Governance for Sustainability and the Sustainability of Governance

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What should be the evolving role of the board in an uncertain global economy? What changes are needed in governance arrangements and board practices to accommodate greater diversity, ensure sustainable innovation and enable more confident and flexible responses to new opportunities and mutating risks? What needs to be done for sustainability to become a new business paradigm? These and related issues will be discussed at IOD India's 2016 London Global Convention.

The 16th London Global Convention on Corporate Governance and Sustainability will review the current and emerging roles and responsibilities of directors and boards, and explore ways of enhancing their effectiveness. With corporate governance at a cross roads and facing multiple challenges, the issues, options and opportunities will be explored from a global perspective.

The Future of Boards

Our corporate governance institutions, codes, principles and practices largely derive from reactions to problems encountered by certain quoted companies in particular countries in what now appears a bygone age. Are they sustainable? In the countries in which the first corporate governance reports appeared the number of companies de-listing has exceeded the number of new listings and many of the new entrants require much less investment in physical assets and/or employ far fewer people.

Corporations face multiple threats. Individual consumers can increasingly use on-line platforms to help themselves or connect with other individuals who can help them, whether by giving them a lift or renting a room. As more offerings are bought on-line and/or produced at home or locally by 3D printer, and lifestyles change to accommodate the need for greater sustainability, what will happen to manufacturers, retailers and distribution chains? Will corporate governance experience the decline of corporations and their de-listing, or like a virus will it mutate to find new hosts?

What will boards and boardrooms look like in five, ten or fifteen years? Will the downward trend in the size of boards with significantly fewer executive directors experienced in some jurisdictions continue? Will board composition change in terms of age, gender and nationality? Will boardrooms and monthly meetings be needed as more connected directors deal with issues as and when they arise, and make greater use of conferencing technologies? In a fast moving world, will waiting for the next opportunity to get onto the agenda of a monthly board meeting seem an archaic practice?

Relationships with Stakeholders

In UK company law directors are required to take account of the interests of stakeholders when they take their decisions. However, are increasing levels of CEO and top executive pay and higher loss of office compensation payments an indication that directors are primarily concerned with their own interests? To mix metaphors, are many directors feathering their nests while they have their snouts in the trough? Was the rejection by BP shareholders of a pay package proposed for the company's chief executive a foretaste of greater shareholder activism and proxy wars to come?

Customers represent an important stakeholder group. Without their continuing support a business cannot survive, while for many customers what happens to their suppliers is of great significance. For some, their purchases can be a matter of life or death. Many activities, operations and associated jobs are dependent upon bought in raw materials, components, supplies or services.

Judging by the problems customers often experience when trying to speak to someone about an issue, companies seem to take their money and then keep them at arms length. In place of head-office teams suggesting what customers might want, should more companies ask them, track their responses and follow what they do in real time? How many CEOs who talk about the importance of the customers whose purchases pay their salaries seek to involve them in the governance process?

Boards in the Political Spotlight

If directors do not respond to investor and public concerns, politicians and others may question and seek to change governance arrangements. In a speech in Birmingham before becoming UK Prime Minister, Theresa May said: “I want to see changes in the way that big business is governed. The people who run big businesses are supposed to be accountable to outsiders, to non-executive directors, who are supposed to ask the difficult questions, think about the long-term and defend the interests of shareholders. In practice, they are drawn from the same, narrow social and professional circles as the executive team and – as we have seen time and time again – the scrutiny they provide is just not good enough. So if I’m Prime Minister, we’re going to change that system – and we’re going to have not just consumers represented on company boards, but employees as well. ”

As Home Secretary Theresa May attended, spoke and presented Golden Peacock Awards at IOD India's London Global Convention. After discussing excessive executive pay and individual and corporate tax avoidance during her speech in Birmingham she concluded: “It is not anti-business to suggest that big business needs to change. Better governance will help these companies to take better decisions, for their own long-term benefit and that of the economy overall. ”

What should “better governance” look like? Will independent directors challenge governance practices? Are they on boards just because of legal, listing or code of practice requirements? Will they come to be regarded as more or less valuable? Might the mood shift to making arrangements for independent and objective advice to be sought whenever important board decisions have to be taken? Much will depend upon the extent to which independent and executive directors understand each others role, duties and distinct perspectives and contributions.

