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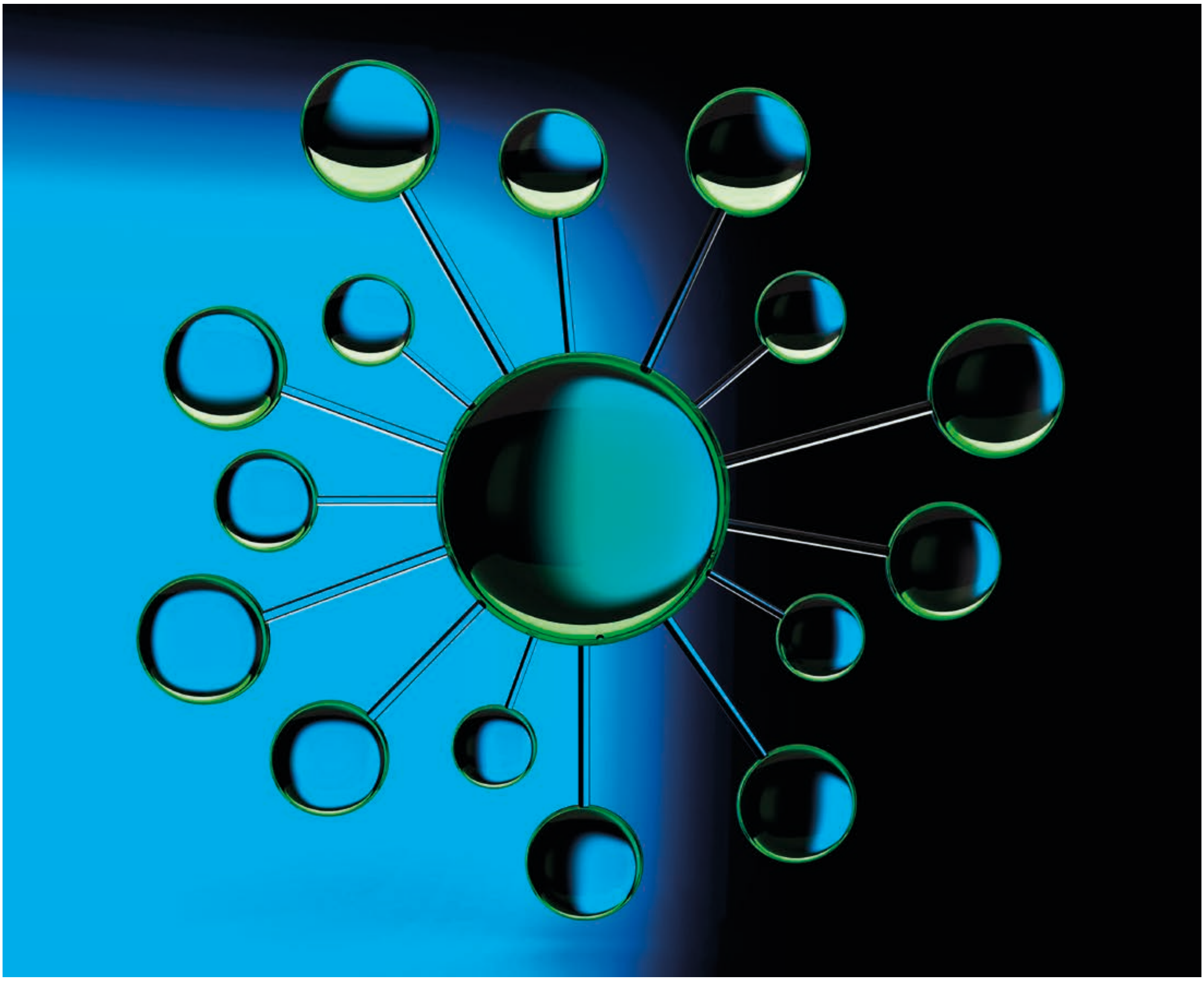

Governance & transparency of private companies

The implications of the Government's Green Paper

Headlines

- The Government is asking serious questions about the governance and transparency of private companies. "It is clear that something has to change" are the words from the Prime Minister in the introduction to the Green Paper on Corporate Governance Reform issued on 29 November 2016.
- For large privately-held businesses there is likely to be a strengthening of the existing corporate governance framework in some form of Code and/or additional reporting requirements – private market companies need to consider how they will respond to this.
- We believe this represents an opportunity for the privately-held business sector to raise awareness of its contribution, its strengthens and to enhance its reputation at the core of British business.

Background

The UK is recognised as having a world-leading corporate governance framework. Key strengths include a unitary board system which makes directors collectively responsible for the decisions of the board and a Corporate Governance Code operating on a 'comply or explain' basis which continues to evolve in line with emerging good practice. However, the UK's strongest corporate governance and reporting standards are focused on public companies where the owners or shareholders are more distant from the executives running the company. Large privately-held businesses are not expected or required to meet the same formal standards as public companies.

