Resources Global Professionals  
FTSE 100 Resources Governance Index 2011

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**1 Introduction**

This is the third year we have surveyed the corporate governance standards of the FTSE 100. The Resources Governance Index (RGI) provides a benchmark across the largest UK listed companies and, with the third set of results, the basis for starting to identify emerging trends. The Resources Governance Index has now been extended to cover European companies in the Euro Stoxx 50® -Europe's leading Blue-chip index for the Eurozone. These results are published by Resources Global Professionals in a separate report.

Governance has been much in the spotlight this year due to the News International affair and the close examination of the controls at the top of the Murdochs’ organisations. Similarly The Independent Banking Commission has focussed on financial services’ governance. While these events have been headline-grabbing, incremental changes across boardrooms and organisations are just as important. Our results for 2011 suggest some interesting changes; we will, of course, have to wait for future reviews to see if these become long-term trends.

The Index is constructed around three categories or dimensions of corporate governance:

* Compliance
* Capacity
* Commitment

Each category is scored A to F on the basis of a considerable number of individual measures. An additional ‘bonus’ is given to companies that are particularly transparent and open to external evaluation, which we see as a positive factor. Interestingly, this component has seen something of a slight decline in 2011.

We believe that corporate governance lies at the heart of prosperous and successful businesses. We are working this year to analyse the connection between governance and performance – both in the long and short term. Our early results show some encouraging connections between our index scores, profitability and growth; and we want to examine these relationships further.

The RGI is able to shine a light on the internal workings of corporate governance to reveal both good practice and perhaps some complacency. The RGI is constructed from public data and its independence provides a reliable reference point for investors, shareholders and other stakeholders as well as providing information for senior management of UK and Overseas companies.

We welcome your comments and interest.

**2 Key Findings**

1. 2010 – 2011 proved a financially rewarding year for much of the FTSE 100, with 78% of the companies reporting an increase in total revenue and 81% of companies reporting an increase in profit. More often than not companies increased profits by increasing sales and revenues, not cutting costs by reducing staff size. More than half the FTSE 100 recruited additional employees and senior staff salaries rose significantly. But if there were more resources generally available it is not apparent that many found their way into a greater ‘commitment’ to ‘good’ corporate governance. Both capacity and commitment scores were down in 2010 – 11 bringing down the average and highest RGI results.
2. Basic compliance scores were sound, particularly in the top half of the RGI. This suggests that larger companies have had sufficient time to implement the additional measures required by the new UK Corporate Governance Code introduced in June 2010. It is likely that the combination of the Walker Report on financial services governance in 2009 and the resultant Financial Reporting Council changes in 2010 have brought new focus to the compliance area.
3. The improved performance in the compliance category is not matched by similar success in the areas we label capacity and commitment. These include evaluation of the internal organisation of governance, culture and ‘going the extra mile’ for communities, employees, the environment and broader social responsibility. This is a trend we noted in 2010 and one that seems to have gathered pace.
4. We measure a selection of social, community and environmental measures but by no means all possible factors. Undoubtedly, there are some shining lights at the top of our RGI and straightforward charitable donations were up overall in 37% of cases. However, approximately the same percentage decreased charitable giving and if we interpret governance to include an external responsibility and citizenship, many obviously see this as a luxury they possibly could, but do not want, to afford. Maybe it is precisely because internal culture and community engagement are so hard to measure and relate to bottom line performance that these areas are neglected.
5. We are undertaking specific analysis to examine the nature and strength of the correlation between various aspects of governance and measures of bottom line performance. Initial work suggests moderate correlation with longer-term performance, but short term results are harder to interpret.
6. Although it is always unwise to draw too great an inference from one component of any index, we note that the number of companies that have a Code of Ethics, Code of Conduct and made a Human Rights Declaration increased from 15 to 22. Companies having two of these three increased from 18 to 28. Companies having none of the above decreased from 27 to 18. We are the first to recognise that signing a declaration or having a code does not ensure ethical culture but it is suggested that this may indicate a growing interest in companies creating and implementing their own internal systems, initiatives and controls on these issues.
7. There are some notable risers and fallers this year, as is to be expected in any index; but there are many more signs of consistency and stability in individual company and sectoral results, allowing broad patterns to be identified. 7 of the 2011 top 10 were in the top 10 in 2010 and it is possible to see a ‘premiership’ of regular high performers emerging. GlaxoSmithKline remains on top spot and HSBC and Billiton seem to be regular fixtures in the top 4. The following have appeared in the top 15 in each of the 3 years of our survey:

* GlaxoSmithKline
* BHP Billiton
* HSBC Holdings
* Lonmin
* Rio Tinto
* Diageo

These companies all represent sectors where risk control and good governance are important in managing reputational risk.

