

## **Theme Paper**

# **2014 London Global Convention**

## **Boards to Lead: Effective Corporate Governance and Sustainability**

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Business leaders, opinion formers and policy makers will be assembling this Autumn for the 2014 London Global Convention entitled “Boards to Lead”. Participants will examine both corporate governance and sustainability. The second theme is the most recent of the two. Sustainability has shot to the top of many agendas. The clock is ticking in various arenas from the control of bacteria that are increasingly resistant to our current generation of drugs to finding alternatives for the increasingly rare minerals required by the hardware that underpins much of our way of life.

Sustainability challenges our governance arrangements and board leadership. Will they facilitate and enable the responses that are required to cope with multiple challenges? The individual and collective performance of directors has been an issue since the establishment of limited liability companies resulted in a separation of ownership and control and the appointment of directors.

### **Historical and Recent Concerns**

The competence of directors and the effectiveness of boards has been discussed since the nineteenth century. The first Institute of Directors was formed in the UK in 1903 and incorporated by Royal Charter in 1906. The contribution of directors and boards to the growth and development of companies has been of importance to investors for over 100 years. In our era of uncertainty, great opportunities and enormous challenges it remains a concern. Building an effective team of competent directors can be the key to the future success of a company. It can transform the prospects of a corporate entity in a number of areas from visioning to providing 'new leadership'.

While traditional activities to improve the effectiveness of particular boards and to help directors address the situations and circumstances facing them have continued, since the late 1980s the terms “governance” and “corporate governance” have rapidly gained currency. In reaction to scandals and the conduct of some directors, committees of enquiry have been set up, codes established and general models proposed. Has the effort devoted to this parallel stream of activity been worthwhile? What is governance adding to director development activities? Does it attract too much attention in relation to building better boards? Is it a distraction from other steps that need to be taken to improve board effectiveness or does it complement them and inform development initiatives?

### **Contemporary Impacts and Responsibilities**

Since more attention has been given to governance we have witnessed irresponsible, inappropriate and reckless corporate behaviour that has led to Government bail-outs, reduced growth rates and austerity in many countries. Corporate conduct and behaviour are still under the spotlight. Where were the directors of financial institutions whose lending practices brought time bombs into these organisations and whose activities have resulted in “bankers” being reviled in some countries? The public are paying for their past excesses. How can we prevent this from happening again?

There seems to be a disconnect between conduct and accountability. Have the people who directed

or advised the institutions whose conduct almost brought down the international financial system displayed the competence and judgement one might reasonably expect from experienced and qualified professionals? Despite the harm caused most of those involved have escaped charges of unprofessional conduct. Lay people might ask where were the regulators and reporting accountants?

Regulators and chartered professional bodies and their equivalents exist to protect the public. Why have more people who developed, authorised, packaged, promoted, distributed, valued and reported on the 'toxic' products and practices that caused so much damage and those who assured the processes involved not been investigated? Despite governance failings, risky lending practices and calls for change, disciplinary investigations and resignations are rare. How do we move on from periodically revising worthy statements and codes to actually holding people to account?

### **Taking Stock of What has been Achieved**

Have new priorities and activities associated with "governance" added value or been a displacement activity? Might the effectiveness of boards and the performance of companies have improved far more if the additional time and resource had been devoted to traditional director, board and business development? Alternatively, should we thank pioneers of corporate governance for highlighting the importance of directors and boards and creating wider interest in improving their effectiveness?

Might things have been much worse in the absence of governance and sustainability requirements? Is a silent revolution under-way, the full effects of which are yet to be apparent? Are more corporate policies being implemented? Is there more or less diversity of practice and is this beneficial?

Is governance itself improving or just changing? Is it maturing and what is the nature of its evolution? Is governance becoming more complex like financial reporting? Are we making progress and if so in what directions? Are we filling in a few remaining gaps or are we stuck in the mud? Are boards more relevant and vital? Are they better informed and more effective? Could the effort devoted to governance have been better employed addressing issues like giving those who invest via institutions a voice and encouraging boards to better engage with shareholders?

What are the outcomes of some twenty years of a growing preoccupation with governance? What fresh insights have emerged? What new breakthroughs have occurred? Where is the innovation in boardroom practice? As citizens and investors, do we sleep more comfortably at night or do we await the next corporate scandal or failure with a mixture of cynicism and resignation? Is governance leading to lower levels of favouritism, fraud and corruption? Has it reduced the number of business failures? Is there greater compliance with health, safety and other legislation?

