SECTION 1: BOARD LEADERSHIP AND COMPANY PURPOSE

An effective board is crucial to setting a positive company purpose, set of values and culture. The board should be diverse and committed to contributing to the long-term success of the company and the boardroom culture must enable each Director to contribute effectively and create a whole greater than the sum of its parts.

Company leadership, purpose and culture vary widely, and investors should work with their advisers and managers to consider which issues are the most likely to be material to value-generation. For instance, one company might have an issue with its supply chain and another an issue with staff retention.

THE ROLE OF CULTURE

The Covid-19 pandemic ushered in a new era of how we look at company culture and the treatment of workforces.

Cultural failures can damage corporate reputation and substantially affect investment returns. The 2018 UK Corporate Governance Code clearly highlighted the role of the board in determining and assessing a company's culture and values, and how the desired culture has been embedded.

Culture is difficult to assess, but there are performance metrics available that can be helpful for raising key questions. The PLSA has undertaken work[14] to determine the value of an engaged, motivated and skilled workforce through a range of proxy metrics. The aim is for investors to use this to assess its company culture through different sources of information, including their communications with employees, shareholders and wider stakeholders.

EVIDENCE BASE

Shareholders will naturally look at financial results and wider evidence that the Chair and the board are adhering to the spirit of the Corporate Governance Code's Principles. For instance, significant pay discrepancies between a company's senior executives and the rest of the workforce, as well as gender or ethnicity pay gaps, can be signifiers of wider issues within a workplace's culture and processes.

To ensure a strong and inclusive workplace culture, clarity on company strategy, culture and the business model should flow through every part of the Annual Report. This should include information on a company's employment model and working practices – given their significance to a company's long-term performance – and how this is linked to the firm's culture and purpose.

[14] Pensions and Lifetime Savings Association 'Understanding the Worth of the Workforce: A Stewardship Toolkit for Pension Funds', Pensions and Lifetime Savings Association (2016) <https://www.plsa.co.uk/portals/0/Documents/0591-Understanding-the-worth-of-the-workforce-a-stewardship-toolkit-for-pension-funds.pdf>.

The Annual Report should have clear information on workforce engagement as well as draw clear links between any employee survey findings, actions undertaken in response to this and the expected impact. Key measures include employee turnover and employee survey follow-up. Additionally, a company's Strategic Report should clearly articulate how its key assets contribute to the generation of sustainable value creation. Clear connections should be apparent between chosen financial and non-financial priorities and KPIs selected by the company. Outcomes for the company and its stakeholders should be measurable, incentivised, and integrated into remuneration arrangements, with appropriate outcome measures over a reasonable time horizon.

Shareholders may want to undertake a closer analysis of the narrative within company statements, noting the tenor and language used in describing the approach to the workforce and stakeholders. In addition, this analysis should consider whether messaging from the Chair and Chief Executive (CEO) statements are clear regarding the aims and culture of the company. A feeling of alignment and consistency should be apparent throughout the document.

Leadership purpose and culture can be difficult to evaluate purely through reading company reports and therefore should be enhanced by shareholder engagement, which is central in reviewing corporate behaviour and assessing performance on an ongoing basis.

The best indicators to use will depend on the situation, the context and the specific environment in which a company operates. Investors should look for reliable and consistent sources of data, which allow comparison with others in the sector over time.

WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- Corporate purpose, culture and values are aligned with company strategy. This alignment should continue through the recruitment, performance management and reward structures, all of which should be aimed at incentivising behaviour that is consistent with the company's purpose and values.
- There is a clear link between good performance, the effectiveness of the board and results that are consistent with the company's stated strategy. Any weakness in performance should be adequately explained and addressed and should not be the result of imprudent management, poor judgement or weakness in corporate governance. It should rather be the result of external factors over which the board has limited control, but which it is taking steps to combat, nonetheless.
- Boards demonstrate awareness of their s.127 Duties under the 2006 Companies Act.[15] This is a requirement for Directors to have regard to other stakeholders, including workers, customers, suppliers as well as the wider society and environment. This should include evidence of a plan for engagement with stakeholders, as well as activities undertaken and consequent outcomes.
- Boards demonstrate positive relationships with key stakeholders. Boards should be able to communicate how stakeholder perspectives are fed into boardroom considerations, which

[15] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/contents>.

should include shareholders - the quality of this dialogue is vital for assessing culture especially.

- The Annual Report offers a fair, balanced and understandable assessment of the company's prospects and position. It should cover both financial and non-financial issues and outline how the board has fulfilled its responsibilities.
- Company statements refer to the workforce as a source of value, not a risk to be managed. The 2018 Corporate Governance Code explicitly clarified a company's responsibilities to shareholders and stakeholders, including its workforce.
- The Chair is engaged with the company's shareholders on governance and culture. The Chair should be accessible, accept legitimate shareholder requests for meetings and convey relevant sentiments and dialogue back to the Board.
- Governance reporting is focused on board decisions and their outcomes in the context of the company's strategy and objectives. Where the board reports on departures from the Code's provisions, it should provide a clear explanation.[16]

HOW INVESTORS SHOULD CONSIDER VOTING

The most appropriate route for voicing general concerns is through voting on the Annual Report and Accounts. Investors should consider **voting against adoption of a company's Annual Report and Accounts** if:

- Key stakeholder relationships, including with shareholders and the workforce, are being neglected and the board is not adhering to the spirit of the Corporate Governance Code requirement to engage and support stakeholder constituencies.
- Disclosure of the business model fails to convey how the company intends to generate and preserve long-term value.
- The company fails to provide a fair and balanced explanation of the composition, stability, skills and capabilities and engagement levels of the company's workforce.

More specific concerns related to the quality of the company's interaction with shareholders could be addressed by **voting against the re-election of the Chair** if:

- The Chair has declined a legitimate shareholder request for a meeting without offering a valid reason as to why or has failed to find a mutually convenient time without undue delay.
- The Chair has repeatedly failed to address investors' concerns about the relationship between the company and key stakeholders.
- The Chair has had significant involvement, whether as an Executive Director or a Non-Executive Director, in material failures of governance, stewardship or fiduciary responsibilities at a company or other entity.

[16] New Corporate Governance Code 2024 principle which comes into force on 1 January 2025.