



Quoted Companies  
Alliance



September 2010

# Corporate Governance Guidelines for Smaller Quoted Companies

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*“Good governance helps to underpin long-term performance and so matters to all companies, irrespective of their size. I welcome the updated QCA guidelines which sets out for smaller companies how they can apply the key principles of good governance in the UK Corporate Governance Code to their own circumstances.”*

**Baroness Hogg, Chairman of the Financial Reporting Council**

*“It is to the credit of the British business community that corporate governance is not considered an inconvenience to be avoided, but is seen as an important part of the UK's international success. Companies from around the globe choose to list in London in large part because of the reputation of the London markets, and the UK corporate governance regime is central to that standing. By promoting high standards of transparency and disclosure, a cornerstone of investor confidence, I feel certain that adoption of the QCA Code will help smaller quoted companies build productive long-term relationships with their investors.”*

**Tracey Pierce, Director of Equity Primary Markets  
at London Stock Exchange Group**

*“Sound corporate behaviour can create allies of shareholders for the good of a company. This guide will help to set management towards that goal.”*

**Andrew Buchanan, Fund Manager, Octopus Investments**

*“The QCA corporate governance guidelines are the governance benchmark for the small and mid-cap quoted company sector.”*

**Bill Brown, Partner, Bluehone Investors LLP**

*"The QCA guide remains a very practical, clear and concise route map through the often confusing terrain of corporate governance. All companies will benefit from this guide, and it should be an invaluable help for smaller quoted companies in ensuring that they have the right approach to good corporate governance."*

**Giles Vardey, Chairman of PLUS Markets Group**

*"The last few years have demonstrated that good governance is important. The challenges of implementation may vary between small and large companies; but whatever a company's size, it should never be a box-ticking exercise and the QCA's guidance is useful in helping avoid this. Boards must think carefully about structures which ensure quality in their decision making, proper management of risk and accountability of the management, and shareholders should be properly engaged in considering these issues."*

**Hugh Savill, Director of Investment Affairs, Association of British Insurers**

*"As a responsible asset manager we believe that it is essential that boards are run well so that they can effectively create and protect value for their owners. This guide from the QCA is a useful tool for directors of smaller quoted companies to help them manage their affairs, providing practical guidance on how to achieve good governance without tick-box adherence to each provision of the UK Governance Code. At Hermes, we believe that the comply or explain approach is of vital importance in strengthening the corporate governance framework of every quoted company and this means that companies should be free intelligently to choose to follow this guide rather than the UK Governance Code, where they believe that doing so is more appropriate for their size and stage of development. Active and engaged shareholders like ourselves will be happy to support boards who do so provided that their explanations make sense and link their choices to the delivery of value for investors."*

**Rupert Clarke, CEO of Hermes Fund Managers Limited**

# 1. INTRODUCTION

These Corporate Governance Guidelines for Smaller Quoted Companies (the 'QCA Code') supersede the QCA's *Corporate Governance Guidelines for AIM Companies* (first published in July 2005) and the QCA's *Guidance for Smaller Quoted Companies - The Combined Code on Corporate Governance* (published in August 2004) and take account of the UK Corporate Governance Code ('UK Code') published by the Financial Reporting Council in May 2010. The UK Code applies to companies that have a premium listing of equity shares. There is no equivalent code directly applicable to other quoted companies, and the QCA Code aims to address this gap.

The central premise of the QCA Code is that transparency and trust between boards and shareholders are of the utmost importance, and that these factors will both promote the success of the company and reduce the demand for greater regulation.

There are two key elements to this. Firstly, constructive and active engagement between shareholders and company boards is important. The QCA believes that a company is an entity owned by its shareholders and operated

on their behalf by directors, who have a fiduciary duty to, and are ultimately accountable to shareholders. An alternative view is that a company is an entity run by dominant managers using risk capital supplied by investors. This view downplays the need for involvement by shareholders and is likely to drive much greater regulation to protect such 'passive' investors.

Companies cannot have it both ways. To minimise the volume of regulation, companies need to encourage greater involvement by shareholders. If boards prefer to keep shareholders at arm's length, then they need to accept that this is likely to lead to greater regulation.

Constructive and active engagement will build trust between boards and shareholders, and may avoid the need for passive investors to seek, or acquiesce to, increased regulation, and for active shareholders to seek board or other changes. An important purpose of the QCA Code is to encourage directors and shareholders to think about how they can actively build trust, rather than treat this as a checklist of corporate governance structures and policies.

The second element is the quality of communication by boards, both directly with shareholders and by way of written reports. Corporate governance reporting is as much about building trust as it is about describing the mechanics of corporate governance processes. Shareholders should seek to understand and test such reporting so they can make informed decisions about the quality of a company's corporate governance. A robust investor relations framework will support both of these elements.

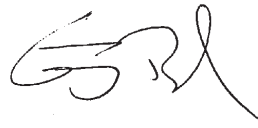
Each company has its own unique set of circumstances and its corporate governance processes need to be tailored accordingly. Such flexibility will be harmed by increased regulation. High quality engagement and communication between shareholders and boards, will build trust with shareholders and promote their acceptance of atypical, but appropriate, corporate governance solutions.

This guide has been prepared for all UK smaller quoted companies, including standard listed, AIM or PLUS-quoted companies. The UK Corporate Governance Code applies to premium listed companies. However, such

companies may still find this outcome-oriented guide useful, particularly when deciding whether to comply or explain.

The QCA believes that good corporate governance creates value for shareholders, and the opposite is also true. If boards and their directors fail to build trust with shareholders, then they will be exposed to the risk of disproportionate regulation and a disengaged share register.

Finally, it goes without saying that companies choosing to refer to and use the QCA's Corporate Governance Guidelines should support this work through membership of the QCA.