### **Assessing the Direction of Travel**

Where is it all leading? Will a growing web of governance and sustainability codes, regulations, laws and policies impose further costs on business, inhibit responsible risk taking, reduce diversity and strangle new developments at birth? Will board members become so concerned with compliance and playing it safe that they slow progress and end up afraid of their own shadows? Will the default position be a no vote against anything that appears unfamiliar or different?

Questions of cost and unintended consequences should not be ignored. Sometimes the vested interests in additional requirements are easier to identify than the 'customers' who might benefit from them. Do accounting requirements distort decision making? Do boards postpone needed investments or even burn cash to improve what is reported in the next set of accounts?

Producing ever more lengthy, detailed and complex accounts on grounds such as "improving

accountability” or “better reporting” may generate extra revenues for accountants but how much of what is produced is actually read? Are shareholders taking more informed decisions or are they ticking boxes to receive the leaflets or brochures that constitute the shorter versions on offer?

If national and international requirements are not to lead to longer and more complex reports and accounts what can be done to reduce the 'clutter'? One might debate whether taken as a whole an annual report is fair and balanced, but are the weighty tomes produced by some companies understandable to most of the shareholders receiving them? What happened to relevance, economy, simplicity, proportionality, adaptability, flexibility and diversity?

### **Identifying 'Customers' and Assessing Relevance**

Are prevailing approaches too Anglo-Saxon or European? Do developing countries, SMEs and public and voluntary organisations have different requirements? Many Governments around the world are seeking to stimulate enterprise. Is corporate governance relevant to the concerns and priorities of ambitious entrepreneurs and business builders? Do they view it as an enabler or a constraint? How many successful entrepreneurs, pioneers and innovators ascribe their achievements to governance arrangements or even the contributions of their boards?

Who are the de facto 'customers' of governance, sustainability and reporting requirements? Are the main beneficiaries people who are remunerated to develop, assure and advise and comment upon them rather than shareholders? Are the interests of the latter best served by the ever greater complexity of requirements and the growing cost of meeting them? When changes are mooted and consultations occur, are the respondents shareholders or those with a vested interest in regulation?

If shareholders, boards and other business interests do not respond to consultations on governance, sustainability and reporting and/or comment upon proposals and developments in these areas they should not be surprised if what emerges reflects interests other than their own. So what should a board do that wishes to lead and develop approaches that are appropriate for the situation it is in, the challenges and opportunities it faces and the interests of a company's stakeholders?

### **Determining Corporate and Collective Responses**

Given current laws, regulations and codes how much scope is there for board leadership and innovation in the arenas of governance and sustainability? What can an individual company do differently to achieve greater impact and contribute more to successful and sustainable business development? The forthcoming London Global Convention “Boards to Lead: Effective Corporate Governance and Sustainability” is designed to address these and related questions. An annual gathering organised by IOD India which this year celebrates its twenty-fifth anniversary, it represents an opportunity to take stock of what governance, sustainability and related reporting have achieved during this period and consider what the next steps should be?

What needs to be done to make people want governance and sustainability policies and initiatives rather than feel that they ought to have them or have to have them? Can initiatives in these areas be reshaped to increase their beneficial impacts? How should one assess such impacts? If the wrong indicators are being used, what should we be expecting or aiming for? Should governance arrangements be seen as a requirement for successful, sustainable and accountable business development and an arena for practical action rather than the discussion of codes?

In Europe, the European Commission which has failed for many years to have its own accounts signed off by its auditors has agreed a new regulation relating to auditors and audit committees. How should boards manage their relationships with auditors? Should they use the let out and as a

board also carry out the functions of an audit committee as some UK companies do?

### **Areas to Explore**

In relation to the codes of practice, self-regulation, legal and listing requirements which lie at the heart of contemporary governance will we see convergence across jurisdictions or a greater diversity according to local situations, conditions and circumstances? How do various requirements affect boardroom practice and corporate conduct? Which requirements do directors and shareholders find the most and least useful? Where do business ethics come into the picture?

Where do we find governance and sustainability 'best practice'? Is it possible to think of best practice when economic development, business ownership, requirements, conduct and levels of corruption and abuse vary greatly between countries, markets and political and other systems?

Where developments in regulation or the revision of a code occur in some jurisdictions, can one talk in terms of catching up or falling behind? Are there certain trends which could be regarded as an improvement, and if so from what vantage point and from whose perspective? Are distinct regional approaches to governance emerging for reasons as varied as questioning the relevance of aspects of a 'western approach' or a desire for a 'level playing field'?

