

# THE EQUALITY TRUST

## Submission to FRC Consultation on the Wates Corporate Governance Principles for Large Private Companies (August 2018)

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### Introduction

The Equality Trust is [a registered charity](#) that works to improve the quality of life in the UK by reducing economic and social inequality. Our perspective in approaching this consultation is, therefore, primarily concerned with the impact of the six Wates principles (“the principles” – see appendix) on the great economic and social inequality that currently [divides and damages the UK](#) in so many ways.

We also comment in the knowledge that it is in the larger companies in the private sector\* (compared to the public and third sectors) where the greatest divides in pay between senior management and employees exist - and that is before consideration of the wealth that the private sector channels to (typically already wealthy) shareholders via dividends and other methods such as share buy-backs.

*\* We acknowledge that publicly-quoted companies, rather than large privately-owned companies, are very likely the worst offenders [in terms of large pay gaps between senior management and other employees](#).*

### Overall Assessment of the Principles

We believe that the principles are logical and coherent and, in and of themselves, are a common-sense approach. However, they are insufficient in terms of producing a more equitable settlement between shareholders, management, employees and other stakeholders, in terms of both economic reward and who wields power within such companies. In this sense, the principles are too narrow and are still too close to the ineffective “cosy-club” mentality of the sort that bedevils our publicly quoted companies.

### A More Detailed Assessment of the Principles

The principles relating to Purpose, Responsibilities and Opportunity and Risk are largely unremarkable and we do not propose to comment further except that, in relation to Purpose, we would hope that is defined in a broad way. The purpose of a company needs to encompass ethical, social and environmental responsibility rather than just a simple devotion to the “bottom line”, profit maximisation and the interests of shareholders (see section on Stakeholders below).

In relation to Composition, Remuneration and Stakeholders, we would comment as follows:

Composition: We believe that this principle, as drafted, is unlikely to address the deficits around employee representation and diversity. We would like to see wording that remedies these deficiencies. We would advocate employee representation on the board and the adoption of quotas and progressive recruitment policies to tackle the diversity deficit. Without these reforms, boards will never be as effective as they could be because vital experience and proper challenge will be missing from the decision-making process. At worst, dangerous “group-think” could prevail.

Remuneration: We are pleased to see the reference to “taking into account pay and conditions elsewhere in the company” but this formulation is weak. We would advocate that large private companies adopt an open and transparent approach around their pay ratios such as that soon to be required for quoted companies. As well as publishing their top-to-median (and, ideally, top-to-bottom pay ratios as well) we would urge that they provide, in their annual accounts, a commentary on their pay ratio policy and a statement on their approach to managing (and hopefully reducing) their pay ratios over time.

We also advocate that employees be elected or appointed to the remuneration committee that oversees board and senior management rewards. Without this proper level of scrutiny, the suspicion will linger (as with publicly-quoted companies) that the board are effectively marking their own homework when it comes to setting their pay and bonuses.

Stakeholders: We would like to see the wording strengthened in this principle. It is too informal and leaves open the possibility that any engagement and consultation with stakeholders will be cursory and, possibly, tokenistic. We would prefer to see wording that states that employees will be actively involved in the governance of the company and that the definition of stakeholders will be suitably broad so as to encompass social and environmental considerations. It should cover matters such as supply-chains, treatment of host communities and maintaining the highest ethical standards across all the company’s dealings.

We also advocate that companies should adopt a long-term strategy to increase the level of employee-ownership by making provision for a proportion of voting shares to be transferred to employees over time. We would also encourage companies to draw up a legacy plan that either provides for the business to be transferred to employees in the event of a sale or, at the very least, ensures that an employee buy-out will be one of the options considered (for more on this, see our [Ownership Charter](#) proposals).

## **Conclusions**

As James Wates himself notes: *“Good business well done is good for society. Private companies are a significant contributor to the UK economy, providing tax revenue and employing millions of people. They have a significant impact on people’s lives, and it is important they are well-governed and transparent about how they operate.”*

We agree that this is the case and that is why we advocate that they adopt similar standards to those that we want to see applied to publicly-quoted companies, notably: pay ratio reporting, employees on boards and employees on remuneration committees. These businesses are too important to the UK to be governed under the narrow, ineffective, cosy-club arrangements that prevail amongst listed companies, arrangements that have brought us (variously) [excessive executive rewards mirrored by poverty pay for workers](#), scandals like Carillion and the slack and conducive environment that permitted the global financial crash of 2007/8.

Large private companies have a great opportunity here to be standard-bearers for a new and fairer way of doing business. At the heart of this new model should be governance arrangements that actively promote greater economic democracy and a narrowing of the income and wealth gap in the privately-owned company sector that will, in turn, help reduce inequality and thereby improve our society as a whole.

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END.

## Appendix:

The six Wates principles are:

- Purpose – An effective board promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.
- Composition – Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.
- Responsibilities – A board should have a clear understanding of its accountability and terms of reference. Its policies and procedures should support effective decision-making and independent challenge.
- Opportunity and Risk – A board should promote the long-term success of the company by identifying opportunities to create and preserve value and establish oversight for the identification and mitigation of risk.
- Remuneration – A board should promote executive remuneration structures aligned to sustainable long-term success of a company, taking into account pay and conditions elsewhere in the company.
- Stakeholders – A board has a responsibility to oversee meaningful engagement with material stakeholders, including the workforce, and have regard to that discussion when taking decisions. The board has a responsibility to foster good relationships based on the company's purpose.