1. We are able to compare FTSE 100 results with a sample of Eurozone companies - those listed on the Euro Stoxx 50. As in 2010, we found that the UK compares favourably with these European companies but we note that the best European companies are catching up and equalling the top UK scores.
2. Finally, we observe that the transparency ‘bonus’ scores which form the final 5% of the RGI - that track openness to external advice and scrutiny - have slightly decreased in 2011. This is hardly a trend so far but it might point to a more defensive approach in the governance area. While it is not difficult to find reasons for this, it is perhaps to be regretted and monitored in the future. We see there being benefits from a more open and constructive dialogue, of which this index and report is a part.

**3 How is the RGI calculated?**

The Index is based on 3 categories:

* Compliance
* Capacity
* Commitment

Each category is comprised of a number of elements.

These elements are scored for every company and combined to create an overall category result expressed as a grade A to F.

The three A-F ratings for each category are then combined in a simple algorithm to give   
the final index.

This approach ensures that although there are many elements included, no one element dominates the result.

Notes:

1. In some elements the scores are benchmarked in relation to all FTSE companies’ current practice and in other cases (where elements more closely relate to individual industry sectors) companies have been scored against the current range for that sector.
2. Each element is weighted according to our judgement of its significance in overall corporate governance.
3. RGI compiled as at 30th June 2011.

**3.1 Compliance**

Compliance is assessed with reference to each of the 48 sections of the Financial Reporting Council UK Governance Code (June 2010) including:

1. The identification of senior roles and key committees
2. Separation of senior roles and appointment procedures and information/professional briefing
3. Identification, proportion and role of Independent, Senior Independent and Non-Executive Directors
4. Performance evaluation of the board, its committees and its individual directors
5. Access to information and professional development
6. Remuneration structures and transparency
7. Audit and accountability
8. Relations with shareholders

Fuller reporting is given greater credit as is the quality of the explanations of why they may choose not to comply.

Results in this category are uniformly high in the ‘top half’ of the FTSE RGI rankings.

**3.2 Capacity**

The evaluation of Capacity is based on an assessment of “Effectiveness”, “Reliability” and “Performance”. The weightings in the category are as follows:

* **Effectiveness (34% weighting)**This relates to such organisational issues as the number of meetings held during the reporting period and the levels of attendance of Board and key committee members at these meetings
* **Reliability (43%)**  
  This relates to measures of the independence, size and composition of the Board and key committees and looks beyond ‘Code’ compliance
* **Performance (23%)**  
  This considers, inter alia, the short versus long term nature of the remuneration of the CEO and the relationship of this remuneration level to company performance

Since Capacity is a relative measure it is usually benchmarked against the best performers in the FTSE 100. For Effectiveness and Reliability (the first two categories) the comparison is normally based on companies with similar market capitalisation.

Overall, the scores achieved in Capacity fell compared to 2009 and 2011.

**3.3 Commitment**

We believe a broader view of governance is necessary. The analysis of Commitment is based on those elements considered to be part of ‘good’ corporate governance that both influence and reflect a sound ethical corporate culture. Three main areas are assessed:

* **Community investment**   
  22% weighting within this category
* **Sustainable development**34% weighting
* **People**44% weighting

Some examples of the elements used in this category are described in more detail below.

1. **Community Investment**The company as “good citizen” and neighbour.

* ‘Employment rate’ seeks to assess the contribution of the company in the community by correlating business growth to change in employment rates. Our formula can only suggest a connection between the two values but gives an indication of how the companies consider their employees, i.e. either as a fundamental part of the business or the first area where costs can be cut in difficult market situations. This relates to salary issues below.
* Social Investments and charitable donations (including, where at all possible management costs and time) relative to revenues.
* Human rights adherence – where reported on.

1. **Sustainable Development**  
   The company in the ‘Age of Responsibility’ with a long term view.

