QUOTED COMPANIES ALLIANCE

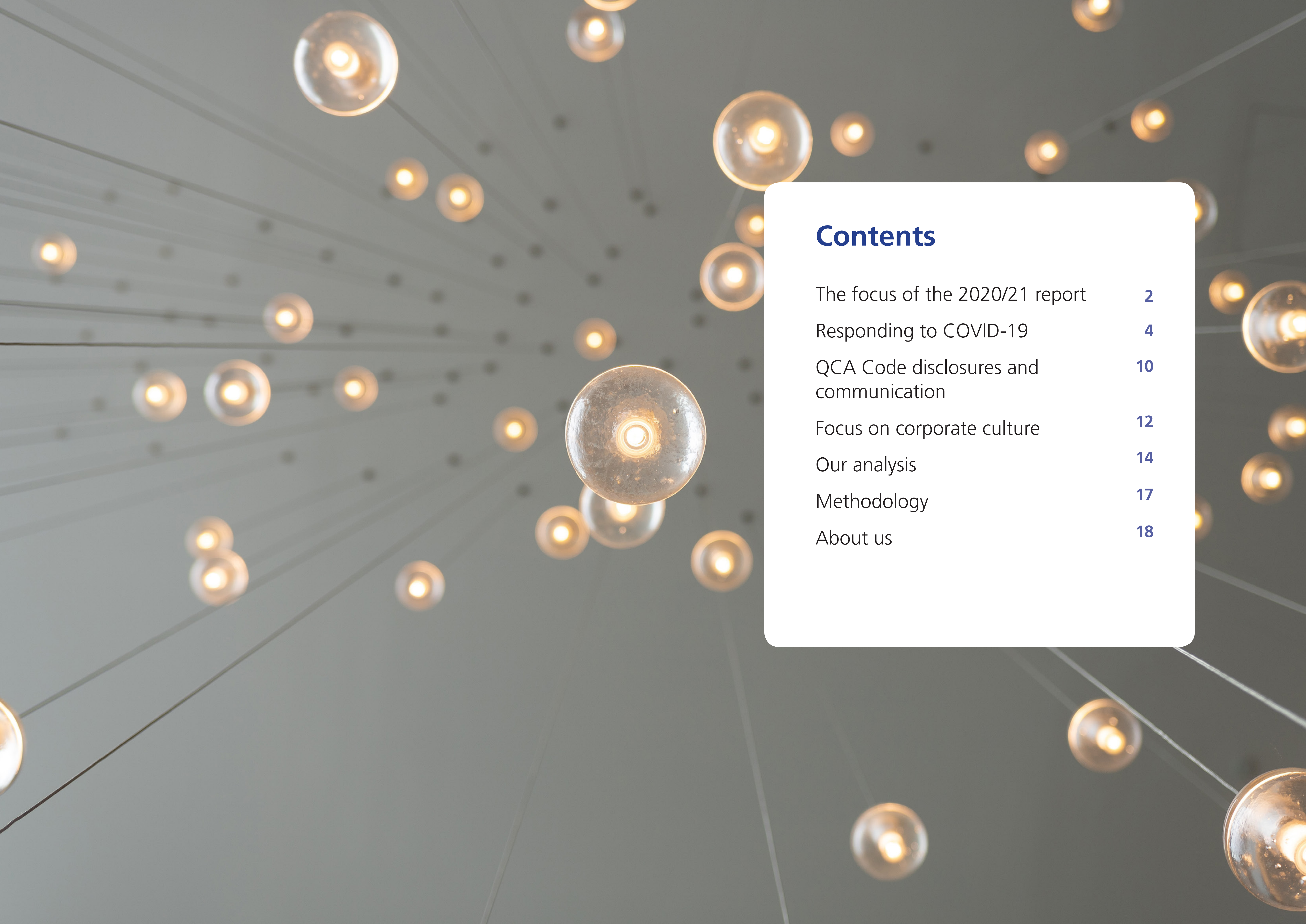
UHY Hacker Young
Chartered Accountants

AIM Good Governance Review

2020/21

Our eighth annual review provides analysis and guidance on corporate governance disclosures for AIM companies

Helping you prosper



Contents

The focus of the 2020/21 report

Three key themes emerged from our review this year for small and mid-sized quoted companies to think about in 2021.