**Edward Beale**

QCA Corporate Governance Committee  
Chairman  
Chief Executive, City Group plc

## 2. WHAT IS GOOD CORPORATE GOVERNANCE?

### **The definition of corporate governance**

Corporate governance is a code of behaviour expressing how management teams in companies (corporates) act and are organised (governed) to both create and protect value on behalf of shareholders. The QCA believes that the purpose of corporate governance is to create and maintain a flexible, efficient and effective framework for entrepreneurial management that delivers growth in shareholder value over the longer term.

### **Key elements of effective corporate governance**

#### **(i) Chairman's responsibility for corporate governance**

The chairman is responsible for the effectiveness of a company's corporate governance system. For many years, it has been accepted that best practice is having separate individuals as the chairman of the board and as the chief executive. Normally the chairman's role is to run the board, and the chief executive's responsibility is to execute the strategy set by the board. However, the connection between 'running the board' and 'being responsible for how a

company's management act and are organised' (i.e. corporate governance) is often not made or, if it is made, is not openly acknowledged. The chairman's role is all about corporate governance. This is why best practice is that the chairman is not also the chief executive.

#### **(ii) Boards as teams**

Being a director is a team activity and, as in any team activity, individuals, especially 'prima donnas' and 'shrinking violets', need to be carefully managed to get the best for the team. This is another way of describing the chairman's role - to make the whole greater than the sum of the parts. Boards need to operate in an environment in which constructive challenge is not only expected, but is actively encouraged by all concerned. Both executive and non-executive directors should expect to be challenged.

#### **(iii) Best practice corporate governance processes**

There are some processes which, when performed diligently, can provide evidence of appropriate behaviour by directors. For example:

- Transparent reporting of remuneration policies will demonstrate how the interests of senior management are aligned with the company's strategy and shareholders' interests; and
- Clear disclosures about how boards review their performance will provide comfort about the degree of contribution and challenge within the boardroom, as well as demonstrating whether there is a process of continuous improvement to maximise the effectiveness of board practices.

We have identified these processes and disclosures in the chapters that follow.

#### **(iv) Independence**

Much attention has been paid to whether non-executive directors are 'independent' and, unfortunately, the guidance on this topic has all too frequently been interpreted as rules. What is critical is the individual's approach to the role, and the ability to behave independently and appropriately, rather than an absence of connections. Any director whose independence can be open to question must be prepared, together with the

chairman, to explain his or her position and the reasoning behind the appointment - usually by a combination of meeting shareholders, by his or her actions on the board, and by clear and reasoned, not boilerplate, disclosure in the annual report. For more information on independence, please see Appendix A.

#### **Conclusion**

To have effective corporate governance, a company needs directors with the right approach, and the necessary mix of skills, experience, knowledge and independence, supported by appropriate structures and practices.

The chairman's role, as in many committee situations, is to ensure that there is a well functioning process for getting in place the right individuals, who have an appropriate mix of backgrounds, and that the resulting board works together in an efficient, effective and entrepreneurial manner to achieve the best possible outcome for shareholders over the long-term.

### 3. THE QCA GUIDELINES

The QCA's view is that the purpose of corporate governance is to create and maintain a flexible, efficient and effective framework for entrepreneurial management that delivers growth in shareholder value over the longer term. To achieve this, we have identified 12 essential guidelines that represent good practice and need to be considered.

#### **Flexible, efficient and effective management:**

**1. Structure and process:** The company should put in place the most appropriate governance methods, based on its corporate culture, size and business complexity. There should be clarity on how it intends to fulfil its objectives and, as the company evolves, so should its governance.

**2. Responsibility and accountability:** It should be clear where responsibility lies for the management of the company and for the achievement of key tasks. The board has a collective responsibility for the long-term success of the company and the roles of the chairman and the chief executive should not be exercised by the same individual.

**3. Board balance and size:** The board must not be so large as to prevent efficient operation. A company should have at least two independent non-executive directors (one of whom may be the chairman provided he or she was deemed independent at the time of appointment) and the board should not be dominated by one person or a group of people.

**4. Board skills and capabilities:** The board must have an appropriate balance of functional and sector skills and experience available to it in order to make key decisions and plan for the future. The board should be supported by committees (audit, remuneration and nomination) that have the necessary character, skills and knowledge to discharge their duties and responsibilities effectively.

**5. Performance and development:** The board should periodically review its performance, its committees' performance and that of individual board members. This review should lead to updates of induction, evaluation and succession plans. Ineffective directors (both executive and non-executive) must be identified and either helped to become effective, or replaced. The

board should ensure that it has available the skills and experience it needs for its present and future business needs. Membership of the board should be periodically refreshed.

**6. Information and support:** The whole board and its committees should be provided with the best possible information (accurate, sufficient, timely and clear) so that they can constructively challenge recommendations made to them before making their decisions. Non-executive directors should be provided with access to external advice when necessary.

**7. Cost-effective and value-added:** There will be a cost in achieving efficient and effective governance; however, this should be offset by increases in value. There should be a clear understanding between boards and shareholders of how this value has been added. This will normally involve the publication of key performance indicators, which align with strategy and feedback through regular meetings between shareholders and directors.

## **Entrepreneurial management:**

**8. Vision and strategy:** There should be a shared vision of what the company is trying to achieve and over what period, as well as an understanding of what is required to achieve this ambition. This vision and direction must be well communicated, both internally and externally.

**9. Risk management and internal control:** The board is responsible for maintaining a sound system of risk management and internal control. It should define and communicate the company's risk appetite, and how it manages its key risks, while maintaining an appropriate balance between risk management and entrepreneurship. Remuneration policy should help the company to meet its objectives whilst encouraging behaviour that is consistent with the agreed risk profile of the company.

## **Delivering growth in shareholder value over the longer term:**

**10. Shareholders' needs and objectives:** A dialogue should exist between shareholders and the board so that the board understands

shareholders' needs and objectives and their views on the company's performance. Vested interests should not be able to act in a manner contrary to the common good of all shareholders.

### **11. Investor relations and**

**communication:** A communication and reporting framework should exist between the board and all shareholders, such that shareholders' views are communicated to the board and shareholders in turn understand the unique circumstances of, and any constraints on, the company.

