asesoria
A PROFESSIONAL SERVICES GROUP

INSTITUTIONAL INVESTOR SURVEY

MAY 2019

Corporate governance, what investors think…

CONTENTS

EXECUTIVE SUMMARY

The Companies (Miscellaneous Reporting) Regulations 2018, and the publication of the UK Corporate Governance Code (The Code) came into force on 1 January 2019. As a result, the Asesoria Group approached over fifty institutional investors through its 2019 Survey, to gain their views on some of the key elements contained within this governance framework.

Evidence of board governance and effectiveness is key for investors when making investment decisions. Satisfactory engagement between company boards' and investors is fundamental to the health of the corporate governance regime. Increased demand brought about by the various reporting regulations, as well as the new Code, and compliance against Section 172 of the Companies Act, means companies must provide evidence and report against matters including:

- How they engage with their workforce and wider stakeholders.
- Board and executive diversity in terms of gender, ethnicity, education, knowledge skills, background and nationality.
- Processes and outcomes of internal and external board evaluations.
- Alignment of culture with the company's purpose, values and strategy.
- Material ESG issues.

This is the third Asesoria Institutional Investors Survey. We hope that the findings from this survey will provide companies with useful insights; and help them to better understand what is required of them as they navigate the complexities of corporate governance.

KEY INSIGHTS

Engagement with Institutional Investors: Whilst institutional investors surveyed identified more work needs to be done in the areas above, **90% highlighted** that they are satisfied with the level of general engagement received from the companies in which they invest, and felt they were proactive in reaching out to them. Most agreed that this engagement has been improved by the focus now placed on corporate governance through the enhanced regulatory requirements.

Workforce Engagement:
Only 20% of investors believe that companies take sufficient account of workforce views when making business decisions. The majority support the need for a formal workforce advisory panel, or one combined with a non-executive director. Feedback implies that, whilst processes may have been put in place, most companies have not yet set up formal committees or have representation at board level.

Stakeholder Engagement:
40% of investors agreed that companies take sufficient account of wider stakeholder views when making business decisions. Comments suggest that companies are doing a better job on stakeholder engagement, but progress must continue. In particular, in the areas of stakeholder prioritisation, board oversight of the process, and definition of scope for board's direct engagement with some stakeholders.

Stakeholder Reporting:
Only 20% of investors say that they are satisfied with the current level of reporting on stakeholder engagement activities within annual reports. Comments include the need for companies to focus on what is material to their business and stakeholders - also being clearer on what they report, including demonstrating how such engagement influences board decisions.

Board and Executive Diversity:
Only 20% of investors indicate that the companies they invest in have diverse boards. It is generally agreed that to embrace the full concept of diversity, and to ensure that board members have the right skill sets and knowledge to deliver long-term value creation, more work needs to be done.

Company Culture:
It was commonly felt by those surveyed that culture is difficult for companies to articulate, and that relevant data is not easily accessible. Board interaction with senior management, employee surveys and turnover and absenteeism rates are the key indicators required by them; to give assurance that the companies they invest in promote the desired culture outlined within the Code.

Board Evaluation:
Investors identified 'Rigour of process undertaken' as ***the number one issue*** when assessing the robustness of an externally facilitated board evaluation process, followed by the outcome and actions taken; and reporting of the key findings and recommendations.

Priority topics (ESG) for engagement throughout 2019:
Investors were asked to highlight which topics they felt were most important to them when engaging with companies during 2019. ***Climate risk disclosure was by far the most important listed,*** followed by board skills and experience, cyber security and ESG risk management and opportunity**.**

Investors highlighted the importance of companies ***reporting honestly and openly against the issues that are most material*** to their business and stakeholders. This includes how these are practically applied and measured. They would also like to see evidence of how ESG matters, workforce and stakeholder engagement has ***influenced or impacted on the board's decision making and how this is translated into the overall strategy.***

ABOUT THE SURVEY

The purpose of this Survey has been to gain an understanding of where investor priorities lie in respect to corporate governance reporting. This is the third year the Asesoria Group has surveyed institutional investors. Approximately fifty such investors, representing around £20 trillion of assets under management, were invited to complete the survey incorporating a range of questions (both qualitative and quantitative), with multiple choice and single answer options.

In addition to the survey, Asesoria had face-face discussions with a select number of institutional investors to gain a more in-depth view of their expectations.

The information provided within this survey will be shared with clients we work with and other interested stakeholders. It is available on-line www.asesoria-group.com. A pdf printed copy, and alternative formats are available on request.

ENGAGEMENT WITH INSTITUTIONAL INVESTORS

Corporate engagement remains a key mechanism used by investors to monitor their investments. The benefits from building long-term relationships with investee companies helps to improve communication channels, during a time when expectations have intensified around the role boards play in managing the company's governance and strategic direction.