These were:
1. Responding to COVID-19
2. Executive Remuneration, and
3. Environmental, Social and Governance (ESG).

Obviously, 2020 has been dominated by how companies have adapted to dealing with the impact of the **COVID-19** pandemic. In terms of stakeholder engagement, there have been many challenges, but the feedback from investors is that smaller quoted companies have adapted well and, in some cases, even improved their communication. A key part of this has been adapting to doing business digitally.

Fund managers want to understand, from a company's governance disclosures and statements in relation to COVID-19, how the board has dealt with the challenges of the pandemic. They require insight into what the major impact of the pandemic has been on the company, the big decisions which have had to be made, how these have been implemented and the resulting outcomes. In addition, they want to know how the board plans to operate in the future as the pandemic continues into 2021 and whether any lessons have been learned.

Remuneration of senior executives within companies is also a current area of focus. In a time when many employees or suppliers have lost their jobs or faced reduced incomes, shareholders are looking for whether or not the senior team actually "shared the pain" (a phrase that came up with investors multiple times). This is an area that most investors regard as a good indicator of the **culture** of the company (which is a topic that we explore further in this review).

Investors are also looking to be sure that, where government support was taken, this went into shoring up the balance sheet and not into executive rewards. For the future, investors anticipate that there are challenges facing remuneration committees in 2021. Primarily, how to reward key people when the company is not reaching targets for reasons beyond its control.

Thirdly, there was a consensus that the **ESG** trend has continued and even gained momentum in 2020. Investors need to be able to understand a company's environmental and social impact, although there is an awareness that, for smaller companies, it is not easy to make additional disclosures and, particularly amidst the current turbulence, they often don't know where to start. However, taking ESG seriously is an opportunity for companies and it should not be ignored.

The **quantitative analysis** of the QCA Corporate Governance Code (the QCA Code) disclosures by small and mid-sized quoted companies on the AIM market this year shows overall high levels of transparency and compliance. However, there were a few notable low points, such as the disclosures on directors' skillsets and time commitments, disclosures on general meeting vote outcomes and board performance evaluation. Investors believe these are things largely in the hands of companies on which to improve communication.

We hope this report provides companies with useful feedback from a challenging year and will help with stakeholder communication in 2021.

Responding to COVID-19

COVID-19 has thrown the importance of strong governance into sharp relief, as companies are faced with managing a new set of risks, new regulations, restrictions and working practices.

The QCA Code states, "Good corporate governance is about ensuring that the board is set up to make robust decisions and manage risk." Certainly, the risk management element of corporate governance has come to the fore during the current health crisis. COVID-19 has created a new set of risks that very few would or could have predicted a year ago, but which boards need to navigate on behalf of their employees, shareholders, customers and suppliers.

Ensuring employee and customer safety, securing PPE, protecting cash flow, securing alternative suppliers where travel restrictions have impacted, keeping abreast of government guidelines, legislation and potential support and looking at new ways of doing things have all come onto the board agenda.

Adaptation and flexibility have been essential for boards: for many, this will have included board meetings themselves taking place remotely via video conference. Whilst the drawbacks of teleconferencing and screen fatigue are well documented, for some this style of board communication will have made them more accessible and increased frequency of contact will have been possible – a huge advantage in a fast-changing situation.

While changes and decisions have been needed and made at an exhausting pace, the Companies Act 2006 states that in promoting the success of the company, directors should have in mind, amongst a number of areas, "the likely consequences of any decision in the long-term" and also consider "the impact of the company's operations on the community and the environment". Both of which are highly relevant in the context of a global pandemic, when so much is unknown about transmission.

Feedback from small and mid-cap investors has been largely positive about how companies have responded to the challenge. In terms of stakeholder engagement, smaller quoted companies have adapted well and, in some cases, even improved their communication with shareholders:

"It's been encouraging that, despite the challenges this year, there has been no let-up in engagement between companies and investors. In fact, in many cases it has gone up."

