

## CORPORATE GOVERNANCE STATEMENT

for Marks and Spencer Group plc ('Marks & Spencer'; 'M&S'; the 'Company') for the year ended 2 April 2011

*The Board's objective is to build a sustainable business through consistent, profitable growth and to make sure that we act responsibly in meeting our accountabilities to shareholders and wider stakeholders.*

The governance rules which apply to UK companies listed on the London Stock Exchange with financial periods beginning before 29 June 2010 are found in the Combined Code on Corporate Governance 2008 (the 'Code'). The new UK Corporate Governance Code was adopted in June 2010 (the '2010 Code'), although not a requirement, this year we have also measured ourselves against the principles of the 2010 Code. The two significant amendments to the Code; the annual election of directors and the external evaluation of the Board at least every three-years have been achieved this year. This statement provides a detailed account of how the Company has applied the Code's principles and how we comply with its provisions. It supplements the information given in our 2011 Annual Report, approved by the Board on 23 May 2011, which sets out our approach to governance.

### Compliance with the Code

*Throughout the year ended 2 April 2011 the Company complied with all provisions of the Code with the exception that for part of the year, the role of Chairman and Chief Executive was exercised by the same individual, Sir Stuart Rose. Stuart stepped down as Executive Chairman on 31 July 2010 but remained as Chairman until the appointment of Robert Swannell as Non-Executive Chairman on 4 January 2011.*

(A.2.1/A.2.2) We recognise that Stuart's role as Chairman and Chief Executive was out of line with best practice as was his independence criteria on appointment as Chairman. We understand the concerns of our shareholders, but maintain that robust governance structures were in place, while benefiting from retaining Stuart at the helm. With the separation of the roles of Chairman and Chief Executive from 31 July 2010 we have now returned to best practice.

Throughout the period of Stuart's combined role independent oversight was maintained and strengthened by the membership of our Board and the emphasis given to accountability. Sir David Michels, Deputy Chairman, took the lead on all governance matters. This included engaging shareholders on their views, chairing the Nomination & Governance Committee and conducting the review of Board performance. At least half the Board comprises independent directors – seven out of 12 on 23 May 2011. All non-executives have been appointed since 2004 and have an average tenure of just over four years.

## A DIRECTORS

*A.1 The Board: Every company should be headed by an effective board, which is collectively responsible for the success of the company.*

The Board agrees with the role for boards given in the Code, which it has adopted in its governance framework:

- to provide entrepreneurial leadership of the Company within a framework of prudent and effective controls which enables risk to be assessed and managed;
- to set the Company's strategic aims, ensuring that the necessary financial and human resources are in place for the Company to meet its objectives and review management performance; and

- to set the Company's values and standards and ensure that its obligations to its shareholders and others are understood and met.

All directors are individually briefed by the Group Secretary, on appointment, on the duties they owe as directors to the Company. Our Governance Framework includes the statutory duties set out in the Companies Act 2006. The central duty is the duty to act in good faith and in a way most likely to promote the success of the Company for the benefit of its members as a whole. In fulfilling this duty, directors should have regard (amongst other matters) to the likely consequences of any decision in the long term; the interests of employees; the need to foster business relationships with suppliers, customers and others; the impact of operations on the community and the environment; the desirability of maintaining a reputation for high standards of business conduct; and the need to act fairly between members of the Company.

One of the special attributes of M&S is the level of trust it has established on the high street. Trust is built up by doing the right things the right way. Good governance is just that and at M&S we have focused on ensuring it is meaningful, relevant and underpins our decision making.

At M&S, we believe that effective governance is realised through leadership and collaboration. The work of the Board should compliment, enhance and support the work of the Executive. Working together, the Board conducts robust interrogation of plans and actions, ensuring high quality decision-making in all areas of strategy, performance, responsibility and accountability. The role of the Chairman is at the heart of ensuring these actions are sustained and harnessed and can drive a culture of continuous improvement in standards and performance across our business. Our Chairman ensures that the Board is greater than the sum of its parts – a unified Board with non-executives acting as 'critical friends' to Chief Executive Marc Bolland and his executive team running the business, ensuring we have a Board that:

- supports the executive team to formulate and execute the strategy;
- demonstrates independence, knowledge and experience to bring fresh perspectives and to hold management to account;
- seeks full information to form views, question management and take strategic decisions;
- is diverse and while acknowledging the recommendations on diversity, ensures that we have the right balance of skills, experience and background; and
- acts responsibly to make sure we meet our accountabilities to shareholders and wider stakeholders.

**A.1.1** The Board met ten times during 2010/11 and plans its meetings at least 18 months in advance in line with its financial reporting calendar. The Board has a formal schedule of matters reserved for its decision and delegates certain matters to committees as set out below. The Board determines the overall Group strategy; creation, acquisition or disposal of material corporate entities or assets; development and protection of the brand; matters of public interest that could affect the Group's reputation; public announcements including statutory accounts; significant changes in accounting policy; capital structure and dividend policy; operating plans and key performance indicators; prosecution, defence or settlement of material litigation; Group remuneration policy and Board structure, composition and succession. The Board has reviewed and updated its schedule of matters reserved which is set out within the Governance Framework, which outlines the terms of reference of the Board and relevant committees and is available on our website. An overview of what the Board has done during the year, along with details of its first ever independently-facilitated Board review, is provided on page 44 of the Annual Report.

**A.1.2** Key Board appointments are carried out by the following people: **Robert Swannell** – Non-Executive Chairman, and Nomination & Governance Committee Chairman, appointed on 4 January 2011; **Marc Bolland** – Chief Executive; **Sir David Michels** – Deputy Chairman, Senior Independent Director; **Jeremy Darroch** - Audit Committee Chairman; **Steven Holliday** - Remuneration Committee Chairman. The Board attendance table is set out on page 42 of the Annual Report, the Nomination & Governance, Audit and Remuneration Committees attendance tables are set out on pages 50, 51 and 53 respectively. **Amanda Mellor** is Group Secretary and ensures that the Board receives information and papers in a timely manner to enable full and proper consideration of agenda items agreed in advance in its annual meeting planner. Any director who is unable to attend a Board or Committee meeting reviews the relevant papers and provides comments in advance to the Chairman or Committee Chairman as appropriate.