### **12. Stakeholder and social**

**responsibilities:** Good governance includes a response to the demands of corporate social responsibility ('CSR'). This will require the management of social and environmental opportunities and risks. A proactive CSR policy as an integral part of the company's strategy can help create long-term value and reduce risk for shareholders and other stakeholders.

## 4. DEMONSTRATING GOOD CORPORATE GOVERNANCE

It is not enough for a company to be well managed. Trust between boards and shareholders depends on the demonstration of the quality of management.

Clear disclosure benefits all the company's stakeholders, not only the company's shareholders. Due diligence, not only from possible investors, but also from customers and suppliers often begins with the annual report. In the absence of high quality reporting, shareholders may not conclude that a company is being well managed.

As good corporate governance is fundamentally about behaviour rather than procedure, the quality of corporate governance can be very difficult to communicate in writing. An emphasis on the primacy of shareholders and the need to communicate clearly to this audience should permeate through all corporate reporting and be reflected in pro-active investor relations.

Annual reports should attempt to link governance to strategy, performance and the management of the risks arising out of its strategy. A clear statement of the company's strategy and plans, linked into its financial

reporting and how it is run, will enable investors to make informed decisions on the company. Boards should therefore decide how best to provide a unified description of their businesses and how they are governed using their annual reports, websites and other publications.

### **Good corporate governance requires a dialogue**

The QCA Code applies key elements from the UK Code and other relevant guidance to the needs of smaller quoted companies for whom the UK Code may not be entirely or directly relevant due to their size or lack of complexity. However, directors need to do what is right for the company in its own unique circumstances. They need to be confident that if they are trusted by shareholders they will be more likely to have support for their actions, even if those actions are contrary to what is regarded as best practice.

To achieve and maintain this trust, good disclosure and an open dialogue are necessary, as is a track record of delivering on promises. As companies evolve, so too will investor expectations. Boards should expect an ever

increasing requirement to explain carefully their approach - whichever corporate governance approach they choose to follow.

Reporting by itself is an essential first step for good governance, but without ongoing dialogue corporate governance reporting is unlikely to be effective. Shareholders need to be able to trust directors and if they are to make informed judgments about the quality of directors, they have to meet them. There is no substitute for looking directors in the eye and asking searching questions. This approach has the added benefit of demonstrating to directors that shareholders care about how the company is being run. In turn, this is likely to reinforce good behaviour. Such a dialogue requires both directors and shareholders to make available the necessary time.

### **Corporate governance reporting**

Companies should publish a corporate governance statement annually that describes how they achieve good governance. This statement must be published in the company's annual report and accounts if it has a premium listing. Other companies would be well

advised to publish this statement in their annual report and accounts as well. Failing that, there should be a report on the company's website (which is also an appropriate place to make available other items required to be on display, such as committees' terms of reference, as set out in 'Minimum disclosures' below).

The annual report should also be published on the website in a way that ensures that it and any separate governance related documents may be easily located. This is normally achieved by having an investors' section of the website with separate pages within it for the annual reports, notices of meeting, share price data and further governance disclosures (see 'Minimum disclosures' below). It is also helpful to have good cross-referencing between both the annual report and the website, using page numbers and precise web addresses.

### **Applying the QCA Code**

It is hoped that all companies will wish to demonstrate good governance and should be able to apply the guidelines set out in the QCA Code. The corporate governance statement should, as a

minimum, describe how each of the QCA Guidelines is put into practice by the company and any additional corporate governance structures and procedures that the company applies beyond this basic level.

Where the company is not able to achieve this, the corporate governance statement should describe how the features of good governance are being achieved. This is the benefit of the UK's 'comply or explain' approach. It presents an opportunity for a company to provide an explanation of why its arrangements are best for the company, and therefore the shareholders, at the company's current stage in development.

Investors and potential investors welcome good, clear and succinct disclosure on governance and other matters. However, it is not sufficient for the statement to assert that the company achieves good governance; the company must also demonstrate how it does so. The guidance set out in the QCA Code is minimum best practice for smaller quoted companies, and boards should therefore consider carefully, and provide a reasoned explanation for, any deviations from the

QCA Code.

### **Minimum disclosures**

As part of explaining how the company achieves good governance, the annual report should include the following:

- A report by the chairman of how the QCA Guidelines are applied to provide for the company's long-term success;
- The number of meetings of the board (normally monthly) and of the committees and individual directors' attendance at them;
- A statement of how the board operates to set, develop and execute the company's strategy, including a high-level statement of which types of decisions are to be taken by the board and which are to be delegated to management;
- The identity of all the directors and their roles and committee memberships;
- The identity of those directors the board considers to be independent and the reasons why it has

- determined a director to be independent notwithstanding factors which may appear to impair that status. (A list of factors which might impair a director's independence is set out in Appendix A);
- The relevant skills and experience that the executive and non-executive directors bring to the board to enable shareholders to take an informed decision on the balance of the board and the election or re-election of directors;
  - A brief description of each committees' work to demonstrate that there is robust oversight of the executive directors on governance matters, such as audit and risk management, remuneration and directors' appointment;
  - A description of any board performance evaluation procedures that the board applies, focusing on its objectives and outcomes and including a summary of how the evaluation procedures have evolved from the previous year, the results of the evaluation and action taken or planned as a result;
  - A Business Review detailing its strategy and how this is communicated to and brought into all areas of the business;
  - An audit committee report explaining the major tasks undertaken and demonstrating how independent oversight of both management and external auditors has been exercised;
  - A summary of risk management and internal control systems and activities, and explanation of how these relate to strategy and link into key performance indicators, remuneration policies and CSR activities;
  - An explanation to shareholders of how auditor objectivity and independence is safeguarded, particularly if the auditor provides significant non-audit services; and
  - A remuneration committee report explaining how the company's remuneration practices align the interests of senior management with those of shareholders.

