GOVERNANCE

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Improving the framework of UK CG

'So the Government should not squander this opportunity by focusing on some of the symptoms of the problem but rather address the fundamental issues which are concerned not with developing yet more rules (we have a good UK Corporate Governance Code) but in improving the behaviour of directors and boards.'

Gerry Brown

How to be a good non-exec

'Knowing how to conduct yourself at a board meeting is an art-form. Boards are living organisms, with the relationships between the members crucial in determining whether they function as effective units.'

Brian Quinn

Content

Essential, Authoritative Analysis and Opinion for Board Directors, Senior Executives, Investment Professionals and Advisers

Feature

Improving the framework of UK CG

Gerry Brown puts forward some suggestions in the light of the UK Government's Green Paper on corporate governance.

The Government should be congratulated on its initiative to improve the framework of Corporate Governance for business in the UK. The issues identified for consultation in the Green Paper are important matters to be improved.

However, a much broader approach is required if the Government is to make a real difference to the problem.

A review of many company corporate governance abuses in the recent past, eg Royal Bank of Scotland, Barclays, HSBC, Tesco, BHS, Sports Direct, BP, Rolls Royce, Sky, GSK and BT to name a few, show that the main issues associated with inadequate corporate governance are much broader than the Green Paper suggests. They include for example tax evasion, bribery, corruption, accounting irregularities, price-fixing and mis-selling etc.

All of these continue to happen despite the six enquiries from Cadbury to Walker and the resultant strengthened UK Corporate Governance Code.

What is needed is action to really improve boardroom behaviour, which is the real issue rather than focusing too much attention on the symptoms however important, for example abuses in executive pay.

The crucial role of directors as the stewards of companies, for the longer term benefit of us all, needs to be given much more attention. The evidence is that too many listed company boards are focused on the short-term, on legal issues and monitoring of performance at the expense of truly examining how the board can really add value to the company. Boards need to be much more in touch with the organisation and its culture in order to make governance work effectively.

We also need to take notice of developments in corporate governance around the world if we are not to be left behind, especially with regard to increasing the professionalism of directors.

Expecting investors to radically change their behaviour and to become much more concerned about corporate governance issues in public companies in a sustainable way is unrealistic. Much of the Green Paper is about empowering shareholders to fulfil a governance role. However, ultimately it is better boards that will make the real difference. Hence the Government's corporate governance policy needs a change of focus.

Fundamentally the responsibility for the governance of companies and avoiding the many scandals including abuses in executive remuneration lies with the company boards and their directors. So action should be focused on how to improve their effectiveness.

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Some of the initiatives required include: increasing the diversity of boards; selecting the best candidates; appointing excellent chairpersons; enhancing the performance of board committees; improving board evaluation and a greater involvement of investors in the companies in which they invest.

For example, concerning the diversity of board members, there is strong evidence that board performance is better with a more diverse board. Indeed the Chairman of the FRC is quoted as saying 'Diversity of background and experience not only encourages better leadership and governance but also contributes to all round board and management performance'.

However, recent surveys by search consultants show that the UK went backwards last year, the proportion of new board appointments who were women has dropped. Globally, the fact is that 96 per cent of chair positions are filled by men.

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With regard to selecting the best candidates for board appointments recent surveys by search consultants show that too often no proper search process is followed to find the best candidate and friends of the CEO or the chairman are appointed despite the guidance to the contrary in the UK Corporate Governance Code.

Then too with regard to board evaluation recent evidence is that only 20 per cent are effective and where an evaluation is carried out, it is largely only shared with board members. It should be mandatory that annual board evaluations are carried out and that it should not just be a box ticking exercise but reach into the culture, experience and behaviours necessary for the board to perform at its best. There should be much more transparency, for example it should be shared with investors and published in the Annual Report.

There is a real need to spread best practice in how to improve board performance and companies should be required to publish a board improvement action plan.

Boards are made up of individual board members, urgent action is needed to improve the effectiveness of individual directors.

In all other professions – such as law, accountancy, engineering, dentistry, medicine, teaching – it is necessary for practitioners to be appropriately trained and to pass qualifications. The benefits of this approach in promoting and achieving professional standards has long been recognised.

Accordingly it is proposed that directors should be required to be professionally qualified, initially for directors of listed companies. Then steps should be taken to investigate the establishment of a professional body for qualified company directors. The professional training of directors could be provided by a range of institutions but we have some of the leading business schools in the world and they could play a key role in spreading best practice in the governance of companies.

Lastly, the independent directors on boards should be expected to be the long-term custodians of companies and there needs to be much greater emphasis on this aspect of their role. Some early actions that could be taken include:

- Requirement for companies to publish their board improvement plans resulting from board evaluation so that they would be more committed to, for example, improving board diversity and more training for board members.
- The FRC to be more rigorous in enforcing the Code requirement for all board appointments to follow a proper selection process.
- Change the legal title of non-executive directors to independent directors to better describe their stewardship role which is to ensure that companies are managed in the best interest of all stakeholders not just shareholders but employees, customers and society at large.
- Requirement that all newly appointed independent directors attend an accredited training programme to cover their stewardship responsibilities in relation to the board, strategy, globalization, risk management, use of advisers, relations with executives.
- All newly appointed chairs of committees eg Remuneration Committee to receive specific training.
- Before companies can list the boards must be properly trained in all the implications of being a listed company (the current AIM programme needs to be considerably enhanced).
- Convene a gathering of interested parties to develop a comprehensive plan to really improve the professionalism of board directors, eg The Institute of Directors who have their Chartered Director programme and the Financial Times NED Directors' Club who have their Diploma.

The Green Paper presents a unique and timely opportunity for the Government to set an improved and enhanced framework for the governance of companies. The consequences of failing to act in the comprehensive way outlined above will be that company scandals will continue with the resulting reductions in company values (fines for the banking sector total £160bn to date), increased unemployment, reductions in the value of pension funds (total deficit is £459bn), the cost of taxpayer funded bailouts (eg RBS £55bn) and an increasing disillusionment of the electorate.

So the Government should not squander this opportunity by focusing on some of the symptoms of the problem but rather address the fundamental issues which are concerned not with developing yet more rules (we have a good UK Corporate Governance Code) but in improving the behaviour of directors and boards.

As we encounter the post Brexit business world UK plc needs every competitive advantage it can find. Having the most professional boards and directors in the world should be at the forefront.

Gerry Brown is an experienced chairman and independent director. He is author of 'The Independent Director : The Non-Executive Guide to Effective Board Presence' (published by Palgrave Macmillan) and a Visiting Fellow at Henley Business School. He is an Associate of Critical Eye, Fellow of The Institute of Directors and Council Member of the University of Exeter.