**A.1.3** The Chairman meets the non-executive directors without the executives present to make sure they are sufficiently prepared for Board and committee duties and to receive further insight into the performance of the Group and management. The Deputy Chairman as Senior Independent Director chairs meetings of the non-executive directors without the Chairman present to review the performance of the Group generally and the Chairman in particular.

**A.1.4** Directors' concerns, which cannot be resolved, about the running of the Group or a proposed action, would be recorded in the Board minutes. On resignation, a non-executive director with such concerns would be expected to provide a written statement to the Chairman, for circulation to the Board. No such concerns have been highlighted.

**A.1.5** Directors are granted an indemnity from the Company in respect of liabilities incurred as a result of their office. In respect of those matters for which they cannot be indemnified, the Company maintains appropriate liability insurance for the benefit of directors.

**A.2.** **Chairman and Chief Executive: *There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.***

**A.2.1** For a part of the year, until 31 July 2010, the role of Chairman and Chief Executive was exercised by the same individual, Sir Stuart Rose. We recognise that this was out of line with best practice and we understand the concerns of shareholders, but maintain that robust governance structures were in place, while benefiting from retaining Stuart at the helm. Stuart stepped down as Executive Chairman on 31 July 2010, remaining as Chairman until the appointment of Robert Swannell as Non-Executive Chairman on 4 January 2011. We therefore returned to best practice from 4 January 2011.

**During the period when the roles of Chief Executive and Chairman were exercised by Sir Stuart Rose, the following robust governance structures were in place:**

The Board reviewed and agreed a clear division of responsibilities under the Board structure to ensure a proper division of responsibilities and balance of power. The Deputy Chairman, Sir David Michels, took joint responsibility with the Executive Chairman for the agenda and the overall Board structure and composition of the Board. He took the lead on all governance matters, engaging shareholders on their views, chairing the Nomination & Governance Committees and conducting the review of Board performance.

In addition, the non-executive directors met independently at least twice a year to keep the governance structure under review to ensure appropriate safeguards were in place to protect shareholder interests.

We set out what we expect from our directors in the Governance Framework which we publish on our website. This covers their individual accountabilities as well as terms of reference for the Board, committees and business functions which support our governance. The profiles for the Executive Chairman, Deputy Chairman and non-executive directors are summarised below:

#### **Executive Chairman (up until 31 July 2010)**

- To ensure the Board achieves its full potential to build a sustainable business for the long term, generating shareholder value through consistent, profitable growth whilst making sure that our customers always trust us to do the right thing.
- To act within delegated authority from the Board for all aspects of the management of the Group, which includes developing appropriate business strategies for Board approval and achieving timely and effective implementation.

To keep the Deputy Chairman regularly informed on all matters that may be of importance to the Group, including its current performance and progress; and to monitor performance of the executive directors in their increased responsibilities, whilst focusing himself on the strategic growth areas of the business.

#### **Deputy Chairman and Senior Independent Director**

- To lead on all governance issues (up until 4 January 2011) including conducting the annual review of Board effectiveness and ensuring that the performance of individual directors is kept under review.
- To provide a communication channel between the Chairman and non-executive directors and, when required, principal shareholders including representative bodies.

To monitor the effectiveness of the role of Executive Chairman; independently to lead the succession process for the appointment of a Chief Executive; and to maintain contact with principal investors and representative bodies on a regular basis, keeping the Board informed.

#### **Non-Executive Directors**

- To bring an independent and external dimension to the Board's activities and play their part in relation to strategy, performance, risk and people.
- Within the spirit of partnership and mutual respect on the unitary board, to support, constructively challenge and monitor the executive team.

To keep the governance structure under review to ensure appropriate safeguards are in place to protect shareholder interests.

**A.2.2** Sir Stuart Rose did not, on his appointment as Chairman on 31 July 2010, meet the independence criteria set out in the Code. The Code states that 'if exceptionally a Board decides that a Chief Executive should become Chairman, the Board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next Annual Report.'

Although not consulting major shareholders in the period leading up to the original announcement on 10

March 2008, of the Board and senior management changes, there was considerable engagement with shareholders ahead of Stuart Rose stepping down as Executive Chairman on 31 July 2010 and remaining as Chairman until the appointment of a Non-Executive Chairman. It had been agreed that a new Non-Executive Chairman would be appointed no later than 31 March 2011, this was achieved with the appointment of Robert Swannell as Non-Executive Chairman on 4 January 2011.

**A.3 Board balance and independence: *The board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.***

On 2 April 2011 the Board comprised 12 directors: the Chairman, Deputy Chairman, five executive directors and five non-executive directors. A full list of the directors, with biographies and details of their committee membership, is given on pages 38 and 39 of the 2011 Annual Report. On 1 May 2010 Marc Bolland joined as Chief Executive. Sir Stuart Rose stepped down as Executive Chairman on 31 July 2010, remaining as Chairman until the appointment of Robert Swannell as a Non-Executive Director on 4 October 2010 and then as Non-Executive Chairman on 4 January 2011. Alan Stewart was appointed as Chief Finance Officer on 28 October 2010 following Ian Dyson resigning from the Board on 14 July 2010. In February 2011 we announced the appointment of Laura Wade-Gery as Executive Director, Multi-channel E-commerce, she will join the Board on 4 July 2011. On 5 May 2011 we announced that Louise Patten has decided not to seek re-election this year and will step down from the Board following the AGM on 13 July 2011. Sir David Michels has also decided to step down from the Board following the end of his second three-year term in February 2012.