Will Pomroy, Federated Hermes

However, as you would expect, different companies have responded in different ways and in some it has 'exposed' how they regard and treat their shareholders:

"It's easy for companies to be transparent when times are good, but it's when the bad times happen that you find out how transparent they really are. The COVID pandemic has exposed this in some companies."

Paul Jourdan, Amati Global Investors

"How companies treat their shareholders has been starkly exposed with the COVID pandemic. You can see if the behaviour has matched up with the words."

Will Pomroy, Federated Hermes

A key part of this has been adapting to doing business digitally, particularly in terms of internal and external stakeholder communication. This is an example of how the pandemic has accelerated a trend that was already in motion:

"Doing business digitally has accelerated as a result of COVID-19, particularly in terms of internal and external stakeholder communications. Companies that were already embracing this have made the transition better."

Rebeca Coriat, Lombard Odier Asset Management

While the decision-making process has sped up, the processes involved and evidence used to support these decisions need to be documented. In a risk management situation like COVID-19, where so much is unknown, there will be imperfect information but assumptions and possible scenarios need to be recorded and revisited.

Some investors noted that they had been trying to encourage video calling with companies for years, but it was not until COVID that most were motivated to do so. However, there was a consensus that it would be best to return to face-to-face meetings between investors and companies as soon as it can be done safely for all concerned.

This was regarded as a key way of observing how executives and non-executives communicate with each other and with wider employees:

"We expect that once the crisis is over we will go back to face-to-face meetings. The best meetings are where we visit the company offices and facilities."

Will Pomroy, Federated Hermes

"Our preference is still for face-to-face meetings and that will come back when it's possible. Video meetings have been essential in 2020 but it will be crucial to get back to physical AGMs when possible."

Rebeca Coriat, Lombard Odier Asset Management

With regards to Annual Reports and chair statements, fund managers want to understand how the board dealt with the challenges of the pandemic.

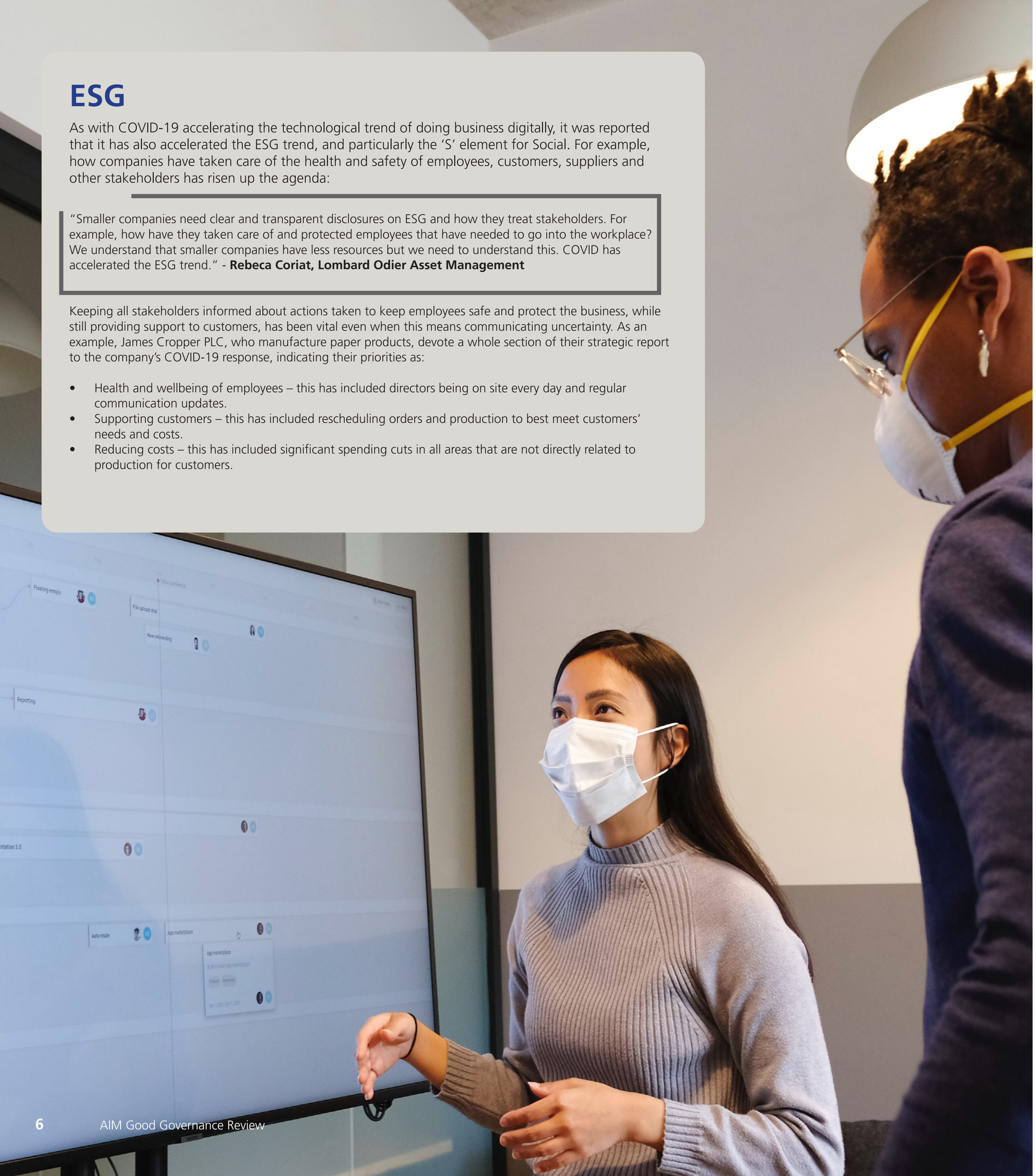
The feedback we received was that they want to understand what big decisions had to be made by the board and the relevant sub-committees, the process for considering these and the resulting outcomes:

