



Artificial intelligence

‘While we cannot expect every board member to have expertise in data science, a real understanding of technological principles and the risks, regulatory, and social implications of AI certainly should be a pre-requisite for board members in any AI-centric company or one planning to capitalise on AI in the future.’

David Nolan

Board diversity beyond the FTSE 350

‘Companies often have inconsistent statements about board diversity spread across three or more sections of their annual report, making it difficult to identify their position on diversity or how they demonstrate accountability for change.’

Tracey Brady

Content

- | | |
|----------------------|--|
| News | 3 Board and employee relationship insight
‘Investors are calling for clearer company disclosures on workforce related issues’, according to the latest FRC Lab report, <i>Workforce-related corporate reporting – Where to next?</i> |
| International | 4 Global CG trends 2020
Global trends in 2020 include a greater focus on the environmental and social part of ESG, the increasing importance of corporate purpose, better board oversight of corporate culture, and a more expansive view of board diversity according to a report by Russell Reynolds Associates |
| | 5 WEF Global Risks Report 2020
The global economy is facing an increased risk of stagnation, climate change is striking harder and more rapidly than expected, and fragmented cyber space threatens the full potential of next-generation technologies according to the World Economic Forum’s <i>Global Risks Report 2020</i> |
| Global News | 6 Attitudes to business ethics
Singapore Exchange reporting requirements
Board role in ESG governance
Strengthening independent checks |
| Features | 8 Artificial Intelligence
David Nolan argues that it’s critical in the age of AI that organisations are able to create cultures that encourage trust and responsibility and that this principal is embodied in their leadership |
| | 10 Board diversity beyond the FTSE 350
Tracey Brady discusses the findings of a recent review carried out by the Company Matters team into board diversity in AIM and FTSE 100 small cap companies |

Feature

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Board diversity beyond the FTSE 350

Tracey Brady discusses the findings of a recent review carried out by the Company Matters team into board diversity in AIM and FTSE 100 small cap companies.

Why did we undertake this piece of research? Easy, there is a lot of research measuring the FTSE 350 and whilst those companies account for a big slice of the economy not all of them are UK based and many are large global corporates. So is there merit in looking a bit wider and seeing what's happening below the FTSE 350? We think so. In our sample the companies are almost all UK and in the FTSE small cap or listed on AIM. An interesting and diverse group of businesses, but are they paying attention to what is happening from a societal perspective where the public want more transparency and to understand and trust business once again.

Perhaps we can start to make greater and faster change with some of the smaller companies as opposed to expecting everything to come from some of the global monoliths of the FTSE 350 which can feel removed and distant. Can trust be built from smaller sound UK businesses 'doing the right things' and behaving as 'good corporate citizens'? So let's start by shining a light on some and see what is happening. Diversity and the metrics we have chosen are a starting point for a conversation and a foundation on which to build in the future, it is by no means perfect but it is a start.

The idea of board diversity has gone from radical to widely accepted as being what makes boards work well. Companies have seen growing pressure to up their game on values, purpose, stakeholder engagement and culture. Major investors are now more likely to vote against re-election of the nomination committee Chair if demonstrable progress isn't made and if the minimum thresholds of female representation aren't met. Boards are not asking 'why' anymore, they're asking 'how'.

We analysed the boards of 100 largest companies of the FTSE Small Cap index (FTSE SMC 100) and in the AIM 50 index by looking at their annual reports and appointments. We reviewed their board diversity and how they report on their approach. We've found that board diversity in these indexes is increasing but it remains low, particularly in the AIM UK 50. In these companies, 15% of directors are women and 36% have all-male boards. These figures are barely higher than the FTSE 100 in 2011.

We've seen more encouraging results in the top 100 companies of the FTSE Small Cap index which, at the time of writing, has a gender balance of 28% women (better than the FTSE 250). This is fairly recent as 44% of new appointments in this index over the last 18 months were women, which is a higher rate than the FTSE 350.

We can only hope this is the direction of travel. Women hold 4 to 5% of executive roles in these companies and this is notoriously slow to change in all markets. The majority of these

women are in CFO or FD roles, suggesting that is an 'easier' route for women to executive roles in the boardroom – even though women are no more likely to have financial experience than men. This is similar to the FTSE 350 where 60% of female executive directors are CFOs or FDs.

Ethnic diversity is low on these company boards too, showing very little change. More than 95% of directors are white and over 80% of boards are all-white. There are some exceptions where a board has more than one non-white director, but these are rare and typically non-UK incorporated or domiciled.

We've found that these companies have greater age diversity on their boards, particularly in male directors who range from 40 to 80+. This is partly because male non-execs have longer tenures and are more likely to be in executive roles, which tend to be younger. The average age of directors is slightly lower than the FTSE 350.

Another big change in the last few years has been higher expectations for companies to report accurately and transparently on:

- Their board diversity policies.
- How they're meeting targets (if at all).
- How their nomination committees account for diversity in appointments.

This reporting should give investors and stakeholders better insight into their board processes, but a review by the FRC found that this is a fairly weak area of reporting in the FTSE 350. We also found patchy reporting in our sample. In the FTSE SMC 100, more than half have basic or boilerplate reporting. Nearly one in six companies either state that they don't consider diversity as part of their appointments (ie an 'anti-diversity' policy), or fail to meet the Code's requirements by not mentioning diversity at all. Figures are even worse in the AIM 50 UK, where 42% have no mention or policy on diversity.