Composition of the committees is as follows: **Audit** - six independent non-executive directors chaired by Jeremy Darroch; **Remuneration** – five independent non-executive directors chaired by Steven Holliday; and **Nomination & Governance** - five independent non-executive directors, the Deputy Chairman and Chief Executive, chaired by Robert Swannell. Other directors may attend committee meetings by invitation as appropriate.

**A.3.1** The Board has determined that each non-executive is independent in character and judgement; commits sufficient time and energy to the role, and continues to make a valuable contribution to the Board and its committees. The Board keeps under review whether there are relationships or circumstances which are likely to affect, or could appear to affect their independence

**A.3.2** At least half the Board, excluding the Chairman, comprises independent non-executive directors, all of whom have been appointed since 2004.

**A.3.3** Sir David Michels is Deputy Chairman and Senior Independent Director provides a communication channel between the Chairman and the non-executive directors. David ensures that the views of each non-executive director are given due consideration. He is an additional contact point for shareholders if they have reason for concern that cannot be addressed through the normal channels of Chairman, Chief Executive or Chief Finance Officer or for which such contact is inappropriate. He also reviews the Chairman's performance on behalf of the Board.

***A.4. Appointments to the Board: There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.***

Robert Swannell was appointed a Non-Executive Director on 4 October 2010, becoming Non-Executive Chairman and Chairman of the Nomination & Governance Committee, following Stuart Rose stepping down as Executive Chairman on 4 January 2011. Robert is currently a Non-Executive Director of HMV Group plc, it has been announced that Robert will step down from the HMV Group plc Board on 23 June 2011. He was until September 2010, senior independent director of The British Land Company plc and 3i Group plc. The Nomination & Governance Committee recommended the appointment of Robert to the Board.

Marc Bolland was appointed Chief Executive on 1 May 2010. Marc joined M&S from Morrison Supermarkets plc where he had been Chief Executive since 2006. He had previously worked in a variety of management roles at Heineken for 20 years. Marc is a Non-Executive Director of Manpower inc. The Nomination & Governance Committee recommended the appointment of Marc Bolland to the Board.

Alan Stewart was appointed to the Board as Chief Finance Officer on 28 October 2010. Alan joined M&S from AWAS, an aircraft leasing company where he had been Chief Financial Officer. Alan previously worked in a number of senior roles at Thomas Cook before joining WH Smith in 2005 as Group Finance Director. The Nomination & Governance Committee recommended the appointment of Alan Stewart to the Board.

On 7 February 2011 we announced the appointment of Laura Wade-Gery as Executive Director, Multi-channel E-commerce. Laura will join the Board on 4 July 2011, from Tesco plc where she has held a variety of senior roles since 1997. Laura brings considerable retail and consumer experience, including significant e-commerce knowledge as Chief Executive Officer of Tesco Direct. Laura is a Non-Executive Director of Trinity Mirror plc. The Nomination & Governance Committee recommended the appointment of Laura Wade-Gery to the Board.

**A.4.1** The appointment of new directors is led by the Nomination & Governance Committee which comprises Robert Swannell (Non-Executive Chairman), Sir David Michels and all five independent non-executive directors: Jeremy Darroch, Martha Lane Fox, Steven Holliday, Louise Patten and Jan du Plessis. The Committee has reviewed and updated its terms of reference which are available on the Company's website. An overview of what the committee has done during the year, along with how their performance was rated, is provided on page 50 of the Annual Report.

The Group Secretary acts as secretary to the Committee and ensures that it receives information and papers in a timely manner to enable full and proper consideration of agenda items agreed in advance in its annual meeting planner.

**A.4.2** The Nomination & Governance Committee's primary role is to ensure that appropriate procedures are in place for the nomination, selection, training and evaluation of directors and for successional plans. It reviews the Company's Board structure, size, composition and successional needs, thereby keeping under consideration the balance of membership and the required blend of skills, knowledge and experience of the Board. Appointments are made on merit and against objective criteria to ensure that the Board maintains a balance of skills and experience.

**A.4.3** Robert Swannell was appointed Non-Executive Chairman of the Company on 4 January 2011, having joined the Board as a Non-Executive Director on 4 October 2010. The appointment of Robert as Chairman was led by the Nomination & Governance Committee, then chaired by Sir David Michels. A great deal of time was spent with our external consultants, defining what the business required. In order to devote sufficient time to the role of Chairman, Robert stepped down as Senior Independent Director from The British Land Company plc and 3i Group plc in September 2010. He is currently a non-executive director of HMV Group plc, it has been announced that Robert will step down from the HMV Group plc Board on 23 June 2011.

**A.4.4** The non-executive directors have ensured that they have sufficient time to carry out their duties. The appointment letter for non-executive directors sets out their terms and conditions of appointment, detailed information on the Group and the expected time commitment, including dates of future Board meetings and AGMs. Their other significant commitments are taken into account before appointment. Their letters of appointment are available for inspection through the Group Secretary or at our AGM.

**A.4.5** No full time executive director has taken on more than one non-executive directorship of a FTSE 100 company, nor the chairmanship of such a company.

**A.4.6** The Nomination & Governance Committee formally met 13 times during the year. We put a great deal of time and effort into securing the appointment of Non-Executive Chairman, Chief Finance Officer and Executive Director, Multi-channel E-commerce, ensuring we have the best Board to support the business going forward. For each position we spent a great deal of time with our external consultants, defining what the business needed. Considerable effort was then spent managing thorough, orderly searches and reviewing prospective internal and external candidates. We interviewed rigorously and have secured what we believe to be great candidates. The Nomination & Governance Committee also reviewed the wider Board and Committees following these appointments and undertook its first external review of its effectiveness. A review on the impact of governance across the business also took place through separate meetings of the Chairman and the non-executive directors.