Increased demand brought about by the various reporting regulations, as well as the new Code, and compliance against Section 172 of the Companies Act, means companies must report and provide evidence against matters; including how they engage with their workforce and wider stakeholders, board diversity, board evaluations, culture and material ESG matters.

90%	**of investors are satisfied by the engagement received from the companies they invest in**

90% of the institutional investors who responded to the survey were satisfied by the level of engagement received from the companies they invest in and believed them to be proactive in engaging with them.

Respondents commented on how they have built good relationships with the companies they invest in, and have good access to the Chair and board members.

As indicated further within this survey, **whilst the level of general engagement is good, there are a number of areas where further improvements are required** in line with enhanced regulatory requirements.

Investor Comment:

"There is a need to provide a more holistic overview on how corporate governance, including sustainability, is embedded into the company's business strategy"

WORKFORCE ENGAGEMENT

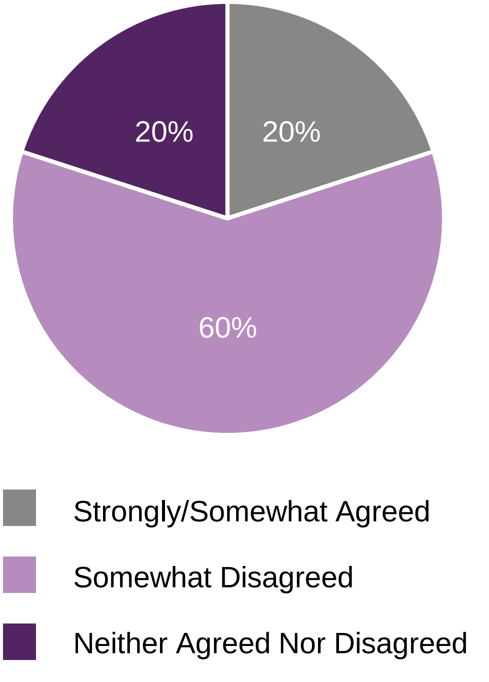
Workforce engagement is essential for understanding the nature of a relationship between an organisation and its employees. Engaged employees are more likely to be committed to the company's goals and values and motivated to contribute to its long-term success.

Over half of the investors surveyed, indicated that the companies they invest in don't take account of their workforce views when making business decisions. Additional comments suggest that evidence of **workforce views being taken into account is generally scarce, despite employee surveys becoming more in-depth**; and that necessary actions are less clear. Others felt that as a result of the Code and shareholder pressure, issues such as executive pay is considered. It was also felt that in certain industries, namely retail, where zero hours contracts are prevalent, that the opposite culture exists - meaning workforce views were not necessarily heard.

Investor Comment:

"I would consider a company to be dysfunctional if their workforce view was not taken into account"

60% of investors disagreed that companies take workforce views into their decision making



WIDER STAKEHOLDER ENGAGEMENT

Stakeholder engagement is considered an essential activity for all companies and should be used to inform the long-term decisions that it makes. This includes how it understands and takes account of its workforce and stakeholder interests, when making strategic decisions at board level**. Good stakeholder engagement can strengthen a business and promote its long-term success.**

Respondents were asked if they felt listed companies currently take wider stakeholder views in to account when making decisions. 50% neither agreed nor disagreed, 40% somewhat agreed and 10% somewhat disagreed.

40%	**of investors agreed that companies take wider stakeholder views into account when making decisions**

Comments suggested that companies are doing a better job, albeit **progress needs to continue, particularly in the areas of stakeholder prioritisation, board oversight of the process; and definition of scope for board's direct engagement with some stakeholders**. Others felt that the language of managing ESG risk, and of promoting the UN Sustainability Goals (SDGs) has not taken root – at least at FTSE 100 level.

One of the provisions within the Code includes the requirement for companies to engage with the workforce through one or a combination of the following methods

1. A director appointed from the workforce
2. A formal workforce advisory panel
3. A designated non-executive director

40% of respondents preferred a formal workforce advisory panel, 40% a combination of a workforce advisory panel with a designated non-executive director and/or workforce appointed director. Others commented that not all companies are the same and may reasonably take different views on what would be best for them.

When respondents were asked what percentage of listed companies already have processes in place as above, or similar, to engage with the whole workforce and report on these activities; approximately 80% felt between 26-50% of companies had processes in place, whilst approximately 20% believe only 0-25% do.

