Corporate governance codes and reporting are often seen as the province of the listed company. In the UK, the UK Corporate Governance Code, to which premium listed companies must adhere, is a well-known and respected standard.

Unlisted companies, on the other hand, have largely operated without such reporting requirements. Private companies, so the assumption goes, should be able to run themselves as they wish. After all, they are risking their own capital, not that of distant shareholders. Of course, it goes without saying that many of these companies already recognise the importance of good governance, but reporting on it was broadly seen as an optional extra.

But that line of thinking has been changing. In the UK, the collapse of the retailer BHS left thousands without a job and placed their pensions in jeopardy. Such a mainstay of the British high street was a noticeable loss, and media and politicians piled on the scrutiny, asking questions about how such a large business could
be allowed to exist (and die) without the sort of checks and balances that are required of listed companies. Private companies enjoy the benefits of limited liability but are not subject to the same level of reporting and accountability requirements as publicly listed companies. So they should bear some of the responsibilities of having a potentially sizeable impact on the wellbeing of numerous employees, suppliers, customers and others.

Of course, the situation is not so simple. Even private companies are subject to numerous regulations and reporting requirements of UK Company Law, but the collapse of BHS nonetheless did expose the lack of a level regulatory playing field when it comes to large private companies and governance.

**Government response**

In 2017, the UK government announced in its response to a wide-ranging consultation on corporate governance that they would introduce a new reporting requirement for large private companies, a group they defined as those with more than 2,000 employees or meeting certain financial thresholds (having both a £2bn balance sheet and more than £200m in annual turnover). This group of companies represents a sizeable portion of the UK economy. About 1,700 companies currently meet those thresholds, having a combined turnover of £1.6 trillion and employing 6.2 million people – about 13% of the UK’s working population.

To satisfy the legislation, such large private companies would have to submit, as part of their annual Directors’ Report, a statement as to whether (and if so, how) they follow a code of corporate governance.

Problem was, corporate governance codes for private companies were scarce. True, the Institute of Directors had in 2010 issued a set of guidance and principles for unlisted companies in the UK, but more recently (in 2017) had called on the government to formally support the development of a new code. Notably, there was also a prominent code developed by The Instituto de Consejeros-Administradores” (IC-A), the Board Directors’ Association based in Spain. This had been adopted by the European-wide [IOD] organisation and gained some prominence.

But the UK government’s new legislation meant that an extremely wide range of companies would need to state their adherence to a code, with no clear candidate for which code that may be.

The way the legislation was drafted meant that it included not only companies one would normally associate as being ‘private’ – eg, those owned by an individual, a family, or a private equity fund – but also wholly-owned subsidiaries of larger, listed companies, including subsidiaries of PLCs in the UK and foreign-owned entities. This meant that extraordinarily diverse companies would be looking for a corporate governance code that they could report against in order to comply with the new legislation.

Anticipating this, the government had approached me in January 2018 to ask if I would lead a coalition group of organisations in the development of a new code.

I was pleased to accept. I do understand the need for government to be seen to respond to the existence of bad apples falling from the corporate tree, but I am aware that the law of unintended consequences often means that government regulation bears a risk of killing off the entire tree.

**The Wates Principles**

Throughout 2018, I worked with a coalition of organisations to delve into the fundamentals of what good governance is really about, and how the government’s broad category of ‘large private companies’ might benefit best from a set of principles and guidance.

With the Financial Reporting Council serving as secretariat and a member of the coalition, this group included the British Private Equity and Venture Capital Association, the Confederation of
British Industry, the Climate Disclosure Standards Board, the Institute of Business Ethics, ICSA: the Governance Institute, the Institute for Family Business, the Institute of Directors, the Investment Association, Mark Goyder (in a personal capacity) and the Trades Union Congress.

We developed a set of six principles, now known as the Wates Corporate Governance Principles for Large Private Companies. They are:

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

**Board 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.

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

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

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

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

In the document published in December 2018 and now available on the FRC website, we also included a short amount of guidance on each principle – not a list of requirements, but examples and further explanation to make the principle clear and to aid companies in interpreting and reporting on them.

These principles and guidelines were the result of some rigorous debate amongst Coalition Group members, a three-month public consultation, and review by an Executive Sounding Board consisting of representatives of UK companies that will be covered by the new reporting requirements.

Hopefully the principles’ logic is clear – purpose is at the pinnacle; and it is underpinned by practical characteristics of good management, plus an obligation to address certain specific matters. Boards are ultimately responsible for good governance, and underlying everything is a long-term perspective.

**Benefits to companies**

These principles provide businesses with a practical framework for ensuring that their companies are well managed and aligned behind a clear purpose. Essentially, they provide a tool to help companies look themselves in the mirror, to see where they have done well and where they can raise their corporate governance standards to a higher level.

The principles also provide a structure for reporting, regardless of whether companies are obliged to do so under UK law. Many companies are justifiably proud of their corporate governance already; many have extensive programmes already in place to consult with stakeholders, for example. These principles are flexible enough to allow just about any organisation to show off the good work they are doing, linking that good work to governance structures.

And if companies follow these principles as they were intended – as principles, not as boxes to tick – companies will be forced to think seriously about why they exist and how they deliver on
their purpose. Then, crucially, they will need to put such analysis into their own words. That should result in a compelling narrative – a sales pitch, if you will – that speaks directly to the people who a company needs to have on side to achieve its mission.

**At its heart, purpose and transparency**

Globally, we are seeing a movement towards businesses placing purpose first. This is not just good PR; it is good for the businesses themselves. Purpose doesn’t supplant profit; it promotes it. It is all about articulating why a company should exist, and how profit is necessary to allow a company to keep doing what it does well and sustainably deliver its social value.

Transparency on corporate governance, whether or not guided by the Wates Principles, puts the key questions and issues into the public domain. It recognises that stakeholders are partners in delivering on the company’s purpose, and provides the foundation for healthy dialogue on how best to deliver.

This is the sort of movement that we need all organisations to join if we are to improve public trust in institutions and pre-empt potentially damaging government intervention. We may never rid the business world of bad apples, but we can raise the tide of behaviour by the many well-meaning, tax-paying businesses that are the bedrock of the economy.

**Looking forward**

It’s still early days since the Wates Principles were published, but to date they have been well received. I see it as a good sign that some commentators say that they go too far; some say they don’t go far enough. While the government cannot dictate that companies follow the Wates Principles, Secretary of State Rt Hon Greg Clark MP warmly welcomed them at the launch.

I’ve committed my own company, the Wates Group, to adopt the Wates Principles as a structure for reporting on corporate governance in our 2018 Directors’ Report, but under the legislation, large private companies in the UK will not be required to report on their corporate governance arrangements until they publish their Directors’ Reports for 2019. So we won’t see exactly how they are being interpreted for some time. Moreover, I am sure that there will be a period of reporting cycles in which companies explore different approaches and properly integrate the principles into their board agendas. So it will take some time before clarity on good practice in reporting matures.

In the meantime, the coalition group, the Financial Reporting Council and I will continue to promote the principles and seek dialogue with those who share our aspirations for raising the tide of corporate governance, in the UK and internationally.