**A.5** *Information and professional development : The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.*

The Chairman ensures that the directors receive accurate, timely and clear information. They receive regular updates on business performance against the annual operating plan and investment decisions, together with business reports and presentations from senior management at Board meetings. Directors are encouraged to update their skills, knowledge and familiarity with the Group through their initial induction, on-going participation at Board and committee meetings, meeting employees at store locations and elsewhere and are kept up-to-date on the views of customers and shareholders.

The Group Secretary and Head of Governance supports both the Chairman and the Deputy Chairman in carrying out their governance accountabilities. She also makes sure the non-executives get the information and access to the people they need. She keeps the directors informed on governance, regulation and legislative change through her written report to each Board meeting. She is supported by the Governance Group - comprising secretariat, legal, insurance, internal audit & risk, pensions, corporate archive and BIG (employee representatives) - which helps and supports colleagues to do the right thing, the right way with governance that

is meaningful, relevant and focused on improving the business, both in the UK and overseas.

The online Board portal provides access to information for directors to carry out their duties and for their ongoing development.

**A.5.1** New directors receive a full, formal and tailored induction to the Group following our corporate induction framework for senior management. This identifies the key areas to be covered including company structure and strategy, industry and competitive environment and sentiment and reputation.

Following his appointment as a non-executive director, Robert Swannell received a comprehensive induction programme, which was supported by one on one meetings with management, visits to stores and distribution centres. He also met with key investors and suppliers. An overview of Robert's induction is given on page 44 of our 2011 Annual Report. Alan Stewart also received a thorough formal and tailored induction programme prior to his appointment as Chief Finance and Officer.

**A.5.2** There is an established procedure whereby the Board or any of its committees may take independent professional advice when appropriate. Any individual director, wishing to do so in the furtherance of their duties, may take independent professional advice through the Group Secretary at the Company's expense.

**A.5.3** The Group Secretary plays a key role in the promotion of good governance, therefore the appointment or removal of this person is a matter for the Board as a whole.

**A.6** *Performance evaluation: The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.*

### **Board performance**

The M&S Board is committed to best practice in its governance activities. In line with this best practice and reflecting the significant changes to the Board line-up this year, we took the decision to commission our first ever independently-facilitated Board review (as recommended by the 2010 Code). Our aim was to capture open and constructive feedback from Board members that would:

- Provide insight into our effectiveness;
- Point to actions for improving our performance; and
- Establish a benchmark for measuring future progress.

**A.6.1** The Annual Report sets out how the Board and its committees have been reviewed and their respective performances during 2010/11, the outputs and the action planning for 2011/12.

Our Board and its Committees reviews were conducted against the principals set out in the 2010 Code. All participants were interviewed according to an agenda tailored specifically for our Board and committees, and all were hugely supportive of our aims, embraced our desire to elicit a diversity of views and demonstrated a commitment to achieving exemplary performance.

### **External evaluation**

During 2010/11 the Board and its Committee reviews were conducted by Ffion Hague of Independent Board Evaluation, a wholly independent consultant who has no other relationship with M&S. Structured interviews with Board members took place, with each participant asked to evaluate the Board, its Committees, the

Chairman and individual Board members. Subjects covered included a general overview as to the 'state' of the Board, how it was operating at the time and how that had changed in recent months. Directors were also asked about shareholder relationships and how these relationships might be improved.

Views were sought on the Board's input into strategy discussions, governance and compliance, risk management and succession planning. The Board's own composition was also examined, looking at culture and the relationships with senior management as well as how new members are selected and inducted.

Insights gathered from the Board review has resulted in a clear action plan for 2011/12. The actions address the key areas of succession and people, Board composition, Board debate, risk management and shareholder engagement.

### **Individual performance**

The Chairman reviewed the performance of the executive directors individually against business and individual objectives. Remuneration is directly linked to these reviews and is determined by the Remuneration Committee. Our Governance Framework gives particular emphasis to the governance accountabilities of the Chairman, Deputy Chairman and non-executive directors. The Deputy Chairman as Senior Independent Director has reviewed the performance of the Chairman, taking into account the views of the executive directors, against these accountabilities and business objectives and confirms that he demonstrates strong leadership of the Group. Following discussions the Chairman held with individual directors, the Board confirms that each non-executive director is independent in character and judgment; commits sufficient time and energy to the role, and continues to make a valuable contribution to the Board and its Committees.

***A.7 Re-election: All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. The board should ensure planned and progressive refreshing of the Board.***

**A.7.1.** Under the Company's Articles of Association, all directors seek election at their first Annual General Meeting following appointment and all directors are required to offer themselves for re-election at least every three years. This year we have decided to comply with the more rigorous guidance set out in the 2010 Code in relation to the re-election of directors, specifically that all directors will be subject to annual election by shareholders.

Robert Swannell is seeking election following his appointment to the Board as non-executive director on 4 October 2010 and Non-Executive Chairman on 4 January 2011; Alan Stewart is seeking election following his appointment to the Board as executive director on 28 October 2010. Laura Wade-Gery will also be seeking election following her appointment to the Board on 4 July 2011 as executive director. All of the remaining directors will be seeking re-election, with the exception of Louise Patten, who, as announced on 5 May 2011 has decided to step down from the Board at the conclusion of the 2011 AGM.

Directors' biographies are given on page 38 and 39 of the Annual Report to enable shareholders to take an informed decision when determining (re-)election.

**A.7.2** Any term beyond six years (ie two three-year terms) for a non-executive director is subject to rigorous review. On 5 May 2011 we announced that Sir David Michels has decided to step down from the Board following the end of his second three-year term in February 2012. Through the performance review described above, the Chairman confirms that each non-executive director continues to be independent in character and

judgment, commits sufficient time and energy to the role, and continues to make a valuable contribution to the Board and its Committees.