The Green Paper does not provide a specific definition of "large, privately-held business" but it does note the variety of ownership models which exist within this sector: large companies owned by private equity investors, significant "founder" or family-owned businesses, large mutual and co-operatives plus subsidiaries of listed and/or foreign parent companies. The paper further highlights the role of bodies such as the British Private Equity and Venture Capital Association (BVCA), the industry body and public policy advocate for the private equity and venture capital industry in the UK, and the work that they do in providing guidelines around disclosure and transparency.

The Green Paper acknowledges that the high profile scandals caused by the behaviour of a limited few has damaged the reputation of the many. So whilst it might appear a disproportionate response, there is an opportunity for private businesses to demonstrate, that despite the few, this is a sector with strong and effective governance arrangements. The paper puts forward the following, additional reasons for exploring whether similar standards should apply to at least larger privately-held businesses:

1. Good governance is about more than the relationship between owners and management – there are other stakeholders with a strong interest in whether a business is well run, including employees, customers, supply chains and pension fund beneficiaries;

2. Society has a legitimate expectation that companies will be run responsibly in return for the privilege of limited liability;

3. Since 1999 there has been a steady decline in the number of public companies and an increase in privately-held businesses; and

4. Good corporate governance provides confidence to key stakeholders, such as banks and suppliers, that a company is being well-run.

The UK is recognised as having a world-leading corporate governance framework.

The contribution of UK Family Businesses

- **760 million** family businesses employ **over 1 million people**

- Family businesses contribute **£460bn** to UK GDP and **20% of all taxes** raised by the exchequer

Source: The UK Family Business Sector 2015/16, IFB Research Foundation, 2015

The proposals

A number of options for reform have been put forward for consideration.

Extending the scope of the existing UK Corporate Governance Code

The drawback to extending the UK Corporate Governance Code to encompass privately-held businesses is that the Code has been designed for premium listed companies and some of the provisions are not appropriate for privately-held companies. The 'comply or explain' principle could overcome this, as companies could choose not to comply with those provisions which are not appropriate. However if too much of the Code is explained away this could lead to a loss of credibility.

Development of a separate governance code for large privately-held companies

This could be tailored specifically to the needs and challenges faced by privately-held businesses. Adoption of the principles of such a Code could be voluntary, or it could be a more formal 'comply or explain' approach. Different approaches could apply to companies of different sizes. The paper calls for views on where and how any size threshold should be set. The paper notes that some companies have adopted the Institute of Directors' Corporate Governance Guidance and Principles for Unlisted Companies in the UK which was issued in 2010 and sets out a number of voluntary principles.

Applying reporting standards more consistently on the basis of size rather than legal form

At present, companies meeting the definition of a "quoted company" per the Companies Act have to meet stronger corporate governance and reporting standards than privately-held businesses. Recent new reporting requirements, such as the Modern Slavery Statement, have been applied to companies or businesses above a certain size criteria irrespective of their legal form or status.

What does this mean for you?

There is a positive opportunity here to promote the value which the privately-owned business sector contributes to the UK economy. Whilst, there is significant momentum in Whitehall for reform in this area, in our work we see many examples of well-governed privately-owned entities. The work of the BVCA's Private Equity Reporting Group on monitoring conformity with the Walker Guidelines for Disclosure and Transparency in Private Equity is an excellent example of the sector working to substantiate its contribution in terms of jobs growth and investment.

As stated by the OECD, effective corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Key concepts of effective governance include delegation of authority, checks and balances, professional decision-making, accountability, transparency, managing conflicts of interest and aligning incentives. To most these will be well-recognised aspects of their business. For others, more attention and effort will be necessary, not just to meet any new regulations or guidelines, but also in the interests of sound business management.

The Institute of Directors' Guidance referred to above can be used as a benchmark to assess your governance arrangements. If you would like to have a conversation to either share your views on the Green Paper proposals or to consider the health of your existing governance arrangements (or both), please approach any of the contacts listed overleaf.

There is a positive opportunity here to promote the value which the privately-owned business sector contributes to the UK economy

Further information

- The Green Paper and online submission form can be found here.
- The Institue of Directors' Corporate Governance Guidance and Principles for Unlisted Companies in the UK can be found here.
- The Walker Guidelines for Disclosure and Transparency in Private Equity can be found here.

Deloitte View

- The private equity market achieves sustainable business growth through an 'active ownership' approach and a close working relationship with the company management team which develops and drives self-perpetuating behaviours which can last well beyond the private equity involvement, generating value and growth for the longer term.
- Equally, we see many family-owned business following a strong 'profits with purpose' approach supported by the family culture and values which have developed over time.
- We agree that businesses (and their stakeholders), whatever their legal form, benefit from strong and effective standards of governance, but would stress the importance of a proportionate, practical and principles-based approach which will not stifle entrepreneurial and innovative development. We strongly recommend that businesses consider implementation of the existing Institute of Directors' Corporate Governance Guidance and Principles for Unlisted Companies in the UK as an appropriate framework.

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