Board Committees and Structures

What will happen to board committees? Where time allows, reference of a matter to the relevant committee can enable a fuller discussion than might be possible with a crowded main board agenda. On the other hand, referral can result in a matter being deferred until a committee reports back. Care needs to be taken to ensure that directors do not abrogate their ultimate responsibility and become too reliant upon sub-sets of directors who attend particular committee meetings.

Many boards only establish the committees prescribed in law or a corporate governance code. Would these be justifiable if such requirements did not exist? What other committees might be helpful? Would a committees, perhaps set up on an ad hoc basis to review a strategy or establish policy in new areas, allow time for a wider range of inputs to be sought?

What about sustainability, or the investigation of an issue on which viewpoints might differ and there is much evidence to examine and/or stakeholder views to canvas, such as whether or not to de-merge or move a corporate headquarters or registered office? Is this a matter for executive management or a single expert to advise on, or should a group of directors consider options?

Remuneration Committees and Executive Pay

Have remuneration committees and the boards they advise been particularly weak, unadventurous

and unimaginative in the area of executive pay? Have they employed policies and approaches such as “paying in the top quartile to attract the best talent “ that automatically ratchet up average levels of remuneration? Going with the flow and failing to challenge has not gone unnoticed.

In her Birmingham speech, Theresa May has also pointed out “The FTSE, for example, is trading at about the same level as it was eighteen years ago and it is nearly ten per cent below its high peak. Yet in the same time period executive pay has more than trebled and there is an irrational, unhealthy and growing gap between what these companies pay their workers and what they pay their bosses. ”

The incoming UK Prime Minister concluded: “I want to make shareholder votes on corporate pay not just advisory but binding. I want to see more transparency, including the full disclosure of bonus targets and the publication of “pay multiple” data: that is, the ratio between the CEO’s pay and the average company worker’s pay. And I want to simplify the way bonuses are paid so that the bosses’ incentives are better aligned with the long-term interests of the company and its shareholders. ”

Such calls could lead to other suggestions relating to reporting and disclosure requirements, depending upon perceptions of purpose and priorities. For example, in relation to sustainability, should companies be required to report steps they are taking in areas such as emissions limits on company cars and other vehicles?

Widening Perspectives and Regulation

Current approaches to corporate governance assume accountability to shareholders. Compliance, “command and control”, onerous reporting and associated bureaucracy can inhibit initiative, reduce spontaneous adaptation and involve significant costs. As barriers to entry and capital requirements fall, and developments are funded by customers, will companies redefine their purpose? Will the perspectives of directors embrace a wider range of interests? What might governance look like if one replaced or supplemented shareholders with customers, employees or business partners?

Governance arrangements need to ensure a board understands the market and regulatory context in which it operates and takes a longer-term view. Given the earth's resources are not infinite and that the consequences of human activity threaten its restorative capacity, should the perspective of governance and boards embrace the planet as a whole? Do attitudes in boardrooms need to change?

There are costs and risks of unintended consequences associated with much regulation, but in relation to the environment and sustainability is such action required? If directors were more engaged in the process, might the effectiveness of some regulations be increased and their costs reduced? Those directly affected by regulations often act to protect their interests. Could involving a wider range of voices counter this, reduce barriers to entry and create both a level playing field and opportunities for entrepreneurs to introduce more sustainable offerings and practices?

Purpose and Sustainability

Boards should ensure that people can relate to the purpose of a company. Vision and mission statements should be more than generalities about being the best. They should have meaning for employees, customers, investors other stakeholders. Some leaders turn their organisations into a cause that motivates others. A clear and shared purpose should guide decisions and drive operations. Does sustainability engage people and align individual and corporate purpose?

Sustainability is a challenge for governance arrangements. A succession of decisions that take account of immediate priorities and short-term considerations, while ignoring externalities and longer-term impacts can have serious future implications. Action to address the negative

consequences of individual decisions can take many forms, from outright bans of harmful activities to collective action to address resulting outcomes. What role could governance codes and practices play as alternatives to legal and regulatory responses? Could pricing emissions address social costs?

Directors are sometimes schizophrenic. They want to avoid certain climate change consequences and natural capital shortages, but without being at a short-term competitive disadvantage. Hence calls for level playing fields. In the meantime, cosmetic rather than substantive initiatives may be pursued. Some boards make hay while the sun shines. Tough decisions are postponed until external pressures build and/or legal or regulatory intervention occurs. Could institutional investors and owning families do more to encourage boards to adopt a longer-term perspective?