## **B REMUNERATION**

*B.1 The Level and Make-up of Remuneration : Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.*

### **Remuneration Policy**

Our long term philosophy for remuneration remains to attract and retain leaders who are focused and encouraged to deliver business priorities within a framework that is aligned with the interests of the Company's shareholders. Our remuneration strategy continues to ensure that a significant percentage of the package remains 'at risk'.

**B.1.1** Performance-related elements of remuneration form a significant proportion of the total remuneration package of executive directors. The expected future value of remuneration components (salary, pension, annual cash bonus and long-term incentives) is given on page 56 of the Annual Report. Amendments to the Company's Long-term incentive Plan will be proposed at the 2011 AGM, details of the amendments can be found in the response to B.2.4 below and a full explanation of the changes is set out on pages 52 to 67 of the Annual Report.

**B.1.2** Executive share options are not offered at a discount.

**B.1.3** A review of non-executive director fees was carried out in December 2010, although reviewed annually, the fees had not been increased since April 2007. As a result the fee structure was realigned from 1 January 2011. The additional fee for committee membership has been consolidated into an increased basic annual fee. In addition, the fee for the role of Audit and Remuneration Committee Chairman was increased. These fees are neither performance related nor pensionable. Non-executive directors do not participate in any of the Company's share schemes nor the Annual Bonus Scheme.

The revised basic fee which includes membership of committees is £70,000 per annum. The additional fee for acting as Chairman of the Audit or Remuneration Committees is £15,000. Each of the non executive director fees are disclosed on page 57 of the Annual Report.

**B.1.4** We recognise that executive directors may be invited to become non-executive directors of other companies and that these appointments can broaden their knowledge and experience, to the benefit of M&S. The individual director retains the fee, details of which are disclosed on page 61 of the Annual Report.

### **Service Contracts and Compensation**

**B.1.5** The Remuneration Committee considers carefully commitments made to directors in respect of remuneration which would impact on early termination. The Company retains the right to terminate the contract of any executive director summarily, in accordance with the terms of their service agreement, on payment of a sum equivalent to the contractual notice entitlement of 12 months' salary and specified benefits.

For all current executive directors, the Company reserves the right on termination to make phased payments which are paid in monthly instalments and subject to mitigation. Entitlement to participate in future share schemes ceases on termination.

**B.1.6** All executive directors and senior managers have rolling service contracts which can be terminated by the Company giving 12 months' notice and by the employee giving six months' notice. Exceptions may exist where new recruits have been granted longer notice periods for the initial period of their employment, reducing to twelve months. The Chairman and Deputy Chairman both have agreements for service which can be terminated on six months' notice by either party. Non-executive directors have agreements for service with the Company for an initial three-year term, which can be terminated on three months' notice by either party. Details of each director's contract terms and current annual salaries/fees are set out on page 61 of the Annual Report.

**B.2** *Procedure: There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.*

**B.2.1** The Remuneration Committee comprises five independent non-executive directors. Steven Holliday (Chairman), Martha Lane Fox, Sir David Michels, Louise Patten and Jan du Plessis. The Committee met 9 times during the year under review. The Committee attendance table can be found on page 53 of the Annual Report. The Remuneration Committee has reviewed and updated its terms of reference which is available on our website. An overview of what the Committee has done during the year, along with how their performance was rated, is provided on page 54 of the Annual Report.

The Committee seeks external advice as necessary, Deloitte LLP were selected and appointed as independent external advisers to the Committee from November 2010. Prior to this, Hewitt New Bridge Street (a brand of Aon) performed this role for over ten years. The Committee also seeks internal support from the Chairman, Group Secretary, Director of Human Resources and Head of Employee Relations and Reward, all of whom may attend the Committee meetings by invitation but are not present for any discussions that relate directly to their own remuneration. The Committee also regularly reviews external data produced through a number of surveys and bespoke benchmarking data, including those published by Hewitt New Bridge Street, KPMG, Monks, PwC and Towers Watson.

The Group Secretary acts as secretary to the Committee and ensures that it receives information and papers in a timely manner to enable full and proper consideration of agenda items agreed in advance in its annual meeting planner.

**B.2.2** The Remuneration Committee's primary role is to recommend to the Board the senior remuneration strategy and framework, giving due regard to the financial and commercial health of the Company and to ensure the executive directors and senior management are fairly rewarded for their individual contributions to the Company's overall performance.

**B.2.3** The remuneration of the non-executive directors is determined by the Chairman, Deputy Chairman and the executive directors.

**B.2.4** Shareholders are invited specifically to approve all new long-term incentive schemes – amendments to

the Long-term Incentive Plan (LTIP) is being proposed to shareholders, for approval at the July 2011 AGM.

The proposal seeks to rebalance the LTIP in the following fundamental ways, full details can be found in the Remuneration Report set out on pages 52 to 67 of the Annual Report as required by the Directors' Remuneration Report Regulations 2002.

#### **Long Term Incentive Plan (LTIP):**

- remove the exceptional award limit of 400% of salary and establish the maximum individual award opportunity at a reduced level of 300% of salary. The Committee's intention is for award levels to be conventionally referenced to 250% of salary. This change, taken together with the change to the annual bonus opportunity, will give a greater weighting in the package towards long-term performance and value creation for shareholders; and
- move away from the use of adjusted (underlying basic) earnings per share (EPS) as the sole metric for LTIP awards, reflecting the strategic priorities we have for the business. LTIP awards in 2011/12 will drive performance based on the following key metrics: cumulative EPS performance (50% of the total award), Revenue (30% based equally on performance in three business segments: the UK, Multi-channel and International) and Return on Capital Employed (20%).

These proposals have been finalised after a thorough consultation, taking into account the feedback we received from our key institutional investors and shareholder representative bodies. The Committee believes that we have developed an incentive structure that will clearly support and motivate the team in a way that is aligned with the business strategy to deliver quality long-term growth for the business.

## **C ACCOUNTABILITY AND AUDIT**

### ***C.1 Financial Reporting: The board should present a balanced and understandable assessment of the company's position and prospects.***

The Board applies a consistent approach in its financial reporting which includes interim and other price-sensitive public reports and reports to regulators as well as information required by statute.