"We want to understand how the board and committees dealt with competing issues around cash flow, employees, reputation, etc in this COVID crisis year. Companies should present the colour of how their governance has impacted their business in the past year. What issues have the board and committees dealt with and how have they made decisions?"

Will Pomroy, Federated Hermes

"In the 2020 annual reports, we want to hear how companies managed in the crisis periods - what challenges they faced and how they overcame them - and how they are going to manage in 2021."

Rebeca Coriat, Lombard Odier Asset Management



ESG

As with COVID-19 accelerating the technological trend of doing business digitally, it was reported that it has also accelerated the ESG trend, and particularly the 'S' element for Social. For example, how companies have taken care of the health and safety of employees, customers, suppliers and other stakeholders has risen up the agenda:

> "Smaller companies need clear and transparent disclosures on ESG and how they treat stakeholders. For example, how have they taken care of and protected employees that have needed to go into the workplace? We understand that smaller companies have less resources but we need to understand this. COVID has accelerated the ESG trend." - **Rebeca Coriat, Lombard Odier Asset Management**

Keeping all stakeholders informed about actions taken to keep employees safe and protect the business, while still providing support to customers, has been vital even when this means communicating uncertainty. As an example, James Cropper PLC, who manufacture paper products, devote a whole section of their strategic report to the company's COVID-19 response, indicating their priorities as:

- Health and wellbeing of employees – this has included directors being on site every day and regular communication updates.
- Supporting customers – this has included rescheduling orders and production to best meet customers' needs and costs.
- Reducing costs – this has included significant spending cuts in all areas that are not directly related to production for customers.

Executive remuneration

Another issue that has been exposed by the pandemic is remuneration. During a time where many employees or suppliers lost their jobs or faced reduced incomes, fund managers are looking to determine whether or not the senior team actually "shared the pain":

> "During COVID we saw two types of companies - those where the execs took a pay cut of around 20% which would have no meaningful impact on them, and those that gave up valuable bonuses thereby sharing the pain with their employees, suppliers and other stakeholders."
>
> **Sid Chand-Lall, Canaccord Genuity Wealth Management**

> "This year, there should be a link between how employees were treated and executive remuneration. The pain should have been shared and we want to understand this."
>
> **Rebeca Coriat, Lombard Odier Asset Management**

Also, investors are looking to be sure that, where government support was taken, this went into shoring up the balance sheet and not into executive rewards.