## **Additional information available to shareholders on the company's website**

- A description of the chairman's, chief executive's roles and responsibilities and, in particular where the chairman and chief executive are the same person, the role of the senior independent director (SID);
- A list of matters reserved for the board;
- The terms and conditions of appointment of non-executive directors;
- The audit, remuneration, and nomination<sup>1</sup> committees' terms of reference explaining their roles and the authority delegated to them by the board;
- An explanation of the role of any external advisers to the board or its committees and any internal advisory responsibilities, such as the company secretary's and SID's role in advising and supporting the

chairman. Where the company secretary is also a director, the company should provide an explanation;

- A brief summary of information received by the board and by individual committees;
- The annual report and other governance-related material, including notices of general meetings; and
- Where votes at a general meeting are by show of hands, the votes by proxy received by the company, including abstentions or votes withheld, should be reported as soon as practicable after the meeting. Where votes are conducted on a poll the actual votes, including votes withheld or abstentions, should be reported as soon as practicable after the poll.

*1. Where the whole board acts as the nomination committee, it should explain its processes.*

## 5. THE QCA GUIDELINES, GOOD PRACTICE EXAMPLES AND BASIC REPORTING

The focus of the QCA Guidelines is on the key features of corporate governance. The summary that follows links the guidelines to some practical examples of governance structures and to the reporting of corporate governance.

### Flexible, efficient and effective management

QCA Guidelines	Examples of governance structures	Minimum disclosures
<p><b>1. Structure and process:</b></p> <p>The company should put in place the most appropriate governance methods, based on its corporate culture, size and business complexity. There should be clarity on how it intends to fulfil its objectives and, as the company evolves, so should its governance.</p>	<ul style="list-style-type: none"><li>● There should be a corporate governance framework which sets the company's strategy and monitors performance against it, taking account the board's risk appetite.</li></ul>	<ul style="list-style-type: none"><li>● A report by the chairman of how the QCA guidelines are applied to provide for the company's long-term success.</li><li>● The number of meetings of the board (normally monthly) and of the committees and individual directors' attendance at them.</li></ul>

## QCA Guidelines

### 2. Responsibility and accountability:

It should be clear where responsibility lies for the management of the company and for the achievement of key tasks. The board has a collective responsibility for the long-term success of the company and the roles of the chairman and the chief executive should not be exercised by the same individual.

## Examples of governance structures

- Senior management should understand who can make decisions on what matters and that decisions on certain matters are reserved for the board.

## Minimum disclosures

- A statement of how the board operates to set, develop and execute the company's strategy, including a high-level statement of which types of decisions are to be taken by the board and which are to be delegated to management;
- A description of the chairman's and chief executive's roles and responsibilities and, in particular where the chairman and chief executive are the same person, the role of the SID. (On the company's website)
- A list of matters reserved for the board. (On the company's website)

**QCA  
Guidelines**

**3. Board balance and size:**

The board must not be so large as to prevent efficient operation. A company should have at least two independent non-executive directors (one of whom may be the chairman provided he or she was deemed independent at the time of appointment) and the board should not be dominated by one person or a group of people.

**Examples of  
governance  
structures**

- The board succession planning process should be defined and documented.

**Minimum  
disclosures**

- The identity of all the directors and their roles and committee memberships.
- The identity of those directors the board considers to be independent and the reasons why it has determined a director to be independent notwithstanding factors which may appear to impair that status.
- The terms and conditions of appointment of non-executive directors. (On the company's website)

**QCA  
Guidelines**

**4. Board skills and capabilities:**

The board must have an appropriate balance of functional and sector skills and experience available to it in order to make the key decisions expected of it and to plan for the future. The board should be supported by committees (audit, remuneration and nomination) that have the necessary character, skills and knowledge to discharge their duties and responsibilities effectively.

**Examples of governance structures**

- Both executive and non-executive directors should have clear personal objectives, reviewed annually.

**Minimum disclosures**

- The relevant skills and experience that the executive and non-executive directors bring to the board to enable shareholders to take an informed decision on the balance of the board and the election or re-election of directors.
- The audit, remuneration and nomination committees' terms of reference explaining their roles and the authority delegated to them by the board. (On the company's website)
- A brief description of each committees' work to demonstrate that there is robust oversight of the executive directors on governance matters, such as audit and risk management, remuneration and directors' appointment.

QCA Guidelines	Examples of governance structures	Minimum disclosures
<p><b>5. Performance and development:</b></p> <p>The board should periodically review its performance, its committees' performance and that of individual board members. This review should lead to updates of induction, evaluation and succession plans. Ineffective directors (both executive and non-executive) must be identified and either helped to become effective, or replaced. The board should ensure that it has available the skills and experience it needs for its present and future business needs. Membership of the board should be periodically refreshed.</p>	<ul style="list-style-type: none"> <li>● The board evaluation process should include a formal assessment of each director's performance and suggestions for additional training.</li> <li>● The SID should annually chair a meeting of the non-executive directors to discuss the performance of the chairman.</li> </ul>	<ul style="list-style-type: none"> <li>● A description of any board performance evaluation procedures that the board applies, focusing on its objectives and outcomes and including a summary of how the evaluation procedures have evolved from the previous year, the results of the evaluation and action taken or planned as a result.</li> <li>● An explanation of the role of any external advisors to the board or its committees and any internal advisory responsibilities, such as the company secretary's and SID's role in advising and supporting the chairman. Where the company secretary is also a director, the company should provide an explanation. (On the company's website)</li> </ul>

**QCA  
Guidelines**

**6. Information and support:**

The whole board and its committees should be provided with the best possible information (accurate, sufficient, timely and clear) so that they can constructively challenge recommendations made to them before making their decisions. Non-executive directors should be provided with access to external advice when necessary.

**Examples of  
governance  
structures**

- Chairmen should require executive directors to prepare timely corporate reports, and the company secretary should prepare timely board and committee agendas and reports.