The sustainability of products and services is now critical. This is not just a marketing strategy, but good environmental practices can also deliver cost savings thanks to efficiencies in the usage of materials. Climate change has increased the focus on this component of ethical business. Unfortunately, most of the data available only relates to environmental matters (which have been weighted as follows):

|  |  |
| --- | --- |
| Co2 Emissions................................................................... | 8% |
| Renewable Energy Usage................................................. | 5% |
| Total Energy Usage.......................................................... | 8% |
| Water Consumption........................................................... | 3% |
| Waste Production.............................................................. | 4% |
| Waste Recycling................................................................ | 6% |
| **Total** | **34%** |

1. **People**  
   The company as an equitable and committed employer. This compares CEO and NED salaries/bonuses with the average employee salary/bonus and relates changes in employee remuneration to changes in company revenue. This helps to clarify the community investment alignment above and is also linked to pension and social security contributions.

**3.4 Additional Credit / Plus Mark**

Additional credit is given for being open and having an internal Code of Ethics and Code of Conduct, although it should be noted that this does not necessarily indicate an embedded ethical culture. It should also be noted that openness to using external evaluation schemes and/or assurance gains extra credit.

**3.5 Final Calculation of the RGI**

By combining the scores for each element a company is given a rating for each dimension from A to E. Where there is insufficient information to rate a company for an individual element they are awarded an F. The scores, once calculated, are combined into the RGI enabling the companies to be ranked. The weightings used to produce the final index are as follows:

|  |  |
| --- | --- |
| **Compliance………………………………………….** | **25%** |
| **Capacity……………………………………………...** | **38%** |
| **Commitment…………………………………………** | **32%** |
| **Plus Mark…………………………………………….** | **5%** |
| **Total………………………………………................** | **100%** |

**4 Results**

**Category Results**

The Index is constructed around three categories or dimensions of corporate governance:

* Compliance
* Capacity
* Commitment

To ensure a state of equality for all organisations, the information used in the analysis is drawn entirely from publicly available reports and accounts. Each dimension is scored A to F. It should be noted that the Index gives additional credit to those organisations offering greater transparency and those who publish fuller information in each category.

For each dimension, a number of independent factors or ‘elements’ have been selected as being significant in assessing the effectiveness of corporate governance.

**FTSE 100: Numbers of companies achieving ratings in each category**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **RGI Ratings** | **A** | **B** | **C** | **D** | **E** | **F** | **Total** |
| **Compliance** | 65 (34) | 33 (42) | 0 (13) | 0 (3) | 0 (3) | 1 (4) | **99** |
| **Capacity** | 1 (4) | 9 (15) | 54 (55) | 20 (21) | 15 (3) | 0 (1) | **99** |
| **Commitment** | 1 (3) | 12 (14) | 70 (56) | 14 (22) | 2 (4) | 0 (0) | **99** |

Notes:

2010 results in brackets

Combining Shell’s two listings i.e. 99 companies

**4.1 The FTSE RGI Top 25 in 2011**

| **Rank** | **Company** | **Compliance** | **Capacity** | **Commitment** | **Plus** |
| --- | --- | --- | --- | --- | --- |
| **1** | GlaxoSmithKline | A | C | B | + |
| **2** | BHP Billiton | A | C | B |  |
| **3** | HSBC Holdings | A | C | C | + |
| **4** | Lonmin | A | C | B |  |
| **5** | Rio Tinto | A | B | C | + |
| **6** | Prudential | A | C | C |  |
| **7** | Johnson Matthey | A | B | C | + |
| **8** | Old Mutual | A | A | C |  |
| **9** | Standard Life | A | A | C | + |
| **10** | National Grid | A | C | C |  |
| **11** | Diageo | A | C | C |  |
| **12** | Capital Shop | A | C | C | + |
| **13** | United Utilities Group | A | C | C |  |
| **14** | Imperial Tobacco Group | A | C | C | + |
| **15** | Hammerson | A | D | C | + |
| **16** | Shire | A | C | C |  |
| **17** | British American Tobacco | A | C | C | + |
| **18** | Scottish & Southern | A | C | C | + |
| **19** | InterContinental Hotels Group | A | C | C |  |
| **20** | Schroders | A | D | C |  |
| **21** | SABMiller | B | D | B |  |
| **22** | Aviva | A | C | C | + |
| **23** | Next | B | C | C |  |
| **24** | 3i | A | C | C |  |
| **25** | BP | A | B | C |  |