There are still reasons to be optimistic. In the FTSE SMC 100, companies are affected by the scrutiny placed on the FTSE 350. Many are making their way towards 33% women on boards at a similar rate. There are also a handful of companies taking their reporting seriously, giving investors and stakeholders good visibility into their policies and accountability.

But there's still a long way to go. A review of the AIM market's reporting shows there are many companies making no attempt to engage with the need to diversify their boards or senior management. This is crucial, because companies in this index are a major talent pipeline for FTSE 250 executive and non-execs.

Feature

Reporting on diversity

How a company reports on diversity – both at board and senior management level – can give us a valuable insight into how seriously they are taking it; whether they have a clear Board Diversity policy, and if they consider diversity to be important in appointments and succession planning. For those companies following the Code this is expected as part of their annual reporting, alongside statutory reporting on the composition of the board, senior management and employees as a whole, mandatory for quoted companies (ie not AIM), and their gender pay gap which is mandated for all companies over 250 employees. In both cases, the reporting requirement should be driving discussion at board level.

‘The idea of board diversity has gone from radical to widely accepted as being what makes boards work well.’

Overall, reporting on diversity in the AIM UK 50 is less informative, both in comparison to the FTSE 350 and the FTSE SMC 100. Forty-two per cent of the AIM UK 50 have no mention of board diversity in their annual report. Another 42% include a simple or boiler-plate response – a statement of commitment to diversity but with no specific details. Only eight companies have reporting that gives additional detail with only nine companies explicitly stating they have a diversity policy. Just two set any measurable objectives for board gender diversity, while 18% mention gender as part of their director succession planning and 22% discuss initiatives they have in place for increasing gender diversity at their senior management level.

A fifth of companies in the AIM UK 50 have a policy that explicitly mentions board ethnic diversity. Only two mention it as part of their director succession planning, and none set any measurable objectives. Four companies mention initiatives they have for increasing ethnic diversity at senior management level, although none of them demonstrated meaningful commitment to these initiatives (for example including targets or periodic review.)

Reporting on diversity in the FTSE SMC 100 is generally better than in the AIM UK 50, and largely in-line with that of the FTSE 250, again suggesting regulatory pressure makes an impact. Eighty-six per cent have some description of an approach to boardroom diversity. Another 6% explicitly state that they do not have a policy on board diversity, and that they recruit based on merit or on skills and experience. Eight per cent have no mention of diversity at all, failing to meet the requirements of the Code.

More than half (55%) only provide relatively minimal or boiler-plate descriptions; for example by stating that their policy on board diversity is that ‘the Board should have a broad range of skills, and that consideration is given to the recommendations of the Code and other guidance on boardroom diversity’. Nearly a third (31%) provide extra detail. These companies for example state that ‘we believe that it is in the interests of shareholders that board appointments are made on the basis of merit but also believe that there are substantial benefits to be had from having a board composed of a diverse range of individuals, who are able to contribute to boardroom deliberations from different perspectives’. These proportions are almost identical to the FTSE 250 in 2018, where 58% of companies had a simple or basic gender diversity policy and just over a third provided more detail.

Forty-two per cent of FTSE SMC 100 companies mention that gender or ethnicity is a factor in director succession planning, although some of these only include a cursory mention. Just eight companies set measurable objectives for gender diversity at board level. Nearly a quarter (24%) mention that diversity is part of the board evaluation process – an encouraging proportion but one that could be much higher.

It is notable that while 86% of the FTSE SMC 100 explain their approach to gender diversity, only 46% actually describe this as a board diversity policy, despite reporting requirements stating companies should have a diversity policy. We found many companies which, for instance, state they do not have a formal board diversity policy but also state that when they recruit directors they pay regard to the need to have a diverse board, and also report on that diversity. This may then suggest a confusion in reporting, where boards assume a Diversity Policy is synonymous with setting diversity targets.

Given that under the requirements of the Code (and for the FTSE SMC 100, the FCA’s Disclosure Guidance and Transparency Rule 7.2.8A), companies have to describe their ‘diversity policy’ or explain why you don’t have one, it is concerning to see such patchy reporting and such reluctance to develop or report on a clear policy, even when they do clearly have an approach to diversity.

It is also common for companies to have statements about board diversity spread across three or more sections of the annual report, and in some cases having contradictory reports – stating in one section that they do not have a policy and then in another that they do. This confusion makes it difficult to identify those companies that are not supportive of diversity from those who have considered it but are not effectively reporting on it, making accountability difficult to ascertain.

Tracey Brady is Managing Director of Company Matters which is part of the Link Group. This article is extracted from Board Diversity in AIM and FTSE Small Cap Companies. The full Report can be found at <https://bit.ly/39pARad>

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Index

Organisations		Companies	
FRC	3, 10	CLP Holdings Ltd	6
Hong Kong Institute of Chartered Secretaries	6	Company Matters	10
		Deloitte	8
		KPMG	6, 8
People		Marsh & McLennan Companies	5
Tracey Brady	10	PwC	8
David Nolan	8	Russell Reynolds Associates	4
Brad Smith	8	Talentmark	8
		Zurich Insurance Group	5

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