**Minimum  
disclosures**

- An explanation of the role of any external advisers to the board or its committees. (On the company's website)
- A brief summary of information received by the board and by individual committees. (On the company's website)

QCA Guidelines	Examples of governance structures	Minimum disclosures
<p><b>7. Cost-effective and value-added:</b></p> <p>There will be a cost in achieving efficient and effective governance; however, this should be offset by increases in value. There should be a clear understanding between boards and shareholders of how this value has been added. This will normally involve the publication of key performance indicators, which align with strategy and feedback through regular meetings between shareholders and directors.</p>	<ul style="list-style-type: none"> <li>● Agreement at board level of key performance indicators and formal reporting at board level of any feedback from meetings with investors (including non-executive director meetings with shareholders).</li> </ul>	<ul style="list-style-type: none"> <li>● A summary of risk management and internal control systems and activities, and explanation of how these relate to strategy and link into key performance indicators, remuneration policies and CSR activities. (Also relevant to 9 and 12 below)</li> </ul>

## Entrepreneurial management

### QCA Guidelines

#### 8. Vision and strategy:

There should be a shared vision of what the company is trying to achieve and over what period, as well as an understanding of what is required to achieve this ambition. This vision and direction must be well communicated, both internally and externally.

### Examples of governance structures

- Executive management presentation of the business strategy and forward looking plans with appropriate communication to all areas of the business.

### Minimum disclosures

- A Business Review detailing strategy and how this is communicated to and brought into all areas of the business.

QCA Guidelines	Examples of governance structures	Minimum disclosures
<p><b>9. Risk management and internal control:</b></p> <p>The board is responsible for maintaining a sound system of risk management and internal control. It should define and communicate the company's risk appetite, and how it manages its key risks, while maintaining an appropriate balance between risk management and entrepreneurship. Remuneration policy should help the company to meet its objectives whilst encouraging behaviour that is consistent with the agreed risk profile of the company.</p>	<ul style="list-style-type: none"> <li>● Annual review of the effectiveness of the internal control systems undertaken by the board.</li> <li>● Board meeting to approve the review process and conclusions.</li> </ul>	<ul style="list-style-type: none"> <li>● An audit committee report explaining the major tasks and demonstrating how independent oversight of both management and external auditors has been exercised.</li> <li>● A summary of risk management and internal control systems, and explanation of how these relate to strategy, KPIs, remuneration policies and CSR activities.</li> <li>● An explanation to shareholders of how auditor objectivity and independence is safeguarded, particularly if the auditor provides significant non-audit services.</li> <li>● A remuneration committee report explaining how the company's remuneration practices align the interests of senior management with those of shareholders.</li> </ul>

Delivering growth in shareholder value over the longer term

**QCA  
Guidelines**

**10. Shareholders' needs and objectives:**

A dialogue should exist between shareholders and the board so that the board understands shareholders' needs and objectives and their views on the company's performance. Vested interests should not be able to act in a manner contrary to the common good of all shareholders.

**Examples of  
governance  
structures**

- Management time committed to allow for formal and informal meetings held with shareholders as part of a pro-active approach to investor relations.
- Establish an appropriate investor relations framework monitored by the board.

**Minimum  
disclosures**

- Where votes at a general meeting are by show of hands, the votes by proxy received by the company, including abstentions or votes withheld, should be reported as soon as practicable after the meeting. Where votes are conducted on a poll the actual votes, including votes withheld or abstentions, should be reported as soon as practicable after the poll. (On the company's website)

## QCA Guidelines

### 11. Investor relations and communication:

A communication and reporting framework should exist between the board and all shareholders, such that shareholders' views are communicated to the board and shareholders in turn understand the unique circumstances of, and any constraints on, the company.

## Examples of governance structures

- Establish an appropriate investor relations framework monitored by the board.

## Minimum disclosures

- The annual report and other governance-related material, including notices of general meetings. (On the company's website)

**QCA  
Guidelines**

**12. Stakeholder and social responsibilities:**

Good governance includes a response to the demands of corporate social responsibility ('CSR'). This will require the management of social and environmental opportunities and risks. A proactive CSR policy as an integral part of the company's strategy can help create long-term value and reduce risk for shareholders and other stakeholders.

**Examples of governance structures**

- Include a separate category within strategy and risk management for CSR risks and opportunities.

**Minimum disclosures**

- A summary of risk management and internal control systems and activities, and explanation of how these relate to strategy and link into key performance indicators, remuneration policies and CSR activities.

## 6. WHAT DO THE QCA GUIDELINES MEAN FOR ME?

### **What does this mean for me - the whole board?**

Good governance aims to ensure that boards make the right business decisions for the long-term financial benefit of the company, and thus the shareholders, rather than tying people up in administrative knots. Shareholders, as well as companies, will do well to remember this.

Appropriate behaviour is the most important factor in good governance and the company's success. A strategy that is well challenged and refined is more likely to be developed and executed optimally when the board is composed of the right people and is encouraged by the chairman to work well together. Appropriate behaviour and suitable checks and balances are more likely to protect the company from too much or unexpected risk. Finally, clear explanations of how the company is run are likely both to demonstrate and encourage good governance. It is for the board to decide why its chosen methods of working are the most appropriate for the company and to explain them effectively.

Board evaluation is an opportunity for

the board to work openly and honestly on how to improve its performance. Disclosure about board evaluation should focus on objectives and targets for improving performance rather than on descriptions of the process followed. Whilst there are time and cost constraints on directors and companies, evaluations can be extremely beneficial. External assistance can also provide additional insight and value, provided that the external body used is sensitive to, but challenging of, the board's culture.

Requirements of directors continually evolve and all directors, executive and non-executive should expect to undertake additional training. Directors with professional qualifications are required by their professional bodies to undertake continuing professional education. Specific training, for example about the markets that the company operates in or the impact of changes in regulations, can also be useful. Shareholders expect to see comments about such skills development in annual reports.

All board members, particularly committee chairmen, should expect to make themselves available for meetings

when requested by shareholders.