### **Encouraging Innovation and Responsibility**

Where is the new thinking and innovation in governance? How are developments in information and communications technologies and an increase in connectivity impacting upon governance and the actions of directors and boards? For example, in respect of "investor relations" and shareholder engagement and involvement are boards polling shareholders to obtain their views and reactions?

Why is there not a greater variety of practice? Why are the board meetings of so many companies a largely unchanging monthly ritual? Why don't we see more diversity in agendas, or the number, timing and place of meetings, or in methods of voting and engaging with owners and other stakeholders? An Annual General Meeting may be prescribed, but one could envisage many ways in which it might be organised and conducted. What about virtual meetings, electronic voting and polling shareholders for their views on important issues and the assessment of board performance?

Is the lack of diversity in basic elements of board operation and practice because prevailing approaches represent 'best practice' and an ideal model, or is it because directors do not challenge existing assumptions and suggest alternative approaches? Directors responsibilities may be imposed by legislation, but there are various ways in which many of them could be discharged.

One sometimes meets experienced directors who complain about a mismatch between the voluminous board papers they receive and their understanding of what is happening in areas for which they are responsible. Board members who feel they do not know what is going on should either resign or take immediate and practical steps to become better informed.

Some directors who are pretending to be discharging their responsibilities might have the gravitas, confidence and wardrobe to play the parts of important individuals in stage productions, but new approaches and contemporary technologies could enable most them to obtain much of what they would like on a 'real time' or 24/7 basis. Why are they content to participate in a charade when so much is at stake and many directors have the potential to contribute so much more?

### **Confronting the Costs of Contemporary Approaches**

At previous conventions a succession of speakers have put the case for corporate governance. One might expect those whose jobs, organisations and businesses are dependent upon continuing corporate interest in governance to stress its merits and benefits, but are there also costs? Certain forms of governance and reporting requirements can impose significant burdens upon business. How cost-effective is governance? At what point does it become a barrier or discourage listing?

Have aspects of governance had a negative impact, for example encouraging an overly cautious, negative and compliance mindset in boardrooms as non-executive directors challenge and oppose more open-minded, entrepreneurial and adventurous approaches? Do governance codes inhibit diversity and innovation with alternative forms of board and different models of governance?

If negative consequences are few, is this because in practice contemporary corporate governance as propounded by well meaning people with the best of motives does not impact upon director and board behaviour? Is it an irrelevant distraction? Are indications that companies observing governance codes perform well evidence of an association rather than of cause and effect?

### **Balancing Costs and Benefits**

If one can identify both costs and benefits, how could the former be reduced and the latter increased? Could lighter touch approaches be introduced? If the balance of advantage is relatively modest and governance is harmless, maybe one should not be so concerned that companies are adopting standard models and box-ticking approaches. Is the smart and pragmatic course to satisfy an externally imposed requirement as quickly and as cheaply as possible so that the board can get on with the task of building a successful and sustainable business?

Alternatively, if it is thought that governance does make a difference and add value, why are more boards not doing more than the bare minimum? If a positive impact upon performance and sustainability can be demonstrated, why are companies that operate internationally through a variety of different legal entities not investing more in a diversity of approaches so that each entity has a form of governance that is appropriate to its situation and circumstances?

Are there hidden or associated behavioural benefits from the increased focus upon the competence of directors and the effectiveness of boards that has resulted from the establishment of governance codes and the practices they have encouraged, such as board evaluations? In the absence of corporate governance codes, would as much effort be devoted to selecting new members of boards?

### **Board Evaluations and Characteristics**

Are board evaluations focusing upon the structural aspects of governance or the behaviours of directors? Are they being carried out by people with board experience and informed by an understanding of what the most effective directors and boards do differently? Is an appropriate and relevant balance being struck in terms of focus and the perspectives of different stakeholders?

What does effectiveness mean in the context of board reviews? How much weight is attached to the observance of governance codes as opposed to a board's contribution to the sustainable growth and development of a company in relation to its purpose and vision and the particular challenges and opportunities it faces? What contribution does governance actually make to sustainability?

How should boards handle inter-generational relationships? Some boards with directors drawn from generation X are working through an executive team composed of members of generation Y to influence the conduct of a front-line drawn increasingly from generation Z. Does our approach to governance reflect its generational origins and the preoccupations of its early founders and

advocates rather than the aspirations of generation Z and the ways of operating its members favour?

Is characterising boards of large and listed companies as composed of a narrow, limited and unrepresentative establishment or elite disrespectful of the contributions of some directors and the diversity found on certain boards? Is such a generalisation overly negative, or does the gene pool from which directors are currently being drawn need to be widened? How relevant are our current approaches to governance to the requirements and concerns of family owned businesses, public sector bodies and voluntary and charitable organisations?