**4. 2 The FTSE RGI Top 25 in 2010**

| **Rank** | **Company** | **Compliance** | **Capacity** | **Commitment** | **Plus** |
| --- | --- | --- | --- | --- | --- |
| **1** | GlaxoSmithKline | A | B | A | + |
| **2** | Diageo | A | B | B | + |
| **3** | Standard Life | A | B | B | + |
| **4** | HSBC Holdings | A | B | B | + |
| **5** | BHP Billiton | A | C | B |  |
| **6** | Hammerson | A | C | C | + |
| **7** | Johnson Matthey | B | C | B | + |
| **8** | Aviva | B | C | B | + |
| **9** | Lonmin | A | C | C |  |
| **10** | Old Mutual | A | A | C | + |
| **11** | United Utilities Group | A | C | B |  |
| **12** | British Airways | A | B | C |  |
| **13** | Standard Chartered | A | C | C |  |
| **14** | Invensys | A | C | C |  |
| **15** | Rio Tinto | A | B | C | + |
| **16** | Vodafone Group | A | C | C | + |
| **17** | Man Group | A | B | C |  |
| **18** | Barclays | A | C | C | + |
| **19** | BT Group | A | C | C |  |
| **20** | Reed Elsevier | B | C | B | + |
| **21** | Prudential | A | C | C |  |
| **22** | National Grid | A | D | B |  |
| **23** | Cobham | A | C | C |  |
| **24** | InterContinental Hotels Group | A | C | C |  |
| **25** | Lloyds Banking Group | A | B | D | + |

**4.** **3 The FTSE RGI Top 25 in 2009**

| **Rank** | **Company** | **Compliance** | **Capacity** | **Commitment** | **Plus** |
| --- | --- | --- | --- | --- | --- |
| **1** | Rio Tinto | A | A | B | + |
| **2** | BHP Billiton | B | C | B | + |
| **3** | Intercontinental Hotels Group | A | B | B |  |
| **4** | British Airways | A | A | C |  |
| **5** | Next | A | A | C |  |
| **6** | AstraZeneca | A | C | A | + |
| **7** | Inmarsat | B | B | A |  |
| **8** | GlaxoSmithKline | B | C | B | *+* |
| **9** | Cairn Energy | D | C | A |  |
| **10** | HSBC Holdings | B | A | D | + |
| **11** | Imperial Tobacco Group | A | C | B |  |
| **12** | Lonmin | B | B | C |  |
| **13** | International Power | B | B | B |  |
| **14** | Diageo | A | C | B | + |
| **15** | Vodafone Group | A | B | C | + |
| **16** | Rolls-Royce Group | B | C | B |  |
| **17** | BT Group | A | C | C | + |
| **18** | Pearson | A | C | B | + |
| **19** | Man Group | B | C | B |  |
| **20** | Sage Group | A | B | C |  |
| **21** | BG Group | A | C | B |  |
| **22** | Tullow Oil | A | C | B |  |
| **23** | Unilever | B | C | C | + |
| **24** | RSA Insurance Group | B | B | D | + |
| **25** | Marks & Spencer Group | B | B | C | + |

**5 Further Information**

Resources Global Professionals intend to compile a similar Index in 2012 and will be planning related papers and events in 2011 and 2012. For further copies of this report and additional information please contact [rgi@resources-uk.com](mailto:rgi@resources-uk.com) or +44 (0) 131 260 3700

**About Resources Global Professionals**

Resources Global Professionals ("Resources Global") is an international professional services firm that helps business leaders execute internal initiatives. Partnering with client teams, we solve problems, execute plans, transfer knowledge and help drive change through all levels of the enterprise, all over the world.

Our professionals are experienced problem solvers with an average of 18-years experience in the fields of finance and accounting, human capital, information management, internal audit, legal, supply chain and governance, risk and compliance (GRC).

Resources Global was founded in 1996 within a Big Four accounting firm. Today, Resources Global is a publicly traded company with over 2,700 professionals (from more than 80 offices) serving 2,100 clients in 66 countries. Headquartered in California, Resources Global has served 84 of the Fortune 100 companies.

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