**C.1.1** The responsibilities of the directors in preparing the accounts and the statement by auditors about their reporting responsibilities are set out on pages 72 and 73 respectively of the Annual Report.

**C.1.2** The directors' going concern statement is given on page 71 of the Annual Report. Based on the Group's cash flow forecasts and projections, the Board is satisfied that the Group will be able to operate within the level of its facilities for the foreseeable future.

### ***C.2 Internal Control: The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.***

One of the Board's key accountabilities is to provide entrepreneurial leadership of the Company within a framework of prudent and effective controls which enables risk to be assessed and managed.

**C.2.1** The Board, through the Audit Committee, has conducted a review of the effectiveness of the systems

of internal control as described below.

### **Accountability and audit**

We believe that effective risk management is critical to the achievement of our strategic objectives and the long-term sustainable growth of our business.

The Board has overall accountability for running the business effectively and for ensuring that risk is effectively managed across the Group. Internal controls and risk management are designed to limit the chance of failure to achieve corporate objectives. On behalf of the Board, the Audit Committee reviews the effectiveness of the Group Risk Process. Independent assurance is provided by the external auditors and internal audit, who present their findings regularly to the Audit Committee.

We have adopted an integrated approach to our risk management, independent assurance and internal controls to ensure greater linkage across our review and assessment of risk.

### **Risk assessment**

Every six months the Board reviews the Group Risk Profile – the tool that drives business improvement and internal audit activity. This is supported by an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. Our principal risks and uncertainties are set out on pages 45 to 47 of the Annual Report.

The Audit Committee is responsible for monitoring the risk process and this year challenged appropriately to ensure that the risk process reflected the risks associated with the new strategic plan. As a result we have maintained a simple and practical approach to risk management, while driving key improvements to the process and quality of risk information produced. Our focus has centred around three key themes:

- Alignment with the three-year plan;
- Clearer risk descriptions; and
- Actions plans for key risks.

Each of these initiatives further strengthens our risk process and enables the Board to make informed decisions on strategy with assurance that our risks are being managed.

### **Principal risks and uncertainties**

We face risk and uncertainties on a daily basis. It is the effective management of these that places us in a better position to be able to achieve our strategic objectives and to embrace opportunities as they arise. Risks are reviewed by all business areas on a half-yearly basis and measured against a defined set of likelihood and impact criteria. This is captured in consistent reporting formats, enabling internal Audit & Risk to consolidate the risk information and summarise the key risks in the form of the Group Risk Profile ('GRP'). The Executive Board discusses the GRP ahead of it being submitted to the Board for final approval.

To ensure our risk process drives improvement across the business, the Executive Board monitors ongoing status and progress of key action plans against each risk on a quarterly basis. Furthermore, the discussions on risk have strengthened at Board level with risk being a key consideration in all strategic decision-making.

Our risk process is designed to identify, evaluate and manage key business risks. A table of our principal risks

and the mitigating activities underway to address them is set out on pages 46 and 47 of the Annual Report with further discussion on financial risk management given on pages 97 to 100. The Board considers these to be the most significant risks to achieving our business goals. It is recognised that the Group is exposed to a number of risks, wider than those listed. However a conscious effort has been made to disclose those risks of most concern to the business at this moment in time and those that have been the subject of debate at recent Board or Audit Committee meetings. Additional risks not presently known to management, or currently deemed to be less material, may also have an adverse effect on the business.

### **Internal control**

The Audit Committee has completed its review of the effectiveness of the Group's systems of internal control during the year, which is in accordance with the Turnbull Guidance 2005. It confirms the necessary action plans to remedy identified weaknesses in internal control are in place and have been throughout the year.

The key features of the Group's internal control and risk management systems that ensure the accuracy and reliability of financial reporting include: clearly defined lines of accountability and delegation of authority; policies and procedures that cover financial planning and reporting, preparing consolidated accounts, capital expenditure, project governance and information security; and the Company Code of Ethics and Behaviours.

This year the Board has reviewed and agreed changes to some key policies and procedures including:

- establishment of the Executive Board: accountable for running the business, making sure we are doing the right thing day-to-day and delivering the Group's strategy. It allocates capital and controls all non-property investments with a risk of material impact on financial results, brand or strategy;
- establishment of the Management Committee: inputs into the Group's strategic plan, monitoring the development of the Group's workstreams against the Group's three-year plan and cascading relevant information through the business;
- establishment of the Property Board: ensures capital expenditure is allocated to the Group's UK and International property portfolio. Approves all UK and International property investments, projects and programmes.

The terms of reference of these committees can be found within our Corporate Governance Framework available on our website.

***C3 Audit Committee and Auditors: The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.***

***C.3.1*** The Audit Committee comprises six independent non-executive directors. Jeremy Darroch (Chairman), Martha Lane Fox, Steven Holliday, Sir David Michels, Louise Patten and Jan du Plessis.

The Board has satisfied itself that at least one member of the Audit Committee has recent and relevant financial experience and is confident that the collective experience of the members enables it to be effective. The Committee also has access to the financial expertise of the Group and its external and internal auditors and can seek further professional advice at the Company's expense, if required.

The Group Secretary acts as secretary to the Committee and ensures that it receives information and papers in a timely manner to enable full and proper consideration of agenda items agreed in advance in its annual

meeting planner.

**C.3.2** The Audit Committee assists the Board in fulfilling its oversight responsibilities and its primary role is to monitor the integrity of the financial statements and other information to shareholders; to review the systems of internal control and risk management; and to maintain an appropriate relationship with the Company's external auditors and to review the effectiveness and objectivity of the audit process.

The Audit Committee met five times during the year and private meetings have been held separately with the external auditors and internal audit after each Committee meeting.