If not all directors stand for election each year, the UK Code requires that companies within the FTSE 350 must provide an explanation. We believe that for companies who are not subject to the UK Code common sense should prevail, and unless there are compelling reasons for the re-election of all directors each year, companies should explain why they do not believe that it is in the company's best interests to hold annual elections.

### **What does this mean for me - the chairman?**

Without a good chairman the board will not function well and the company is likely to underperform.

The QCA agrees with the almost universally accepted dictum that the chairman should be independent on appointment and should not be the former CEO. The chairman should demonstrate true independence of thought and vision and be capable of drawing together the talents of the board to provide the right level of challenge and questioning of established and new executive thinking,

rather than someone with a history or current relationships which might make questioning the status quo difficult.

No chairman is ever fully non-executive. That does not mean that investors will deem all chairmen not to be independent and so unacceptable to sit on board sub-committees and provide independent oversight of management - provided that the individual was independent on appointment and continues to demonstrate independent leadership of the board. What it does mean is that chairmen must no longer, if any ever did, see the role as a figurehead position, solely to do with running board meetings. Nor must they see the role as running the business. It is a role which is separate from that of chief executive. When times are good they may not need to devote significant time to the role, but they need to be prepared to increase their time commitment substantially when required and particularly in an emergency.

Ensuring the board operates properly is central. To affect this, the chairman will need to work alongside the executive team, encourage the best from them and ensure that the company is driven forward to entrepreneurial success.

The chairman has a crucial, but not an exclusive, role in maintaining good relations with shareholders.

To achieve success, the chairman's role is to make the most out of the individual attributes of each director and harness them into a team that is more effective than its individual constituents. Where this means that directors need to be tested and asked to improve their performance, the chairman must do so. Ultimately, the chairman must not shy away from considering whether individuals must be replaced and ensuring orderly board succession, not least his or her own. How well succession, particularly of the chairman, is managed is a key measure of the success of a board.

### **What does this mean for me - a non-executive director?**

The position of the non-executive director is an important and professional one. Non-executive directors play a crucial role in challenging and inspiring executive directors to ensure optimal strategic development and execution with appropriate risk management. For this, the appropriate balance of knowledge,

skills and experience are essential.

Independence of non-executives also importantly allows them to provide appropriate oversight, not least by constructively challenging strategy, risk management, the audit process and remuneration. Whilst independence is a state of mind, it should also be demonstrable and explained well in the annual report and elsewhere. To enable non-executives to play the role expected of them, they should expect:

- A formal appointment process and a structured induction process, including meetings with shareholders;
- To provide a significant commitment to each directorship, including sufficient time commitment;
- That board committees are functioning effectively and their roles are formalised, with full and public terms of reference. If needed, committees can hire independent advisers to assist them in performing their duties effectively;
- To commit time to investor relations;

- Additional and ongoing education and training; and
- Their performance to be assessed on a regular basis, alongside that of the board and its committees as a whole, with the objective of improving personal and collective performance.

It is worth noting that all non-executive directors are expected to make themselves available to shareholders when requested. This is likely to be a relatively rare occurrence, except when there are particular areas of concern. Non-executives should consider how they can best seek to meet shareholders during their induction.

The result of increasing demands on non-executives may be higher fees. Payment partly or fully in shares, held during the director's term of office and for a significant period afterwards sends a good signal about the alignment of the director's interests to those of the company's owners.

### **What does this mean for me - the senior independent director ('SID')?**

The role of the SID is a very important one and requires particular sensitivity to the views of shareholders and of the board, especially at times when there may be divergent opinions. The SID's role is:

- To act as a sounding board for the chairman and to serve as an intermediary for the other directors or for shareholders when necessary. This aspect of the role is particularly important if, for example, the chairman exerts more than usual influence as a founder, a significant shareholder or as an executive director.
- To chair the (usually annual) meeting of the non-executives without the chairman present. This meeting's primary purpose is to assess the positives and negatives about the chairman's contribution to the board, as part of the overall evaluation process.

Some companies use their SID as a deputy chairman, whether formally or

not, so that the SID would chair meetings when the chairman is unavailable.

None of these duties should be burdensome in a period of stability at a well functioning company, and should not result in significant additional workload of the SID. Where crisis strikes and there are real concerns, for example about the future of the chairman, the role will become much more substantial. This means that the individual will need to be certain that he or she will have the flexibility to devote sufficient time to the role should a crisis arise.

### **What does this mean for me - an audit committee member?**

The audit committee has a crucial role in providing shareholders with confidence in the annual report and accounts and other public announcements of the company. The committee has a role to challenge both the external auditors and the management of the company. Given its crucial role, the QCA has published a guide to the work of audit committees - *Audit Committee Guide for Smaller Quoted Companies* - which covers their

role in greater detail.

The audit committee's terms of reference (which should be publicly available) should include:

- Responsibility for monitoring the integrity of financial statements and announcements, in particular by scrutinising the important transactions, accounting policies and judgements made by management;
- Reviewing internal controls, including overseeing internal audit and whistleblowing arrangements;
- Satisfying itself that the company's approach to risk and its management of risk conforms with the risk appetite determined by the board;
- Managing the relationship with the external auditor, including responsibility for its appointment, agreeing the scope of the audit, the non-audit services' policy and the fees charged by the auditor;
- Reviewing and monitoring the independence of the external

auditor;

- Reviewing the need for internal audit and where required assist with appointments; and
- Reporting on the committee's work and, in particular the issues above, in the annual report.

Whilst at least one member of the committee should have, what the board agrees is "recent and relevant financial experience", those without such qualifications can play a useful role on the committee. Accounts need to explain matters clearly and often directors who do not have extensive financial experience are best placed to challenge the clarity of explanations. All directors should have sufficient competence to understand, analyse and, when necessary, challenge the management accounts and draft public financial statements.

