of the Parker Review e.g., one director from an ethnic minority background by 2021 for a FTSE 100 company (or 2024 for FTSE 250).
- ▶ How diversity has been incorporated into director succession planning.
- ▶ How diversity is considered within the board's evaluation.
- ▶ Initiatives for achieving ethnic diversity at senior management level.

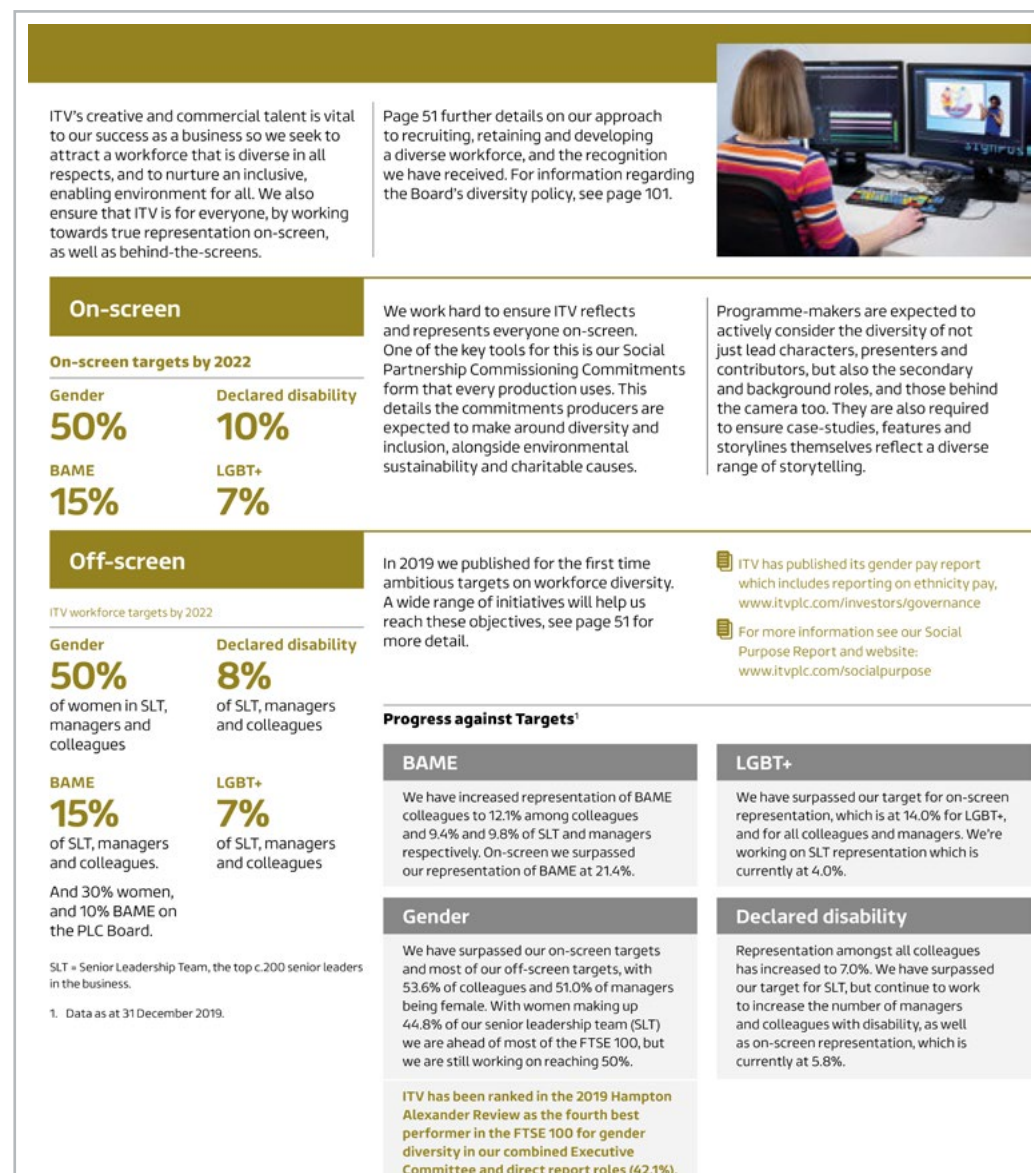
Wider company diversity

The reporting of broader D&I below board level remains light and limited to policies and commentary on initiatives. More could be done to increase transparency by broadening the metrics reported, particularly on ethnicity. **ITV plc** (Figure 31) demonstrates how companies can create accountability by reporting on their progress against a spectrum of diversity targets across the company.

Another way to improve insight into diversity issues is to highlight particular initiatives e.g., through case studies evidenced with relevant progress statistics. **Glencore plc** (ARA 2019, page 33) presents a case study on its #SheRocks campaign, describing the initiative to encourage more women into the mining industry. Statistics on the number of women students in the company's programmes, as well as prior-year comparisons, are quoted. **Man Group plc** (ARA 2019, page 45 and 46) includes Q&As with employees who have taken up flexible working policies around caring and parental responsibilities. The disclosure from **Balfour Beatty plc** (ARA 2019, pages 44 and 45) provides detail on key achievements and external recognition of its diversity progress, including around gender. **Fresnillo plc** (ARA 2019, page 70) demonstrates how it is encouraging greater gender diversity, stating what has and will be done to achieve improvements. It considers many aspects that might unconsciously influence gender bias e.g., in performance appraisal practices and the use of role models.

There is a drive for increased accountability to help meet broader diversity objectives. This may come through future iterations of the 2018 Code or legislative measures e.g., ethnicity pay gap reporting. In the meantime, companies should be proactive and transparent about their actions and progress on the diversity agenda.

Figure 31: ITV plc 2019 ARA, page 48 and 49



Appendices



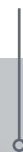
Appendix 1: Resources

EY's Corporate Governance team provides practical guidance and thought leadership on governance and narrative reporting matters for management and boards. It also contributes to wider discussions on good governance, based on our research and engagement with investors, boards and regulators. Our services include bespoke reviews of narrative reporting, governance diagnostics and board training.

The reports highlighted on page 75 and further resources are available on our website:
<https://www.ey.com/corporategovernance>

Designated NEDs: The journey from scepticism to meaningful insights

Following a series of virtual discussion roundtables with DNEDs, company secretaries and HR directors, this paper provides practical thoughts on how to approach workforce engagement. It will help DNEDs evolve and become more effective in their role.



Assessing the quality and effectiveness of the external audit – A practical tool for audit committees

Toolkit for audit committees to assess audit quality and complementary questionnaires to help audit committees get feedback from management and their auditor.



Deconstructing the Section 172(1) statement

Practical guidance including our suggested framework for companies to report a separately identifiable s172.



Preparing your interim narrative under COVID-19

This paper provides an overview of the trends in interim (or half-yearly) reporting based on a review of a sample of interim reports of UK issuers with a March or June 2020 period end.



Section 172 (1) reporting: Emerging observations from December 2019 reporters

Observations on the s172 reporting based on a review of over 60 published annual reports and accounts of 31 December 2019 FTSE 350 reporters.



Governing culture: Practical considerations for the board and its committees

This paper is designed to help boards and committees consider the decisions they make and the oversight they exercise through the lens of culture.

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We thank Beatriz Diego, Vicky Johnson, Samantha Chew and Maruschca Kotze for all their help in producing this report.

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