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The Importance of **Good Corporate Governance**

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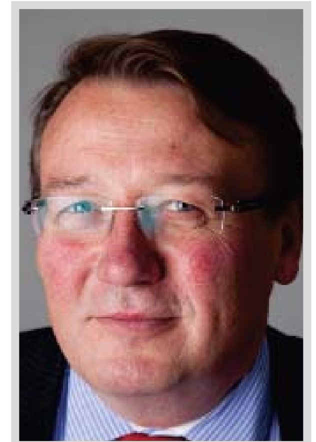

Good corporate governance is vital to building respect in business, to encouraging inward investment and the running of successful economies. Put simply, if businesses are not respected, they will not be trusted. In a world of increased globalization and the rise of social media, important issues such as climate change, working conditions, behavioral issues like sexual harassment and bullying, diversity, corruption and aggressive tax strategies are all lightning conditions which can instantly destroy the value of a brand, reputation and trust. Trust can be hard to build yet incredibly easy to lose.

Across the business world, the importance of Environmental, Social and Governance factors (ESG) now plays an important role in earning or hindering business trust. Many investor participants to a recent FRC project noted Boards and management gain credibility when they are willing to discuss and disclose what they are doing on ESG matters. In my view the involvement of the Board in tackling ESG factors is critical.

Revised UK Corporate Governance Code

In 2018, the FRC updated its Guidance on Board Effectiveness alongside a revised UK Corporate Governance Code. This was designed to stimulate Boards' thinking about how they can better carry out their role and improve their effectiveness. The review of the UK Corporate Governance Code was inspired in part by concerns that public trust in business was low, and a growing impression that businesses weren't paying enough attention to the impact they were having on society and the environment.

The new Code places significant emphasis on the need for Boards to take into account the interests of all key stakeholders, the importance of long-term value creation and developing a culture that supports this longer-term vision. The Code requires Boards to decide what type of behaviour and culture they wish to promote in order to deliver their business strategy. Since behaviour and values must run through the whole organization, that requires advocacy and monitoring from the Board.

The ongoing success of a company and its culture are directly linked to diversity and succession planning. The new Code calls on Boards to consider and understand 'how diversity and effective succession planning helps in achieving their strategy and promote long-term value'. 'Overboarding', where directors take on too many roles, Directors who overstay their useful length of service, Board refreshment, succession planning and diversity are also addressed in the new Code. The Code sets out a Chair's length of service should be restricted to nine years, subject to 'comply or explain', the same as that of non-executive directors.

The Code also introduces alternatives for engaging with the workforce. Employees should be satisfied that their views have been taken account of in key decision making.

Executive pay is a very emotive issue and the Code sets out how Boards need to be transparent about their pay policies and ensure they are linked to company culture and behaviour. The new Code also strengthened the role of the remuneration committee which should work to simplify the structure of remuneration policy. Simpler structures help reduce the reliance on consultants, and they improve direct communication with shareholders and the workforce.

At present, investors feel there isn't enough information about how Boards decide their sustainability strategies and have asked for more data on issues like climate change. It is a defining issue of our time and presents far-reaching risks. The FRC's expectation in this area is clear - Boards should address and, where relevant, report on the effects of climate change. Reporting should set out how a company has considered the resilience of its business model, including the risks, uncertainties and viability in both the immediate and longer-term. Reporting should also set out how a company intends to respond to climate change, and how climate change has been considered in its strategic planning.

An important role of Boards is to regularly challenge the views of the CEO and the Executive Committee. Groupthink should not influence how key decisions are made and successful

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Boards should not be comfortable places all the time. The Code promotes constructive challenge in the boardroom. Only through effective debate can issues be resolved.

An effective Board defines the company's purpose and then sets a strategy to deliver it. A well-defined purpose will help companies articulate their business model, and develop their strategy, operating practices and approach to risk. Companies with a clear purpose find it easier to engage with their workforce, gain the support of customers, and the respect of the wider public.

While measuring corporate culture isn't an exact science, there is plenty of information Boards have at their disposal to ensure they have their finger on the pulse. Employee surveys, exit interviews, whistleblowing reports and their outcomes, net promoter scores, and staff turnover rates are examples of what can be used as benchmarks for corporate culture. This data is often already readily available in the database of corporations and is not an additional burden. It is simply not made enough use of.

New and Strengthened UK Stewardship Code

The FRC recently published a new and substantially strengthened UK Stewardship Code which improves standards for how money is invested on behalf of UK savers and pensioners. It has established a clear benchmark for the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries.

The new Code, which takes effect on January 01, 2020, is a vital part of the comprehensive revision of the UK's world leading corporate governance framework. It reflects the changing expectations of investors and the significant developments in sustainable and responsible investment, since the Code was last revised in 2012.

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It focuses on protecting the interests of UK savers and pensioners by ensuring their money is managed responsibly with a new emphasis on creating long-term value.

Key changes in the new Code include a widening of asset classes, to include asset owners, pension funds, insurance companies, and service providers as well as asset managers.

Signatories will be expected to report annually on their stewardship activities and crucially, their outcomes. This will include their engagement with their investments, their voting records and how they have protected and enhanced the value of those investments.

Signatories will also be expected to take environmental, social and governance factors, including climate change, into account, ensuring their investment decisions are aligned with the needs of their clients.

The new Code will enhance the UK's position as a destination for long-term, sustainable investment and promote transparency and integrity in business bringing with it wider benefits for the economy, the environment and society.

Wates Principles for Large Private Companies

A further piece of the Corporate Governance jigsaw is the Wates Principles, designed for private and non-listed companies.

The principles provide a framework for companies to consider their own approach to corporate governance. Signatories are encouraged to take into account their own particular circumstances and should not be reluctant to copy what they consider best practice from publicly-listed companies.

The Principles are not intended to be a burden, but rather an opportunity to showcase what private companies are doing to demonstrate the vital role they play in our society. These companies provide an enormous contribution in terms of turnover, tax and jobs.

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The Wates Principles also create a platform for greater prominence in the overall narrative about a country's openness to business and investment. Larger Private Companies will begin to report on their governance arrangements from 2020.

This is a long-term project and like the UK Corporate Governance Code the Wates Principles will develop over time. History suggests they will do so successfully. The UK Corporate Governance Code is an excellent precedent. It has been in place since 1992 and has evolved from the initial Cadbury Report into a Code which is now renowned across the world.

Conclusion

Effective corporate governance is fundamental to trust in big business. Good governance is not a static concept and must evolve with time.

Directors should regularly be reviewing the effectiveness of their arrangements, testing them against best practice and ensuring they evolve to meet the ever increasing complexity of business and the needs of shareholders. ▪

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