# **Corporate governance for large private companies:** a flexible framework

The final form Wates Corporate Governance Principles for Large Private Companies (the Wates Principles) have been published by the working group chaired by James Wates CBE. The government asked the working group to develop a set of corporate governance principles for large private companies as part of the package of measures to improve the UK's corporate governance framework (*see box "Recent background"*).

## Recent background

When the government published its corporate governance reform green paper in November 2016, it sought views on whether the UK's largest privately held businesses should be expected to meet certain minimum standards of corporate governance and reporting given the disparity between the requirements imposed on listed companies and those for private businesses (*see News brief "Corporate governance green paper: restoring trust and confidence?", www.practicallaw.com/0-638-0471*). The government noted that, while the owners of private businesses do not need the same levels of reassurance and information as the shareholders of listed companies, the consequences for other stakeholders in private companies, such as employees, customers and pension scheme beneficiaries, can be equally severe when things go wrong.

In its response, the government committed to strengthening corporate governance in large privately held companies (*see News brief "Corporate governance reforms: government proposals published", www.practicallaw.com/w-010-4890*). It invited the Financial Reporting Council to work with other interested parties to develop a voluntary set of corporate governance principles for large privately held companies and announced that James Wates CBE would chair the working group.

Separately, the Companies (Miscellaneous Reporting) Regulations 2018 (*SI 2018/860*) introduce a requirement for all companies of a significant size to disclose their corporate governance arrangements in the annual report and on their website, including which formal governance code they follow (or an explanation as to why they do not follow one). UK-incorporated companies with either: more than 2,000 employees; or turnover of more than £200 million and a balance sheet total of more than £2 billion, are required to disclose their corporate governance arrangements with effect from financial years beginning on or after 1 January 2019.

The Wates Principles will be of particular interest for those large privately owned companies which are required, for financial years beginning on or after 1 January 2019, to produce a statement of their corporate governance arrangements. However, as stated in the introduction to the Wates Principles, the working group hopes that a wider range of companies will adopt the Wates Principles, as they offer companies that are not directly subject to the UK Corporate Governance Code (the Code) an opportunity to demonstrate good corporate governance practice and how they achieve the long-term sustainable success of the company.

### The six principles and accompanying guidance

The Wates Principles have been developed specifically for use by privately owned companies. They are relatively flexible and high level, and do not prescribe or advocate a particular course of action. This reflects the fact that a "one-size-fits-all" approach to corporate governance in large private companies is not appropriate given the variety of management and ownership structures, which include family-owned and run businesses, companies backed by financial investors and UK subsidiaries of larger groups.

Each of the six principles is accompanied by guidance to help companies understand how they can apply the relevant principle in a way that is appropriate to their circumstances.

Following consultation, only minor changes were made to the six principles. However, a significant number of changes were made to the accompanying guidance, including providing more detailed guidance in relation to board structure and independent directors, key considerations when setting executive remuneration and the identification of, and dialogue with, stakeholders. There is also more emphasis on consideration of environmental and social issues throughout the guidance. The changes are discussed in the feedback statement that accompanied the final form Wates Principles.

The six principles, and the accompanying guidance, have clearly been influenced by the 2018 edition of the Code, which applies to companies with a premium listing (*see feature article "Corporate governance reforms: widening responsibilities", www.practicallaw.com/w-016-1385*). A number of common themes run through both the Code and the Wates Principles, including the importance of purpose, values and strategy, engagement with stakeholders and aligning executive remuneration to the long-term sustainable success of the company. This may make it easier for any subsidiaries of premium-listed companies that are required to produce a corporate governance statement to adopt the Wates Principles when describing their corporate governance arrangements.

The six principles 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 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 to identify and mitigate 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 taking decisions.

### Reporting on the principles

The Wates Principles adopt an "apply and explain" approach, which means that companies are expected to apply each of the six principles and, for each one, provide a supporting statement that gives an understanding of how their corporate governance processes operate and achieve the desired outcomes in the context of that company's specific circumstances. This is in contrast to the "comply or explain" approach of the Code. The accompanying guidance does not need to be reported on.

The introduction to the Wates Principles notes that the "apply and explain" approach seeks to move beyond a tick-box approach to describing and explaining how the policies and practices achieve the six principles and instead demonstrate outcomes. It says that this approach offers increased transparency for stakeholders and links to the other new reporting requirements introduced by the Companies (Miscellaneous Reporting) Regulations 2018 (*SI 2018/860*), which are to explain how the directors have had regard to the matters set out in section 172(1)(a) to (f) of the Companies Act 2006, how the directors have engaged with employees and had regard to employee interests, and how the directors have had regard to the need to foster relationships with the company's suppliers, customers and others.

Given the overlap between these new reporting requirements and the Wates Principles, incorporating cross-references to information contained in other parts of the annual report in the corporate governance statement is encouraged where appropriate.

The first reporting against the Wates Principles will only be seen in 2020. The Financial Reporting Council and the working group have committed to ensuring that reporting is monitored, including highlighting emerging best practice.

### In practice

Given the continued focus on corporate governance, responsible business practices and the importance of considering stakeholder interests, the Wates Principles provide a helpful roadmap that allows privately owned companies to navigate the increasingly complex legal and regulatory landscape as well as the reputational and other damage that may ensue from failing to meet political, media and stakeholder expectations.

The Wates Principles provide a user-friendly framework and benchmark for those large privately owned companies that are required to produce a statement of their corporate governance arrangements. The flexibility provided by the six principles is helpful in allowing companies to apply them in a way which is most appropriate for the company's circumstances. However, this lack of prescription also means that companies will need to consider carefully their corporate governance arrangements, what is appropriate to their circumstances, and why and how to articulate this through their reporting.

*Kashmira Halai, Gareth Sykes and Ben Ward are members of the Corporate Governance Advisory Team at Herbert Smith Freehills LLP.*

*The Wates Principles and feedback statement are available at www.frc.org.uk/directors/corporate-governance-and-stewardship/governance-of-large-private-companies.*