In relation to sustainability decisions, what should be sustained and when? Those advantaged by the *status quo* usually favour its continuation. Those left behind may want to catch up before reigning back. Is resilience becoming more important, along with the ability to cope with changes as they occur and maintain essential services? Directors who see the bigger picture and can link different considerations may detect a relationship between innovation, entrepreneurship and sustainability.

Public Policy Intervention

Peter Drucker suggested that human institutions can outlive their original purpose as situations, circumstances, perspectives, requirements and priorities alter and can imperceptibly change from being a solution to a pressing problem to become a new obstacle to progress. To what extent does his advocacy of innovation and entrepreneurship apply to corporate governance and sustainability?

Has Government intervention in the form of legislation and regulatory requirements facilitated or inhibited innovation and entrepreneurship? Where they occur is this in spite of public policy rather than because of it? Has regulation created a community of advisers with a vested interest in ever more detailed intervention because their livelihoods depend upon it?

In an era of greater diversity and uncertainty, alternative business and organisational models, and new ways of working and operating, is a prescriptive approach, the use of single standards and a compliance bias out of sync with such changes? Are they resulting in tick-box and legalistic attitudes, rather than a focus on outcomes and allowing more scope for imagination and innovation in terms of how they are achieved? How might more flexibility be introduced?

Will an excess of regulation, requests for more information and disclosure and greater media scrutiny discourage people from seeking CEO and senior executive roles? Will greater exposure to scrutiny and enhanced risk of investigatory and legal action put more people off seeking board positions? At the same time, the emerging crowd-based economy depends upon trust. Who and what will protect the consumer when peer-to-peer services disappoint or result in harm?

Passing the Innovation Test

Many boards do little to actively encourage innovation and entrepreneurship. In established companies their focus is often upon consolidation, rationalisation, cost-cutting and squeezing more out of existing operations. Corporate cash is disbursed as dividends or used to buy-back shares rather than invest in new industries. The emphasis is often upon keeping an existing show on the road and avoiding failure rather than creating a better alternative.

Are some big company bosses leaving innovation to sole entrepreneurs, family businesses or smaller enterprises who are less influenced or constrained by corporate governance considerations. Is corporate governance largely a set of arrangements for dealing with maturity, stagnation and slow

decline? Is it a retirement home for when founding entrepreneurs and companies run out of steam?

Must creative spirits in T-shirts be replaced by cautious retainers in suits? If corporate governance attitudes and advisers are introduced too early, might the cold draft of compliance snuff out the sparks of innovation? Will more companies seek to avoid such negative associations by de-listing? Would innovation and entrepreneurship be best served by avoiding a standard model developed for a different context, and instead adopting bespoke governance arrangements that are right for an enterprises stage of development and particular situation and circumstances?

Emerging Realities and Requirements

The innovative responses a sustainable future requires thrive on diversity. Hermann Simon has found that market leaders in niche specialisms are often not large and/or listed. Many of them are family owned and keep a low profile. Although based outside of major cities they often trade internationally. They engender customer and staff loyalty. They work hard to remain innovative and competitive in their chosen field. They are managed and governed in a way that works for them and allows them to excel at what they do.

Digital developments present businesses with a variety of challenges and opportunities. What role will directors and boards play in crowd-funded, web-enabled, organically evolving, creative and networked enterprises that need to adapt and mutate in real time? In more democratic and participative markets will an intermediary role of directors and boards be required? Will governance become a series of questions to address to determine what is best for a particular network at one moment in time, rather than a set of principles and rules that assume a standard requirement?

What proportion of assets and economic activity will be in the hands of large companies owned by external shareholders? Will more of the corporations for which corporate governance has evolved be cut out as people directly barter and share what they have, whether empty space or home grown vegetables? Will those living healthy lives for longer, become more self-sufficient and help each other within their communities rather than depend upon the state or a weekly shop at the nearest supermarket? How successful will our directors be at acquiring a trade or skills others might want?

In a connected world, self-employed individuals may use networks of relationships to access what they need and do what they enjoy and feel they are good at. They may find their individual ability to quickly adjust, embrace new technologies and re-learn or embrace new opportunities exceeds that of less flexible centrally controlled groups that have to await a new policy or direction from a board before they can change. Will entrepreneurial people become their own directors, rather than expect someone else to undertake directorial activities on their behalf? Will they govern themselves?

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