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The value of governance

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The role of the company in society

At one time – indeed until 1980s - prevailing view was that the role of a company was to make money for its owners, and nothing else.

But – it's more complicated than that:

As well as being required to make money, companies must conform to:

- the laws/regulations of the society in which they operate
- the ethical norms of that society – they need a licence to operate

Otherwise they will be liable to legal and moral sanctions.

The role of the company in society

Why is this?

The owners of the company – the shareholders – and those who control the environment in which the company operates – politicians, press and public – will have differing priorities.

It is simply not tenable to assume that they will all want the same.

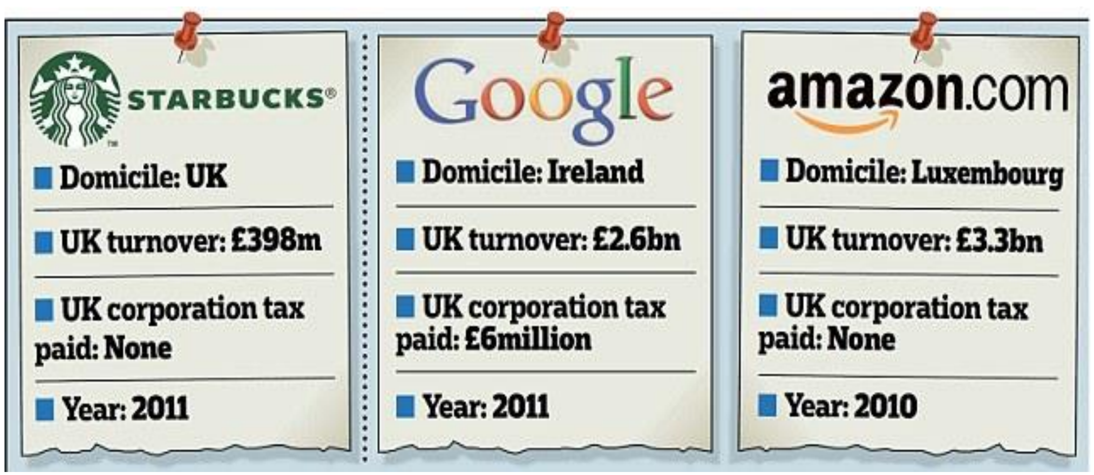
Hence ethical funds/high or low risk investments, etc.

Therefore traditional corporate measures will suit some stakeholders, some of the time: they will never suit all of the stakeholders all of the time.

The role of the company in society

So, company managers must balance conflicting interests of owners, let alone the conflicting interests of regulators, press and public.

As we all become increasingly technically aware – how many here tweet? – these considerations become increasingly important. E.g.



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The role of the company in society

All these companies were the target of significant public campaigns in the UK

The role of the company in society

- Companies’ tax affairs were targeted by protesters
- Loud cries of “It’s not ***fair**!”
- “The idea of a strictly ‘fiduciary’ duty to avoid tax is wholly misconceived....[and] unknown to English law”: Farrer & Co
- Have companies learned? Yes and No

*The new four letter F-word!

The role of the company in society

- Similar issues have affected companies with poor records for working conditions; use of child labour, etc
- Other companies have been affected by Government decisions taken for political reasons or by social campaigns related to climate change, pollution or environmental damage
- So, companies are responsible not just to their owners, but also to a myriad of other stakeholders

Q.1: Is it possible for well-governed companies to fulfil all these responsibilities; and to do so profitably?

Q.2: What do we mean by corporate governance?

Corporate Governance Code

"The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company. "

- Leadership
- Effectiveness
- Accountability
- Remuneration
- Relations with shareholders

Corporate governance

The first version of the UK Corporate Governance Code (the Code) was produced in 1992 by the Cadbury Committee. Its paragraph 2.5 is still the classic definition of the context of the Code:

"Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting."

Corporate governance

Corporate governance is therefore about what the board of a company does and how it sets the values of the company, and is to be distinguished from the day to day operational management of the company by full-time executives.

Not much there that is uncommercial ……

Corporate Governance – Leadership

Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.

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.

The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

- Succession / diversity / split roles

Corporate Governance – Effectiveness

The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

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Corporate Governance – Effectiveness 2

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.