**What does this mean for me - a remuneration committee member?**

Remuneration should be aligned to performance with no rewards for failure, and contracts should not permit

excessive payoffs. Remuneration committees should be strong enough to ensure that this simple sounding, but in practice very complex, principle is applied. They should ensure that they consult with major shareholders and explain carefully in the annual report why they have chosen the remuneration structure adopted. Remuneration policy should also ensure that it motivates the right behaviour and that any risk created by the remuneration structure is acceptable to the committee and is within the board's risk appetite.

Succession planning is very important for smaller quoted companies and reports need to explain how remuneration policies encourage good succession planning, perhaps by ensuring that equity is retained for a period after employment ceases.

**What does this mean for me - a nomination committee member?**

The nomination committee should work closely with the board and the chairman to identify the skills and experience that are needed for the next stage in the board's and company's development. It should keep a close eye

on succession plans and the possible internal candidates for future board roles. If necessary, it must support the chairman (or the SID) in taking the necessary steps to remove underperforming executive or non-executive directors, including the chairman.

### **What does this mean for me - a company secretary?**

The company secretary plays a vital role in ensuring the good governance of the company. This role is not limited to ensuring legal and regulatory compliance; the company secretary should also behave as the conscience of the company. As part of this role, the company secretary should assist the chairman in applying good governance standards in the way that board meetings are prepared for and run, including the timely dissemination of appropriate information. He or she should also act as a conduit for all the directors, particularly the non-executives, into the workings of the company, providing not only an induction programme but ongoing advice and guidance.

At times, the company secretary may have to act as a confidential sounding board to one or more directors. Given the importance of the role and its close links to the non-executive directors, who should provide independent challenge to management, it is difficult for the company secretary also to be a director. Therefore, we recommend that the company secretary has the appropriate character and other attributes to fulfil the role and, where he or she is a director, that the reasons for this are cogently explained.

### **What does this mean for me - a shareholder?**

Investors need to concern themselves with corporate governance. Long-term investors in particular should enter into a dialogue with companies. They should also:

- Apply the principles set out in the UK Stewardship Code published by the Financial Reporting Council (or other suitable guidance), which should be reflected in fund management contracts;
- Consider carefully companies' explanations for departures from

the QCA Code or the UK Code and make reasoned case by case judgements;

- Be prepared to give an explanation to the company of any governance concerns, in writing if necessary, and be prepared to enter into a dialogue with the company if they do not act on these concerns;
- Avoid a box-ticking approach in assessing corporate governance;
- Have regard to the company's size and complexity, and to the nature of the risks and challenges it faces when assessing corporate governance; and
- Meet as many directors as possible, including by attending AGMs where practicable.

Consideration of governance issues and, in particular, explanations of companies' arrangements may well occupy more of investors' time than has been the case to date. These discussions should create a useful dialogue which should benefit both parties. Long-term investors should ensure that any concerns are raised

with companies at the earliest possible stage.

Companies will find it useful to identify the individual at each major investor responsible for corporate governance queries (which might be the fund manager for each holding, or one individual or team for all holdings).

Shareholders should make clear to companies the number of shares they own and their voting intentions at the earliest possible stage, to ensure that dialogue on any issues can be as open and productive as possible. However, there can be no substitute for informed, ongoing engagement between companies and their owners - dialogue in the run up to general meetings should not be the only discussions that take place.

## APPENDIX A: WHAT IS INDEPENDENCE?

The UK Corporate Governance Code provides a useful set of criteria against which the independence of non-executive directors can be assessed. These criteria are set out below.

Notwithstanding these criteria, it should be emphasised that independence remains a state of mind, rather than something driven by a checklist. Companies should explain both in their annual report and in discussions with shareholders the reasons why they consider directors to be independent if they do not meet these criteria. Shareholders are unlikely to be convinced by boilerplate disclosure. Directors should therefore make efforts to demonstrate their independence, not least by meeting shareholders.

An assessment of the strengths and weaknesses of the board is key to the investment decision process. Part of this assessment is to ascertain the executives' willingness to be constructively and independently challenged. It is therefore vital for the company to provide in the annual report, and elsewhere, well-explained assessments of the independence and the other qualities, in particular relevant skills and experience, that each

director brings to the board if it is to secure understanding and flexibility from its investors. Investors can then use this information to challenge the composition of the board.

Investors should be willing to recognise the value which 'non-independent' non-executives can bring, and it is important to note that while the UK Code recommends that large companies have at least half the board (other than the chairman) as fully independent non-executives, there is a relaxation of this guideline for companies below the FTSE 350. Nevertheless, smaller quoted companies would be wise to ensure that their (at least two) non-executives plus the chairman are independent, and be aware that they may need to increase the size of their board as the company itself grows.

A complex issue is that of directors associated with major shareholders. Long-term institutional investors may be likely to feel their interests are more aligned with a director linked with a significant but stable family shareholding, than with a director employed by a venture capitalist or private equity firm. Boards that contain directors associated with significant

shareholders would be well advised to explain publicly, and in meetings with institutions, the reasons for those individuals sitting on their board, the details of any relationship agreements, and the benefits of the particular knowledge, skills or experience that the individual brings to the board.

## Independence guidelines in the UK Code

The UK Code contains guidance on factors which might impair a director's independence in Provision B1.1. This is set out below, with the QCA's additional comments shown in italics:

The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances (*including financial dependence on his relationships with the company*) which are likely to affect, or could appear to affect, the director's judgement.

The board should state its reasons if it determines that a director is independent notwithstanding the

*2. On the rare occasions, post-IPO, that non-executive directors participate in such schemes, they should have different performance conditions from the executive directors and should be required to hold their shares for at least 12 months after leaving office.*

existence of relationships or circumstances which may appear relevant to its determination including if the director:

- has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's fee, *has a significant participation* in the company's share option or a performance-related pay scheme<sup>2</sup>, or is a member of the company's pension scheme;
- has close family ties with any of the company's advisers, directors or senior employees;

- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- *is or* represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.