For the future, investors anticipate that there are challenges facing remuneration committees in 2021. Primarily, how to reward key people when the company is not reaching targets for reasons beyond its control.

> "A challenge for future remuneration is that in many companies the senior executives have worked harder than ever this year but the results will not generally reflect this."
>
> **Rebeca Coriat, Lombard Odier Asset Management**

Investors also want transparency on directors' remuneration targets and to ensure that these are sufficiently challenging:

> "There should be transparency on Long Term Incentive Plans for senior management. The detail made available on these is often vague and just say that the targets will be 'challenging' without providing specific detail on metrics being used. Also, targets for senior management should always be in excess of analysts' expectations or else they are effectively rewarded for underperforming."
>
> **Sid Chand-Lall, Canaccord Genuity Wealth Management**

Corporate Governance in 2021

Looking ahead, investors want to know how companies plan to operate in the future as the pandemic continues into 2021. Investors seek to understand what the challenges will be and how the company expects to deal with these, particularly based on the experiences of the pandemic in 2020 and the lessons learned to improve the governance of the company going forward. It was highlighted that there will be longer-term impacts from the pandemic that will challenge companies. For example, junior colleagues not being able to learn from watching and interacting with more experienced people in the workplace as they did before:

> "Younger workers will suffer the most from home working and not being able to informally learn from senior colleagues." - **Rebeca Coriat, Lombard Odier Asset Management**

The challenge of the current environment is how to react to current issues in a timely and thoughtful fashion while being mindful of the long-term implications to the business. As the QCA Code says, "While there are particular circumstances which, at times, lead directors to focus on the short-term, in most cases, a stable company will be focused on the medium to long-term".

While it may feel like board members need to wear varifocals to focus on the short and longer-term at the same time, those who already have good governance structures in place will be in the strongest position to navigate the challenges of COVID-19 and safeguard both their employees and their business.

QCA Code disclosures and communication

Aside from COVID-19, the quantitative analysis of QCA Code disclosures by small and mid-sized quoted companies on the AIM market this year shows overall high levels of disclosure but are notably low in a few areas, such as:

1. Describing the time commitment required from directors
2. Explaining how each director keeps their skillset up-to-date
3. Explaining what actions the company intends to take where a significant proportion of votes have been cast against a resolution at a general meeting

These are all things that are in the hands of companies to improve themselves through better communication and some investors noted that they would like to see improvement in such areas:

"It's frustrating to see low levels of transparency around vote disclosures in the findings of this report."

Will Pomroy, Federated Hermes

There was further feedback that companies can take on board as they explain their governance processes in reports and on the corporate website. For example, with regards to the chair's statement, which was sometimes seen as a missed opportunity by the company:

"Sometimes you get a feeling that the chair's statement has not been written by the chair themselves. It is an opportunity to communicate frankly and honestly to investors and should be treated as a letter to the shareholders. The chair needs to own this."

Will Pomroy, Federated Hermes

Further, it was noted that there are differing levels of performance with regards to investor communication. It is desired to be seen as an important and ongoing process:

"Companies should not just go through the motions of engaging with shareholders but should take on board what they hear and demonstrate that they have listened. Good companies don't just have one conversation, they follow up and keep the shareholders informed of how things are progressing."

Sid Chand-Lall, Canaccord Genuity Wealth Management

There are also specific areas for small and mid-caps where transparency could be improved:

"There are often unacknowledged conflicts on the boards of small and mid-sized companies. It's better to be transparent about these than have them come out later."

Will Pomroy, Federated Hermes

Focus on corporate culture

Trying to describe a company's corporate culture has persistently been something that chairs and directors have found challenging. However, there is now more pressure on companies to make reference to how culture is monitored and reported – this is reflected in the results of our research.

