Feature

The crisis of governance

Gerry Brown has studied the recent BEIS White Paper and found it wanting. He argues that what UK governance needs is not more consultation but proper implementation and enforcement of the existing regime.

The crisis of governance is a real problem that affects us all. Wherever you choose to look there is a crisis of governance with many and various governance challenges. The businesses we work for as well as many other institutions we depend on are only as effective as their governance. All too often, as the ongoing litany of scandals and bankruptcies in the public, private and third sectors shows, governance is being challenged and sometimes failing. And often failing badly.

Many of the crises that come to public attention do so when it is too late. These failures often involve significant financial sums so, understandably, the sheer size of these numbers attracts media and government attention to police the situation. Inevitably, of course, once the financial elephant has run away from the company accounts circus, it is already way too late to prevent meaningful damage.

Though proclaiming himself as the Minister most likely to stop further scandalous damage by the herd, the recently mooted Kwasi Kwarteng White Paper *(Restoring Trust in Audit and Corporate Governance)* appears to still want to fail to catch these metaphorical runaway business elephants. But, instead, still be seen to be doing something and vaguely consulting about it too. Like so many before him, Mr Kwarteng looks likely to settle for some additional eye-catching headline snatching initiatives – doubtless gussied up with flimsy extra red tape – rather than bother with the less glamorous but more effective grind of enforcing existing corporate governance regulations.

Clearly, it should go without saying that it is important to avoid shareholders, customers, the workforce, patrons and – most importantly but most frequently overlooked – the wider community bearing the exogeneous cost burdens of corporate governance failures and, instead, to hold company directors responsible. Indeed, looking to find some positives from Kwarteng's White Paper, these proposals laudably include 'Malus and clawback clauses' designed to penalise companies that fail or get embroiled in scandals as well as some attention-grabbing signals about a welcome review of the audit and accounting regulatory and supervisory body. Nevertheless, toothless enforcement against the company directors responsible for scandals and bother still looks likely to remain the order of the day and plague the future nearly as much as it does the present.

Though I hold no mandate for accounting forms of any stripe, consulting over re-arranging the organisational structure and seating plans of the present accounting regulator with additional emphasis upon financial reporting issues via this White Paper focuses on the symptoms of the problems and, thereby, sets aside the chance to influence circumstances at source. To switch and mix my metaphors, if unexpectedly heavy rain sees our rivers swell then only addressing the deluge at the points downstream where water bursts the banks misses the upstream opportunities to prevent and mitigate damage. As currently presented, the Kwarteng White Paper prefers to only wade onto the flooded plain and ignores so many other very important corporate governance issues. If choosing our approach better, it is clear that we do not need more rules downstream especially since we already have a good UK Corporate Governance Code on the statute book to govern and enforce boardroom behaviour and practice.

Of course, there is a rich tradition of government ministers responding to real or imagined business malfeasance and corporate scandals by commissioning reports – especially in the area of corporate governance – as well as endlessly defining and re-defining the roles of directors and non-execs. These changes are either delivered with sound and fury or tremulous whispers but, invariably, accomplish more or less the same thing. Namely, little or nothing beyond unintended effects while still leaving many of the key issues either unresolved or without effective legislative teeth. Any brief history of these committees and reports must include mention of the Cadbury Report (1992), the Greenbury Report (1996), the Hampel Report (1998), the Higgs Report (2003), the Walker Report (2009) and the Code of Corporate Governance (2012).

With Treasury bookshelves already heaving with these official Audit Reports and Corporate Governance Reviews aplenty, properly functioning audit committees as well as the enforcement of existing substantial guardrails and safe-guards that already appear on the Companies Act statute book and the Combined Code would be a both quicker and more effective solution than the delay of further consultation over this latest White Paper. I would suggest that the following measures (below) honour the direction and analysis of the original Greenbury Report. Though nearly three decades old now, the suggested measures, improvements and recommendations remain – in most part – still relevant today. These measures include:

- Requirement for companies to publish their board improvement plans resulting from board evaluation so that they would be more committed to, for example, improve 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 role.

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Other notable Greenbury recommendations, based upon best company practice largely arising from the work of the Cadbury Committee, included that the roles of Chair and Chief Executive should be separate to avoid undue concentration of power; that all boards should require a minimum of three non-execs and that these non-execs should be selected by a formal process; remuneration committee memberships should be made up of independent non-execs, while the Chair of the committee should also be a non-exec. Looking at one aspect of the numbers that so attract Mr Kwarteng's attention, audit committees should consist of at least three independent non-execs. It would be helpful to better corporate governance if one-third of the entire board retired annually by rotation and that the Annual Report should state reasons for retaining any directors aged over 70 at the time of their election/re-election.

Having written about these matters, I need no further persuasion that company boards constituted obeying basic good governance principles and practices with properly trained and effective independent non-execs are much more likely to avoid financial elephants leaving the circus to run amok and trample our good governance forests. Or, if you prefer, fast flowing waterfalls and rivers overwhelming the communities downstream. It should be obvious that if Mr Kwarteng stopped holding his telescope the wrong way round or glance up at the departmental bookshelves, he might instead decide to insist upon greater enforcement of the existing powers and legislation.

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It is all too easy for less diligent companies to over pay executives, gift egregious dividend payments or file erroneous annual accounts at Companies House with little fear of examination or prosecution. The number of times company directors have been remanded in custody at Her Majesty's Pleasure for business scandals is pitiful in comparison to instances where the threat of some actual time in the chokey might have taken the edge off or stopped some of the more outlandish boardroom activities, actions and behaviours. To quote a recent *Financial Times* leader ‘If the UK is to tackle the mountain of fraud forecast as a result of the pandemic and government support the Serious Fraud Office needs to raise its game and the government should give it the legal tools it needs to get past the foothills’.

Recent research undertaken by Henley Business School could provide food for thought for Secretary of State for Business, Energy and Industrial Strategy Kwarteng. Their already drafted key recommendations include: more and better training for independent directors so they are better able to carry out their complex and vital jobs; the need for all directors to be professionally qualified including a special qualification for independent directors; better, more professional approaches to selection and recruitment; increasing board diversity, with particular emphasis on BAME and disabled recruitment, but also greater diversity of background, experience and mindset.

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Though historically a contentious topic of debate, HBS advocate remuneration for all independent directors, including in the voluntary sector, to increase participation by people who are at present deterred because they cannot afford it or cannot spare the time. Along with self-development for directors and especially for Chairs, to ensure they are effective in their roles. Whatever aspect of the corporate governance of business life Kwasi Kwarteng wishes to consider, there already exists a welter of practical solutions on hand to quickly implement.

Finally, while the proof is going to be in the pudding when it comes to this White Paper, I would also question the value of yet more cumbersome and bureaucratic processes which just result in more stifling box ticking red tape and do nothing to help the UK become an even more attractive location for international business. Despite Kwasi Kwarteng's best intentions going down this White Paper route, even if he achieves his stated aims the likeliest result is going to be grand-sounding after the event, gentle taps on the wrists with a few extra new compliance boxes to tick rather than any root and branch reform of corporate governance behaviour of boards of directors.

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