*For the avoidance of doubt, the fact that a director is or has been paid by the company wholly or partly in shares would not be considered of itself to impair his independence provided that there are restrictions on how quickly those shares can be disposed of.*

## APPENDIX B: PREMIUM LISTED COMPANIES

A company with a premium listing of equity shares has, under the Listing Rules, to provide a statement in its annual report and accounts that allows its shareholders to evaluate how it has applied all the main principles of good corporate governance as set out in the UK Code and a statement as to whether or not it has complied with all the provisions set out in the UK Code. If a company has not complied with one or more of the provisions of the UK Code, it must set out its reasons for not complying.

These corporate governance requirements also apply to overseas companies with a premium listing. However, overseas companies only have to comply with the requirements in respect of financial years beginning after 31 December 2009.

The FRC, in conjunction with ICSA, provide guidance on the application of the UK Code. Copies of this guidance can be accessed from their websites (see Appendix C - Useful Sources of Information).

In contrast, both UK and overseas companies with a standard listing are not required to 'comply or explain' their

compliance with the Code. They must, however, under the Disclosure Rules and Transparency Rules, publish a corporate governance statement detailing their approach to corporate governance. This requirement for overseas companies applies in respect of financial years beginning after 31 December 2009.

## APPENDIX C: USEFUL SOURCES OF INFORMATION

### **Financial Reporting Council (FRC)**

[www.frc.org.uk](http://www.frc.org.uk)

The FRC, along with ICSA, provide guidance on the application of the UK Corporate Governance Code.

- The UK Corporate Governance Code
- Revisions to the UK Corporate Governance Code (Formerly the Combined Code)
- Internal Control - Revised guidance for directors on the Combined Code (Turnbull Guidance)
- Guidance on Audit Committees (Formerly known as the Smith Guidance)
- Suggestions for good practice from the Higgs Report (Also known as the Higgs Guidance)
- The UK Stewardship Code

### **Institute of Chartered Secretaries and Administrators (ICSA)**

[www.icsa.org.uk](http://www.icsa.org.uk)

ICSA produces many guidance notes that help companies implement aspects of corporate governance best practice. These include:

- Guidance Note - Roles of the Chairman, Chief Executive and Senior Independent Director under the Combined Code
- Guidance Note - Good Boardroom Practice
- Guidance Note - Terms of Reference - Audit Committees
- Guidance Note - Terms of Reference - Nomination Committee
- Guidance Note - Matters Reserved for the Board
- Guidance Note - Executive Committees - Terms of Reference
- Guidance Note - Induction of Directors

## **Association of British Insurers (ABI)**

[www.abi.org.uk](http://www.abi.org.uk)

[www.ivis.co.uk/Guidelines.aspx](http://www.ivis.co.uk/Guidelines.aspx)

- Pre-emption Group Guidelines - Disapplying pre-emption rights - A statement of principles
- ABI/NAPF (National Association of Pension Funds) - Pre-emption and Underwriting
- ABI Executive Remuneration - ABI Guidelines on Policies and Practices

## **Investor Relations Society (IRS)**

[www.irs.org.uk](http://www.irs.org.uk)

The IRS offers training, guidance and information on all aspects of relationship development and communications between public companies, their shareholders and the wider investment community.

- IR Best Practice - Websites, Annual reports printed and online, and Online presentations

## **The Quoted Companies Alliance**

[www.theqca.com](http://www.theqca.com)

- Audit Committee Guide for Smaller Quoted Companies
- Rewarding Enterprise III - Guidance for Companies on Employee Share Schemes
- Guidance on Institutional Investor Guidelines for Share Incentive Schemes
- A Guide to Better Communication between Small Companies and Big Investors
- Investor Relations Guidance for Smaller Quoted Companies
- AIM Website Guide - Rule 26

## APPENDIX D: THE QUOTED COMPANIES ALLIANCE

The Quoted Companies Alliance (QCA) is a not-for-profit trade organisation that works for small and mid-cap quoted companies in the UK and Europe to promote and maintain vibrant, healthy and liquid capital markets.

The QCA represents small and mid-cap quoted companies outside the FTSE 350 including those on AIM and PLUS Markets. The small and mid-cap quoted sector is vital to the UK economy - there are nearly 2,000 such companies, representing 85% of all quoted companies.

We are an independent not-for-profit organisation, founded in 1992 (originally known as CISCO), and are funded by our membership. Our membership consists of small and mid-cap quoted companies, their advisors, investors, companies seeking admission to a UK equity market and other market participants.

### What we do

The QCA is the thinking department for the small and mid-cap sector. We exist to ensure that the regulatory burden does not fall disproportionately on the sector and help improve investment in small and mid-cap quoted companies through promoting vibrant, healthy and liquid capital markets.

The QCA has three main activities:

- **Lobbying:** We successfully lobby on and raise awareness of regulatory and tax issues that are important to small and mid-cap quoted companies. We carry out this work through our eight committees.
- **Education:** We help the sector to understand and implement new rules and promote best practice through our extensive guidance booklet series and topical seminars.

- **Networking:** We provide a forum for small and mid-cap quoted company directors to network and share ideas with other directors, fund managers, brokers and advisors. Through our events, we help put small and mid-cap quoted companies in touch with leading players in the markets.

For more information, contact The Quoted Companies Alliance, 6 Kinghorn Street, London EC1A 7HW

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Fax: **020 7600 8288**  
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Website: **www.theqca.com**

## APPENDIX E: THE QCA CORPORATE GOVERNANCE GUIDE WORKING GROUP

The QCA Corporate Governance Guide Working Group, which produced this guide, comprised of members of the QCA Corporate Governance Committee, including:

Edward Beale (Chairman)	City Group plc
Louis Cooper	Horwath Clark Whitehill LLP
Clive Garston	Davies Arnold Cooper LLP
Tim Goodman	Hermes Equity Ownership Services Limited
Kate Jalbert	The Quoted Companies Alliance
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*The QCA would also like to thank members of the QCA Corporate Governance Committee for their assistance in preparing this guide.*

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