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

- Succession / diversity / tenure / overboarding / evaluation

Corporate Governance – Accountability

The board should present a fair, balanced and understandable assessment of the company's position and prospects.

The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting, risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors.

- Audit Ctte / audit rotation / (integrated) reporting

Corporate Governance – 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.

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.

- Reporting / policy / say on pay / ratios etc

Corporate Governance – Relations ….

……. With 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.

The board should use the AGM to communicate with investors and to encourage their participation.

Stewardship ….. And all of the above

What do you see as the purpose of stewardship? (tick all that apply)

It is about building a mutual understanding of trust between company and institutional investors	85%
It is about shareholders holding boards to account for company performance	73%
It is about enhancing company value and investment returns	46%
It is about getting shareholders to vote and attend meetings with companies	42%
It is about shareholders raising environmental social and governance (ESG) issues	25%
None of the above	2%
Other …please explain* * About ensuring good governance and management of companies for the benefit of shareholders and broader stakeholder groups	2%

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Do you see investor stewardship as (tick all that apply)….

An essential part of the legal structure through which public companies are governed and controlled	67%
Promoting the interests of your shareholders/beneficial owners	62%
Promoting the interests of the company	35%
A public duty	23%
None of the above	2%
Other …please explain* * When engaged with properly it enhances communication between a company and its shareholders. It is an unnecessary burden	4%

Should asset managers that clearly demonstrate they comply with the code to a high standard: be recognized in some way?

Yes	67%
No	33%

"Industry recognition they can advertise...perhaps a modern day version of a kite mark"

"The FRC could give a Commitment to Stewardship Award to those investment houses deemed to take their responsibilities sufficient seriously"

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Has engagement with investors helped you make better decisions?

Not at all	10%
Some of the time	77%
Most of the time	12%
All of the time	2%

Corporate Governance

But is good governance an end in itself?

Enron won various awards for governance, notably from Fortune magazine which dubbed it ‘most innovative company’, and on paper it had a model board of directors.

As did RBS

But were these governance tools effectively applied?

Were the issues that arose simply completely unexpected?

No-one expects a Corporate Governance crisis

Corporate Governance

Well, not entirely perhaps ………

Enron was, largely, a victim of internal malfeasance, but:

- Compensation and performance management systems encouraged a culture obsessed with short-term earnings to maximize bonuses.
- Costs were largely disregarded.
- Risk, whilst subject to sophisticated risk management tools, was ultimately self-hedged.
- Aggressive accounting practices were approved by the board, and in many cases too complex for board members to understand.
- Audit and audit oversight lacked rigour.

Similar considerations plagued some of the UK banks.

Corporate Governance

The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company.

"Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting."

Corporate Governance

So it is about putting in place a set of processes which enable the management to run the business effectively and in a commercial manner.

- Processes which follow the constitution of the company - the agreement between owners and managers as to how managers will exercise their authorities.
- Processes which ensure that the business will comply with relevant law and regulation.
- And which will give due weight to appropriate societal norms.

But processes – we all know they're bad ……. You want to move the business ahead but processes get in the way, they're just a pain in the neck ……..

Comply or Explain

But you don’t have to …..

The UK Corporate Governance Code is based on the principle of “Comply or Explain” - it is not a rigid set of rules, which a smart lawyer might circumvent, but rather principles with supporting provisions which outline the standards that the overwhelming majority of major companies and their investors deem appropriate.

The only requirement is either to say that you comply with the Code or, if you don’t, to explain – clearly, carefully and for good (commercial !) business reasons - why the Code is not appropriate in your case.

So therefore Governance is not the enemy of commerciality, but a tool to help companies be more commercial.

Comply or Explain

57% of FTSE 350 companies now comply with the UK Corporate Governance Code, up from circa 51% over the past three years.

- That is, fully compliant. The other 43% are mostly compliant.
- 85% of those companies that were not fully compliant complied with all but (literally) one or two provisions.
- 61% provided informative explanations (and it is on failures here on which attention will fall in 2014).
- The most common area of non-compliance was in a lack of independent directors on the board.

So do all those companies believe governance is uncommercial?

Source : Grant Thornton Corporate Governance Review 2013

Comply or Explain

No – they understand that governance is an increasingly high-profile requirement of investors.

And so part of the 'price' to be paid for their investment.