The findings of this report show that 96% of companies describe, within the chair's corporate governance statement, how the culture is consistent with the company's objectives, strategy and business model (in line with principle 8 of the QCA Code, "promote a corporate culture that is based on ethical values and behaviours"). However, anecdotally companies report that this is a hard thing to do, as culture is not a tangible thing that can be easily measured – most end up describing culture by linking it to corporate values, but this often results in a boilerplate presentation.

Investors understand this and, overall, there is no consensus on how to assess culture or a recognised metric to measure it, but there are some interesting insights into what some investors look for from companies.

"Employee engagement surveys are a good tool. In smaller companies it is easier to make employees feel listened to."

Rebeca Coriat, Lombard Odier Asset Management

"We like to see what KPIs the management look at in terms of employee turnover and satisfaction but we don't think culture can be boiled down to a single metric."

Will Pomroy, Federated Hermes

In addition, some want to examine how much time the company's leadership dedicate to ensuring the right culture flows throughout the organisation and how culture is linked to a company's strategy and in protecting its brand.

"The culture of the company needs to come from the top and ties closely to strategy. The CEO needs to dedicate sufficient time in their day-to-day schedule to ensure this. However, it's difficult to quantify culture and make it part of senior management remuneration."

Rebeca Coriat, Lombard Odier Asset Management

Others regard the company's remuneration report as giving a good insight:

"Reading the remuneration committee report of a company gives a great insight into the corporate culture."

Paul Jourdan, Amati Global Investors

As noted above, many fund managers make their judgements on a company's culture by meeting the directors face-to-face, visiting the offices and sites, and seeing how employees at all levels interact.

The QCA Code emphasises the importance of culture within the corporate governance framework, explaining that good governance is, "increasingly about ensuring that a healthy culture is in place which combines a strong focus on performance and a sense, shared throughout the workforce, of what is acceptable and what is unacceptable in terms of behaviour".

Culture is hard to define — it's not something that can be seen — although the practices occurring as a result of a particular culture can be very tangible. The FRC defines corporate culture as "a combination of the values, attitudes and behaviours manifested by a company in its operations and relations with its stakeholders". Key stakeholder groups for most companies will include: employees, customers, suppliers, investors and the local community/ environment.

Developing and protecting a strong culture is an important part of a company's governance. Investment in relationships with particular stakeholders will vary depending on the type of company and the sector in which it operates.

Transparency in stakeholder relationships has always been important, but no more so than in a time of uncertainty as created by the COVID-19 crisis. Employees need to know where, how and if they can continue to work safely; consumers need to know how and if they can access services in a safe manner; and investors want to know what the principal risks are for the business going forward, even if these cannot be accurately quantified. Clear communication is key, by whatever means necessary, within government legislation and regulatory guidelines. This has required some quick pivots and also emphasised the importance of a strong digital capability.

Our analysis

This section details our measure of corporate governance behaviour by showing the percentage of the sample that included the minimum disclosures of the QCA Code. This includes comparative information for the last three years, however, as some principles were not tested in 2019, this information was not available.

Deliver growth

Principle 1

Establish a strategy and business model which promote long-term value for shareholders

	2020	2019	2018
Explain the company's business model and strategy, including key challenges in their execution (and how those will be addressed).	**100%**	100%	78%

Principle 2

Seek to understand and meet shareholder needs and expectations

	2020	2019	2018
Explain the ways in which the company seeks to engage with shareholders and how successful this has been. This should include information on those responsible for shareholder liaison or specification of the point of contact for such matters.	**98%**	98%	56%

Principle 3

Take into account wider stakeholder and social responsibilities and their implications for long-term success

	2020	2019	2018
Explain how the business model identifies the key resources and relationships on which the business relies.	**96%**	86%	86%
Explain how the company obtains feedback from stakeholders and the actions that have been generated as a result of this feedback (e.g. changes to inputs or improvements in products).	**94%**	66%	56%

Principle 4

Embed effective risk management, considering both opportunities and threats, throughout the organisation

	2020	2019	2018
Describe how the board has embedded effective risk management in order to execute and deliver strategy. This should include a description of what the board does to identify, assess and manage risk and how it gets assurance that the risk management and related control systems in place are effective.	**100%**	n/a	92%