Investor Comment:

"Whilst processes may have been put in place, most companies have not yet set up formal committees or representation at board level"

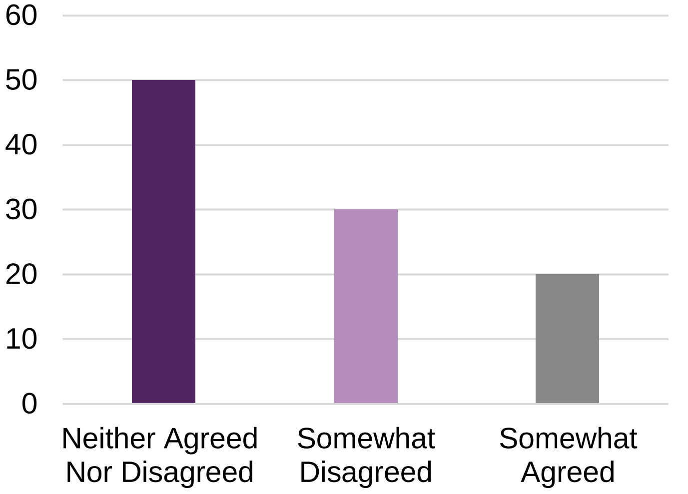
STAKEHOLDER REPORTING

The landscape for corporate governance and reporting continues to change in line with the legislation, which places increased emphasis on employee and stakeholder engagement and reporting. Companies remain under scrutiny from investors and other stakeholders, not only on their financial performance, but also how the business operates in a responsible way.

Many investors believe that company annual reports and responsible business reports are too long and difficult to navigate. The debate around the quality of integrated reporting is ongoing - it's purpose is to demonstrate succinctly how a company's strategy, governance, performance and long-term vision, lead to value creation. Questions have been raised as to whether companies are aware of and understand the connection between their strategy and performance.

Workforce Engagement: When asked if they were satisfied with the current level of reporting on workforce engagement activities within annual reports, 40% of respondents neither agreed nor disagreed, 30% somewhat agreed, 20% somewhat disagreed and 10% strongly disagreed. It was felt by some, that companies need to be clearer when reporting on how such engagement has influenced or impacted on the board. Also, there is a need to focus on how efforts and findings from workforce views translate into the company's overall corporate strategy.

Stakeholder Engagement: When asked if they were satisfied with the current level of reporting on stakeholder engagement activities within annual reports and how stakeholder views are considered in the business decisions, 50% neither agreed nor disagreed, 30% somewhat disagreed and 20% somewhat agreed.



Some respondents commented on how companies need to provide more background information, on how stakeholder engagement has shaped their priorities and action. Recognising it is difficult for companies to know how to materialise what issues most matter to their stakeholders, **recommendations included reporting more deeply around key material issues rather than attempting to report more broadly.**

Investor Comment:

"Businesses find it hard to identify the material issues that matter to its stakeholders"

COMPANY CULTURE

Company Culture encompasses the values and behaviours that contribute to the long-term success of a business - having a positive company culture promotes employee enthusiasm, encourages better productivity and effectively leads to better overall performance.

The Code requires the board to assess and monitor its company culture. This includes reporting on actions taken to ensure that the Code aligns with its purpose, values and strategy.

As part of the Survey respondents were asked to select from a set of indicators, those that promote the desired culture outlined within the Code. The three most highlighted were:

- Board interaction with senior management and workforce
- Employee surveys
- Turnover and absenteeism rates

Other areas not listed within the Survey, but felt to be important cultural indicators, include health and safety data and regulatory breaches and fines.

Some respondents commented on how they gauge the culture of a company based on the people they meet, such as the Chairman and members of the Executive Committee.

Investor Comment:

"Culture is difficult to articulate and relevant data is not easily accessible"

BOARD DIVERSITY

The focus on board diversity has been ongoing on for several years. By increasing diversity at board level it encourages innovation, provides better risk management, develops stronger connection with stakeholders; and delivers better financial performance over the long-term.

only

20%

of Investors agreed that companies they invest in have diverse boards

Respondents were asked about the diversity of boards and whether they believe the companies they invest in have diverse boards in terms of gender, ethnicity, education, knowledge, skills, background and nationality. 40% somewhat disagreed, 30% neither agreed nor disagreed, 20% somewhat agreed and 10% strongly disagreed.

Investor Comment:

"More work needs to be done to embrace the full concept of diversity, ensuring board members have the right skill sets and knowledge to deliver long-term value creation"

It was commonly felt that wider diversity, beyond gender, is not well understood and, whilst progress is being made against the 30% target for women on boards, there remains companies where there is a lack of executives from different ethnic and social backgrounds.

When asked about companies they invest in having the right policies and practices in place to develop a diverse pipeline of executives, 40% of respondents somewhat disagreed, whilst 30% neither agreed nor disagreed and 30% somewhat agreed. Comments also included the need for continued focus on implementation such as mentoring, training and inclusive recruitment processes.

Respondents overall had a mix of views on what areas of diversity they felt were most important to them. These ranged from skills, knowledge and experience to gender and ethnicity, as well as female management.

BOARD EVALUATION

Board evaluation provides independent assessment of the strengths and capabilities of a board, its committees and individual directors. The Code includes the need for companies to put more emphasis on reporting the outcomes of board evaluations (both internal and external evaluation).