There are an increasing number of academic studies demonstrating that well-governed companies have been affected less-badly by economic headwinds.

So in a sense good governance is an insurance policy – proving to those around you that you operate in an appropriate manner and ensuring that you don't go off the rails.

Acting as a seat-belt ….or a brake.

Giving and receiving confidence.

So what has gone wrong?

- Has regulatory compliance dulled sensibilities? You can't be blamed if you can put a "tick in the box"
- Has box ticking compliance impaired ethical judgment? Arguable that it has; people may not think about rights & wrongs of their actions or decisions
- **SO** good insightful governance is not the enemy of commerciality but regulation may be:
  - inherent rigidity of rules.
  - rules try to address yesterday's problems rather than tomorrow's or even today's.

What conclusions may one draw?

It comes back to:

- Organisations need to set clear, well articulated values
- Cascade and instill those values
- Back up with an ethics programme
- Tone set at the top – the power of good examples
- Culture, culture, culture
- People, people, people
- A good company secretary

The governance role of the company secretary

Balancing the interests of different groups –

- Chairman v the SID or other directors
- Chairman v CEO or CEO v Board
- Executive directors v NEDs
- Investors v management; or private v institutional investors

Being a 'wise friend' to them all.

The bearer of unwelcome advice (aka 'The Shot Messenger') –

- Telling Chairman or CEO that he/she lacks the requisite authority.
- Reminding executive directors of undertakings/requests to provide board with data which they are not keen to disclose!

A "jack of all trades" –

- Expected to know what is going on in all key areas of the business.

Conclusions

1. Governance and commerciality are not and should never be at odds.
2. Regulation needs to be more insightful.
3. Ultimately the complexity and issues arise because of us – people!

The role of ICSA

What is ICSA?	**Short answer:** ICSA is the professional body for governance. **Longer answer:** ICSA is the professional body for governance. Our Royal Charter requires us to lead 'effective governance and efficient administration of commerce, industry and public affairs'.
What do you do?	We develop people to be experts in governance across all sectors by providing training and guidance on the legal, ethical and financial requirements for informed decisions at board level. We are a membership body and award chartered status to those who qualify and gain sufficient experience. We work with regulators, policy makers and other stakeholders to develop good practice and provide technical guidance. We also offer publications and software.
What do your members do?	They are responsible for creating and implementing the governance processes that help boards to run their organisations effectively.

The role of ICSA – strategy

To establish ICSA as a centre of excellence and influence providing skills, knowledge and information for governance and compliance professionals.

To support and represent the needs of our Chartered Members, graduates and students and promote their value to employers, regulators and other stakeholders.

The role of ICSA

Increase awareness and recognition of ICSA

- Rebranding exercise 2014
- Raising public profile
  - Focus on press activity eg Bellwether / other research
  - Content – use of blogs / social media etc
- Policy activity
  - Bellwether
  - Academic Research
  - Government / Regulatory / Market engagement
  - Consultation responses

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The role of ICSA

Increase awareness and recognition of ICSA

Developing positions and giving opinion on governance issues to establish wider recognition of ICSA as the home of good governance and of company secretaries as the providers of good governance.

- The value and relevance of a Company Secretary
- The requirement for a Company Secretary in all companies
- Culture
- Stewardship
- Board effectiveness
- Diversity
- Remuneration etc.

The role of ICSA

Develop a wider range of qualifications, awards and training products

- Chartered Secretaries Qualifying Scheme.
  - One of the most broad-based professional qualifying schemes available.
  - Revised in 2010 – now under review.
- A wider range of market-led education and training products.
- Expand programme of short training courses.
- Review international finance qualifications.

The role of ICSA

Develop a wider range of qualifications, awards and training products

Support Chartered Members and students

- Company Secretary Development Programme.
  - Residential programme or one-day courses.
  - Leadership development; strategic and influencing skills.
- Designed for senior company secretaries and deputies looking to take the next steps in their career.

www.icsa.org.uk/residential

The role of ICSA

Support Chartered Members and students

- Continue to develop additional support for students (e.g. revision webinars, study skills support)
- Fortnightly Technical Briefings
- Enhanced website
- Upgrading the Members in Public Practice scheme
  - Providing creative and promotional services.

Find out more

Visit www.icsa.org.uk for a full overview of our products and services, and how to become a member.

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Thank you

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