Maintain a dynamic management framework

Principle 5

Maintain the board as a well-functioning, balanced team led by the chair

	2020	2019	2018
Identify those directors who are considered to be independent; where there are grounds to question the independence of a director, through length of service or otherwise, this must be explained.	**100%**	84%	58%
Describe the time commitment required from directors (including non-executive directors as well as part-time executive directors).	**54%**	92%	80%
Include the number of meetings of the board (and any committees) during the year, together with the attendance record of each director.	**88%**	84%	58%

Principle 6

Ensure that between them the directors have the necessary up-to-date experience, skills and capabilities

	2020	2019	2018
Identify each director.	**100%**	100%	100%
Describe the relevant experience, skills and personal qualities and capabilities that each director brings to the board (a simple list of current and past roles is insufficient); the statement should demonstrate how the board as a whole contains (or will contain) the necessary mix of experience, skills, personal qualities (including gender balance) and capabilities to deliver the strategy of the company for the benefit of the shareholders over the medium to long-term.	**98%**	46%	26%
Explain how each director keeps his/her skillset up-to-date.	**56%**	52%	32%
Where the board or any committee has sought external advice on a significant matter, this must be described and explained.*	**50%**	16%	8%
Where external advisers to the board or any of its committees have been engaged, explain their role.*	**42%**	38%	14%
Describe any internal advisory responsibilities, such as the roles performed by the company secretary and the senior independent director, in advising and supporting the board.	**92%**	64%	28%

* This does not consider whether or not the disclosure is applicable to 100% of the companies tested and therefore could actually be 100% of the relevant companies.

Principle 7

Evaluate board performance based on clear and relevant objectives, seeking continuous improvement

	2020	2019	2018
Include a high-level explanation of the board performance effectiveness process.	**72%**	78%	42%
Where a board performance evaluation has taken place in the year, provide a brief overview of it, how it was conducted and its results and recommendations. Progress against previous recommendations should also be addressed.	**46%**	38%	8%
Include a more detailed description of the board performance evaluation process/cycle adopted by the company. This should include a summary of: • The criteria against which board, committee, and individual effectiveness is considered; • How evaluation procedures have evolved from previous years, the results of the evaluation process and action taken or planned as a result; and • How often board evaluations take place.	**14%**	16%	12%
Explain how the company approaches succession planning and the processes by which it determines board and other senior management appointments, including any links to the board evaluation process.	**86%**	48%	20%

Principle 8

Promote a corporate culture that is based on ethical values and behaviours

	2020	2019	2018
Include in the chair's corporate governance statement how the culture is consistent with the company's objectives, strategy and business model in the strategic report and with the description of principal risks and uncertainties.	**96%**	n/a	62%
Explain how the board ensures that the company has the means to determine that ethical values and behaviours are recognised and respected.	**94%**	n/a	80%

Principle 9

Maintain governance structures and processes that are fit for purpose and support good decision-making by the board

	2020	2019	2018
Describe the roles and responsibilities of the chair, chief executive and any other directors who have specific individual responsibilities or remits (e.g. for engagement with shareholders or other stakeholder groups).	**94%**	n/a	70%
Describe the roles of any committees (e.g. audit, remuneration and nomination committees) setting out any terms of reference and matters reserved by the board for its consideration.	**100%**	n/a	98%
Describe which matters are reserved for the board.	**82%**	n/a	42%
Describe any plans for evolution of the governance framework in line with the company's plans for growth.	**62%**	n/a	9%

Principle 10

Communicate how the company is governed and is performing by maintaining a dialogue with shareholders and other relevant stakeholders