**C.3.3** The Audit Committee has reviewed and updated its terms of reference which are available on our website. An overview of what the committee has done during the year, along with how their performance was rated, is provided on page 51 of the Annual Report.

**C.3.4** The Audit Committee has reviewed 'whistleblowing' procedures including the reporting and follow-up of any concerns by employees regarding possible improprieties in matters of financial reporting, other fraud-related matters and bribery. Our Code of Ethics and Behaviours (a copy of which is on our website) outlines the behaviours that M&S expects of its employees and advises them to report any suspected wrongdoing by the Company, colleagues or others involved with the Company by reporting it to a manager, calling a confidential employee helpline or reporting it to the Group Secretary, as the Independent Internal Individual.

**C.3.5** The Audit Committee ensures that the internal audit department is adequately resourced and continues to have appropriate standing within the Group, and to keep under review its members' independence and objectivity. It also reviews the internal audit programme including any significant findings and the effectiveness of internal audit.

**C.3.6** The Audit Committee has primary responsibility for making a recommendation on the appointment, re-appointment and removal of the external auditors, which would be put to the Board and then to shareholders. As authorised by shareholders at the 2010 AGM, the Audit Committee determines the level of remuneration for the external auditors on behalf of the Board. Details of this year's fees are given in note 4 page 83 to the financial statements in the Annual Report.

**C.3.7** The Audit Committee keeps under review the independence and objectivity of the external auditors, including the review of audit fee proposals and non-audit fees. The effectiveness of our external auditors is key to giving us confidence in the Group's approach to controls and risk and to enable us to recommend the reappointment of PricewaterhouseCoopers LLP. The Committee judge them on the quality of their audit findings, management's response and stakeholder feedback. The Committee check on their independence by making sure they are sufficiently challenging on management. The Committee also set the audit and non-audit fees (see page 83) and make sure that our auditor engagement policy (a copy of which is on our website) is adhered to when commissioning non-audit work. Audit partner rotation is important to retain the objectivity of the process – Stuart Watson was appointed lead audit engagement partner in 2008/09.

## **Assurance**

On behalf of the Board, the Audit Committee examines the effectiveness of the Group's:

- systems of internal control, primarily through approving the internal audit plan and reviewing its

findings, reviews of the annual and half year financial statements and a review of the nature, scope and reports of external audit;

- management of risk by reviewing evidence of risk assessment activity and an internal audit report on the process; and
- action taken or to be taken to manage critical risks or to remedy any control failings or weaknesses identified.

The Audit Committee has completed its review of the effectiveness of the Group's systems of internal control during the year, which are in compliance with the Turnbull Guidance 2005. It confirms the necessary action plans to remedy identified weaknesses in internal control are in place and have been throughout the year.

Internal audit's work is focused on areas of priority as identified by the Group Risk Profile and in accordance with an annual audit plan approved each year by the Audit Committee and by the Board. The Board receives a full report from internal audit each year on the department's work and findings and regular interim updates on specific issues. The Audit Committee monitors and assesses the role and effectiveness of the internal audit function on behalf of the Board.

The external auditors are engaged to express an opinion on the financial statements. They review and test the systems of internal financial control and the data contained in the financial statements to the extent necessary to express their audit opinion. They discuss with management the reporting of operational results and the financial position of the Group and present their findings to the Audit Committee.

## **D. RELATIONS WITH SHAREHOLDERS**

*D.1 Dialogue with Institutional Shareholders: There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.*

### **Communication**

We are committed to ongoing engagement with shareholders and have a well established cycle of communication based on the Group's financial reporting calendar. This includes our preliminary results in May, Annual Report in June, half year results in November and interim management statements in January and July.

We consider ourselves fortunate that many of our institutional investors are willing to make time for open dialogue throughout the year. The introduction of the Stewardship Code in 2010 is also a welcome development to encourage institutional shareholders to engage. We truly believe that continued engagement will build greater understanding of views, opinions and concerns, which is beneficial to all. There will always be a wide diversity of opinion amongst investor groups. However, we believe we all share the same goal: for M&S to be a market leading, sustainable, profitable business.

Our website provides up-to-date information including simultaneous webcasts of our financial results and AGM presentations; regulatory announcements; Annual Reports; corporate governance and share price information and answers to frequently asked questions. The website is now our principal means of communicating with investors.

## **Institutional Investors**

Since joining the business in October 2010 Robert Swannell has met with many investors and shareholder representatives. Steven Holliday (Remuneration Committee Chairman) and/or Amanda Mellor (Group Secretary) also met with many investors and shareholder representatives as part of the consultation process on the changes to the senior executive remuneration framework. We have listened to investors' comments and these are always then fed back to the Board and its Committees. Marc Bolland, Alan Stewart and our investor relations team met with representatives from over 221 investment institutions during the year to keep them updated on performance. These ranged from one-on-one meetings to group presentations.

For an independent view from investors, the Board retains the services of Makinson Cowell, the capital markets advisory firm. Makinson Cowell provides the Board with an annual presentation of major investors' views on Company management and performance, based on results of surveys and extensive interviews. This survey also helps to keep our investor relations programme on track.

## **Private Investors**

Private investors represent more than 95% of the shareholders on our share register so we are mindful of the need to engage with them regularly. We continue to provide shareholder feedback cards with our Annual Report documents. Responses to these are summarised and passed to the Board and the head of each business area. Our Chairman addresses the top three topics at the AGM. Shareholders can also email the Chairman with their comments, write to us or telephone our helpline.

We actively encourage our private shareholders to become more informed investors. By providing us with their email address we are able to email them when trading updates are added to our website. In line with our Plan A objectives, we were keen to reduce the amount of paper sent to shareholders. In February we mailed shareholders who were receiving the Annual Report or the Annual Review and offered them 10% off their next online purchase if they opted to receive information electronically. We recognise that not all our shareholders are online, so we suggested they receive our smaller M&S 'At a glance' booklet instead which is published with the private investor in mind. We were delighted that investors responded positively to this engagement.