### **Identifying Requirements for Change**

What are the leading professions contributing to the ability of directors and boards to handle their responsibilities? For example, in an era of uncertainty, rapid change, discontinuity and black swan events, for how much longer will accountants prepare accounts with single number values that auditors sign off as representing a true and fair view while ignoring confidence accounting?

For over twenty years relatively bureaucratic forms of large company organisation with hard shells have been transitioning to more flexible models composed of networks of relationships that can evolve organically and expand or contract as circumstances dictate or allow. How will or should governance evolve to match changing structural forms and the models of operation that are emerging and address the requirements of virtual and nomadic companies and networks of entities?

In India, Prime Minister Modi has called for less government and more governance. While Chief Minister in Gujarat he took steps to reduce bribery and corruption. Yet for every bribe accepted by a public official one must be offered. How will, could or should corporate behaviour at all levels in India alter as a result of the 2014 election? What changes in legislation and regulation should business leaders campaign for? Should immunity provisions relating to public officials be changed?

### **Addressing Sustainability Concerns and Opportunities**

The twin themes of IOD India's London Global Convention are governance and sustainability. In some companies these are the responsibility of different champions and their teams. Are they distinct areas of operation and concern or do they overlap? Should they be integrated? How should they be handled within the boardroom and how do they relate to corporate social responsibility? Are there governance aspects of sustainability and how sustainable are our current governance arrangements? Should the latter embrace sustainability considerations?

Currently the most visited place on the planet is not a world heritage site or other centre of great cultural, moral or historical significance. It is a shopping mall in Dubai which could be viewed as a monument to aspiration, or as evidence of an infatuation with brands and showing off, depending upon one's point of view. Much of what is on offer at this location and smaller equivalents comes at a huge cost to the environment and suggests sustainable consumption is not a universal priority.

Our ability to damage the environment has increased at an exponential rate, and there is compelling evidence of our impact upon climate change and global warming. Our future prospects and quality of life depend upon the extent to which we innovate and/or show restraint. Views may polarise between green activists, libertarians and advocates of Government intervention? Some may favour making hay where consumption is still possible. How will boards respond? Businesses can exploit current opportunities while resources last, or think longer-term and develop innovative solutions.

Individuals can reign in their excesses, slow down and/or adopt simpler and healthier lifestyles, creating opportunities for entrepreneurs to address their sustainability concerns. Organisations can

act to limit their environmental footprint. Governments can be more responsible in their own activities. They can also use laws, regulations, penalties and incentives to bring about changes they consider desirable. If business leaders do not take appropriate action the State may intervene.

### **Board Leadership and Corporate Action**

Simplification and reducing the number, cost and complexity of corporate initiatives is an important element of 'new leadership' which aims to shift board attention and focus effort upon approaches that simultaneously deliver multiple objectives for people, organisations and the environment. It can be adopted by boards independently of corporate cultures, structures and governance arrangements. Integrated accounting is an example of an approach that can bring together different considerations, activities and outputs into a single and more comprehensive framework. Much will depend upon the detail of what emerges. As implemented, will it increase or reduce the cost of regulation?

The 'new governance' that is associated with 'new leadership' involves a change of emphasis in the boardroom in a number of areas, for example from board structures, strategy formulation and planning to what directors actually do, implementation and intelligent steering. It is more flexible and better able to adapt and evolve as a business grows and requirements change than contemporary approaches to governance. In uncertain and dynamic contexts is the notion of putting in place an ideal or right form of governance and then monitoring compliance a relic of a bygone age?

In relation to governance codes, sustainability and reporting requirements some boards tick boxes and hand 'compliance' to 'experts', such as those found in the team of a company secretary or chief financial officer. In contrast, 'new governance' aims to be more relevant to challenges faced by practising directors and their priorities for innovation and delivering greater customer value, building individual and corporate capabilities, fostering mutually beneficial relationships, generating higher and sustainable returns for investors, and reducing environmental harm.

Commercial organisations have a central and critical role to play in developing imaginative, practical and affordable solutions to environmental, sustainability and other problems. The alternative choices created by entrepreneurs in small businesses, medium sized enterprises and large corporations will determine the quality of life of future generations. Perhaps the acid test for governance practices and board leadership is whether they create the conditions for challenging assumptions, developing innovative responses and enabling breakthroughs to occur. It is vital that boards lead, which is why participation in the IOD's London Global Convention is so important.

### **Author**

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