	2020	2019	2018
Describe the work of any board committees undertaken during the year.	**94%**	n/a	42%
Include an audit committee report (or equivalent report if such committee is not in place).	**70%**	n/a	32%
Include a remuneration committee report (or equivalent report if such committee is not in place).	**92%**	n/a	66%
If the company has not published one or more of the disclosures set out under Principles 1-9, the omitted disclosures must be identified and the reason for their omission explained.*	**14%**	n/a	12%
Disclose the outcomes of all votes in a clear and transparent manner.	**62%**	n/a	54%
Where a significant proportion of votes (e.g. 20% of independent votes) have been cast against a resolution at any general meeting, the company should include, on a timely basis, an explanation of what actions it intends to take to understand the reasons behind that vote result, and, where appropriate, any different action it has taken, or will take, as a result of the vote.*	**6%**	n/a	2%
Include historical annual reports and other governance-related material, including notices of all general meetings over the last five years.	**100%**	n/a	92%

* This does not consider whether or not the disclosure is applicable to 100% of the companies tested and therefore could actually be 100% of the relevant companies.

Market	Number of companies in the sample	Average number of disclosures	Min number of disclosures	Max number of disclosures
AIM Companies	50	23.5**	17**	28**

** Out of a total of 31

Methodology

Quantitative analysis

The initial analysis was conducted on 50 annual reports and corporate websites of a range of small and mid-sized companies with equity securities admitted to trading on the London AIM market across all sectors.

UHY Hacker Young assessed these sampled annual reports and accounts and governance disclosures on the corporate websites against the minimum disclosures of the Quoted Companies Alliance Corporate Governance Code 2018. The key areas of focus for the 2020 review were: COVID-19 disclosures and the culture of the entity in addition to all ten of the QCA Code principles.

The assessment was predominantly completed on a binary measure: did the company disclose the requirement or not. However, where there was evidence that the company had a strong attempt to meet the disclosure some judgement was made on the qualitative nature of the disclosure.

Qualitative interviews

Four small and mid-sized quoted company investors were interviewed by the QCA and UHY Hacker Young over video call to give their views on the results and on smaller company governance in general.

About us

UHY Hacker Young

At UHY it is our mission to be exceptional accountants and business advisers delivering integrated client service. Through our international network of over 270 offices across over 100 countries, we harness global intelligence and combine this with local presence and knowledge to share technical and commercial insight.

Our people have a deep understanding of a number of diverse sectors ranging from education to natural resources, from automotive to healthcare. It is this depth and breadth that gives us tangible and proven insight into the commercial landscapes in which our clients operate. It also allows us to apply our expertise to our clients, particularly those listed on the UK markets, irrespective of their market and sector.

AIM services

As AIM specialists, we offer a range of AIM admission and support services, backed by our wide AIM market experience.

Whether your company is looking to raise funds ahead of an IPO, requires assistance selecting a NOMAD or broker, is seeking reporting accountants to conduct the due diligence necessary to meet the admission requirements for an AIM admission or seeking advice on tax related matters, our team of AIM accountants will spend the time getting to know your company and working with you to achieve your goals.

Our corporate governance services

Whatever kind of company you have, whether listed or unlisted, UHY's team can advise on all aspects of your governance, including:

- assessing compliance with your chosen corporate governance code
- providing insight into best practice, using our work as part of this report to benchmark your business against your competitors
- working with you to identify risks and potential process improvements, ensuring that the governance practices you have put in place meet the expectations of your stakeholders
- reviewing your procedures and the effectiveness of your board to improve the performance of your business.

Quoted Companies Alliance

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small and mid-sized quoted companies.

The value of our members to the UK economy is vast – as is their potential. There are around 1,250 small and mid-sized quoted companies in the UK, representing 93% of all quoted companies. They employ approximately 3 million people, representing 11% of private sector employment in the UK, and contribute over £26bn in annual taxes.

Our goal is to create an environment where that potential is fulfilled. We identify the issues that matter to our members. We keep them informed. And we interact to build the understanding and connections that help our members stay ahead. The influence we have, the influence we use, and the influence we grow ensures that our members always benefit from the impact of our initiatives.

theqca.com

The QCA Corporate Governance Code

The QCA Code is a practical, outcome-oriented approach to corporate governance that is tailored for small and mid-sized quoted companies in the UK. Since its initial release in 2013, it has become a valuable reference for growing companies wishing to follow good governance examples.

The QCA Code was published in 2018 and includes 10 corporate governance principles that companies should follow, and step-by-step guidance on how to effectively apply these principles.

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