Respondents were asked within the Survey which three elements they felt are most important to them, when assessing the robustness of an externally facilitated board evaluation process. Rigour of the process undertaken was identified as the most important issue, followed by the outcome and actions taken; and reporting of the key findings and recommendations:

1. **Rigour of the Process Undertaken**
2. **The Outcome and Actions Taken**
3. **Reporting of the Key Findings and Recommendations**

Some respondents also commented on the need for companies to be more honest and transparent, recognising critical issues and at the same time, exposing areas of weakness. It was also felt that talking about what actions are being taken to address the weaker issues, demonstrated a better run business; allowing investors to have a full picture and, therefore, better confidence when making investment decisions.

Investor Comment:

"The Code has put more emphasis on board evaluation. It's definitely a hook into engagement - looking at objectives etc enhances the dialogue with executives"

ENVIRONMENTAL, SOCIAL AND GOVERNANCE

Environmental, Social and Governance (ESG) company standards are used by sustainably minded investors, to screen possible investments. ESG incorporates a broad range of impacts on the risk and return values of an investment; generally related to regulation changes, business ethics, or direct impacts on financial, operational, strategic or reputational risks.

Respondents were also asked to highlight which topics from the following list will be the most important to them, when engaging with companies during 2019.

- Board Skills and Experience
- Board Diversity
- Board Succession Planning and Refreshment
- Executive Compensation
- Senior Management Diversity
- Climate Risk and Disclosure
- Supply Chain
- ESG Risk Management and Opportunities
- Cyber Security
- Stakeholder Engagement

Climate risk disclosure was, by far, the most important highlighted, followed by board skills and experience, then followed by cyber security and ESG risk management and opportunity.

Additional comments included how engagement on ethical and sustainability matters is good due to its focus. It is recognised, however, that **climate change risk can be difficult to define**, and companies continue to struggle when engaging and reporting on these matters.

When asked what other ESG topics not identified are important, **respondents highlighted areas such as business strategy, including its execution as well as the impact of products and services linked to the UN Sustainable Development Goals.** Other points raised included audit independence, quality and tenure.

Investor Comment:

"Promoting the UN Sustainability Goals (SDGs) has not entirely taken root – at least at FTSE 100 level"

Climate risk was highlighted as the most important ESG issue …. although companies struggle to define, engage and report

ASESORIA COMMENTS

Whilst Institutional investors, overall, are satisfied with the level of engagement received from the companies they invest in; they recognise **there is still work to do to deliver against the key elements contained within the current corporate governance framework**. This is demonstrated by 60% of investors disagreeing that companies currently take workforce views into their decision making for example.

Changes defined within the Code are designed to bring about a shift in focus and improve openness and transparency – the characteristics of good governance and reporting. The way in which companies can respond to this, is to develop a more collaborative approach to doing business through engagement with its workforce, and key stakeholders, on the impacts of their activities and report accordingly.

As part of this survey process, investor feedback suggests that good progress has been made as a result of the Code, but what they would like to see from the companies they invest in, is an open and transparent account of what they do on matters that are material to their business and stakeholders, how it's practically applied and measured.

Comments suggest they would also like to see evidence of how workforce and stakeholder engagement has influenced or impacted on the board and how this is translated into their overall company purpose and business strategy

As one institutional investor commented … "the more long-term a company's thinking is, the more they consider the views of its wider stakeholder groups. The longer out they take their Plan, the more their workforce and other stakeholders are energised by what they are doing with their business".

For those companies wishing to take their approach forward in line with investor requirements, our suggestion would be to undertake the following:

- **Stakeholder mapping exercise**
- **Materiality assessment to identify sustainability priorities**
- **Review strategy to ensure alignment to the company's purpose, values and material issues**
- **Develop relevant KPIs and targets**
- **Ensure transparent corporate and associated reporting**

The Asesoria Group team is here to help – please contact Caroline McCarthy-Stout, Director of Stakeholder Engagement and Reporting should you have any questions or require support.

caroline.mccarthystout@asesoria-group.com

ACKNOWLEDGEMENTS

We would like to thank all the institutional investors that took part in the Survey anonymously as well as those listed below who agreed to be interviewed by the Asesoria team and who helped shape the content of this report:

- Seb Beloe, Partner – Head of Research, Listed Equity, WHEB Group
- Matt Crossman, Stewardship Director, Rathbone Investment Management
- Charles Henderson, Business Manager, UK Equities, Henley Investment Centre, Invesco
- Ashish Ray, Head of Governance and Sustainability, Jupiter Asset Management

CONTACT DETAILS

ASESORIA GROUP LTD
107 CHEAPSIDE
LONDON
EC2V 6DN
TEL: 0203 053 8630
asesoria-group.com