We remained committed to our 'lost shareholder' programme returning further shares and unclaimed dividends to shareholders who had failed to keep their details up to date. This is an industry-wide challenge and M&S has been very much at the forefront in repatriating these holdings. Despite all our efforts, however, there are some instances where we are not able to find the shareholder. If we are confident we have done all we can to find them, and they have been gone from the address we have for them for more than 12 years, their dividends and shares are forfeited and used for good causes. This year the forfeiture has helped fund the relocation of the M&S Company Archive.

**D.1.1** Our Chairman, Deputy Chairman, Chief Executive, Chief Finance Officer and Group Secretary play key roles in our relationship with major shareholders and all executive directors attend our full and half year results presentations. The Senior Independent Director is also available for shareholders as required.

**D.1.2** As noted above, the Board is regularly updated on the views of our major shareholders by the Chairman following meetings they have with him, the Deputy Chairman, the Chief Executive, Chief Finance Officer, Group Secretary or Investor Relations. Independent feedback is also provided on Investor relations by Makinson Cowell.

*D.2 Constructive use of the AGM: The board should use the AGM to communicate with investors and to encourage their participation.*

Our AGM is the best attended of all the FTSE 100 companies, attracting 2,000 people last year and another 250 joining via our live webcast. The meeting begins with a business presentation, followed by a question and answer session led by the Chairman. Voting on the resolutions is then conducted by electronic poll, which gives a democratic result of all shares represented on the day and those lodged before the meeting. The indicative result is screened at the meeting with the final results announced via the London Stock Exchange. Shareholders who are not able to attend are encouraged to vote online in advance of the meeting at [sharevote.co.uk](http://sharevote.co.uk) or using the proxy card that we mail to them. In 2010, 94% of the proxy votes received were logged electronically through the CREST system.

The Notice of Meeting sets out the 23 resolutions being proposed at the AGM on 13 July 2011. Last year all resolutions were passed, with votes ranging from 85.7% to 99.9%,

**D.2.1** Since 2004 voting at the meeting has been conducted by poll, using the electronic Votenow system, rather than a show of hands. All resolutions are voted separately using three way voting – shareholders can either vote for, vote against or withhold their vote on a resolution.

**D.2.2** Our registrars record all proxy votes received up to 48 hours prior to our AGM and report the votes 'For', 'Against' or 'Vote Withheld' to the Chairman prior to the meeting. These votes are included in the indicative poll result screened at the meeting. The final results are announced via the London Stock Exchange and shown on our website.

**D.2.3** The 2010 AGM was attended by all directors, including the Chairman of the Audit Committee (Jeremy Darroch), Remuneration Committee (Steven Holliday) and Nomination & Governance Committee (Sir David Michels), who were available for questions. On 4 January 2011 Robert Swannell became Chairman of the Nomination & Governance Committee, replacing Sir David Michels, who remains as a Committee member.

**D.2.4** The Notice of Meeting and related papers for the AGM are sent to shareholders at least 20 working days before the meeting.

## **PENSION SCHEMES GOVERNANCE**

The Group operates a pension scheme which has a defined benefit ('DB') section for all employees with an appointment date prior to 1 April 2002 and a defined contribution ('DC') section open to those joining the Company on or after 1 April 2002. More information is given in note 11 on pages 87 to 90. The Board of the Pension Trust ('Trustee Board') manages the DB and DC assets of the pension scheme, which are held under trust separately from those of the Group. The Board has four main committees: DB, DC, Investment and Actuarial Valuation. The Actuarial Valuation Committee meets only during times of planning and finalising the triennial funding review or more frequently if there are additional valuations.

The Trustee Board comprises Graham Oakley as independent Chairman, who replaced Tony Watson following his retirement on 1 April 2011, and Law Debenture Trust as independent Trustee, together with five Company representatives and five member representatives (Member Nominated Trustees – 'MNTs'). On 1 April there

were two new Company representatives and one new MNT. A further MNT was confirmed in post for a second five year term. MNTs are appointed through a selection process.

The Trustee Board has a business plan and at the start of each year reviews performance against the plan and objectives from the previous year in addition to agreeing its objectives and associated budget for the current year. The Trustee Board is committed to clear member communication and has a communications strategy and plan which is reviewed at least annually.

During the year the pension scheme received several commendations including a Professional Pensions award for Best Benefit Statement. The Trustee Board also has a risk register and associated action plan, a conflicts of interest policy and a register and code of ethics, all of which are reviewed at least annually. A Board effectiveness review takes place each year and each Trustee Board Director has an individual training plan, which is based on the Pension Regulator's Trustee Knowledge and Understanding requirements and tailored to any skill gaps and specific committee roles. Eight Trustee Board members hold the Pensions Management Institute Award in Trusteeship and the new appointees are encouraged to join them.

All advisers, investment managers and suppliers are appointed through a rigorous tender process. They are monitored via quarterly reports and periodic meetings. There is a rolling programme of adviser reviews with an informal review annually and a formal review every three to five years. During 2010/11 the appointment of the Scheme Actuary and Investment Adviser were reviewed and the existing advisers, Towers Watson, were retained.

The 2009 valuation was finalised in May 2010 and was followed by a project to introduce a new style of asset allocation monitoring which facilitates ongoing assessment of the investment strategy within established risk parameters. It is intended that this will provide enhanced measurement of key metrics for both Company and Trustee Board between valuations.

During the year the Scheme became a signatory to the UN Principles for Responsible Investment. The Trustee employs a specialist engagement service, Hermes Equity Ownership Services, to enhance stewardship and governance oversight of companies in which the scheme invests. The Scheme has also committed to become a signatory to the UK Stewardship Code which was published by the Financial Reporting Council in July 2010. The DC section is a holder of the National Association of Pensions Funds Pensions Quality Mark Plus.