A look at corporate governance and what constitutes a high performing board

Why does trust matter?

Businesses live in an age of unprecedented scrutiny. Clients, customers and other stakeholder groups are increasingly demanding greater transparency and ethical behaviour from the businesses with which they interact. Reputation, the sum of past interactions with stakeholders, used to be seen as integral to the ongoing success of a business with its stakeholders. But reputations are frequently failing as a bulwark against sustained scrutiny. Many businesses are now realising that reputation alone is not enough and that something more is needed. That something is Trust.

Good corporate governance and a high performing board are essential elements of achieving "trusted company" status among stakeholders generally. Leadership must be focused not only on making profits but also on contributing to society. Ultimately high performance with high integrity creates the fundamental trust among shareholders, creditors, employees, recruits, customers, suppliers, regulators, communities, the media and the general public. This trust is essential to sustaining a company’s licence to operate. Increasingly, in order to achieve this, companies are focusing on how they do things and many are implementing a values based culture that permeates the whole organisation as part of this.

In October 2014, Baker & McKenzie hosted the Trust Matters forum, bringing together senior executives from across the world to explore how organisations can build trust in order to meet the expectations of the law, their stakeholders and the communities in which they operate. At the forum, senior executives attended a roundtable to discuss Corporate Governance and what makes a high performing board. The individuals discussing this topic came from a wide range of industries but all were leaders in their respective fields. The debate took place under the 'Chatham House rule' and discussed the following:

- What good corporate governance looks like and the common pitfalls
- The fact that whilst a high performing board is a pre-requisite, it is not enough to achieve long-term success – what more is needed
- The link between a values based culture, achieving effective corporate governance at all levels of the company and long-term success.
Participants identified the following areas as key to improving and sustaining good corporate governance:

Clarity on the role of the board and NEDs

What is it realistic to expect from NEDs and their ability effectively to challenge executive directors? Problems arise when the board gets too involved in the day to day operational management of the organisation. When this happens, the board is acting more like a management committee, second guessing management and potentially losing sight of the wider strategy. As one participant outlined, this leads to mistrust between the board and management, “we [the board] spend time on the ‘nitty gritty’ management issues rather than focusing on the wider strategy leading to a breakdown in trust with local management. Close to 70% of our time is spent on these issues and the chair does not control proceedings properly”. This view was supported by another participant who said “the biggest pitfall is where [the board] micro manages”. It is also important for NEDs to ‘pick their battles’ - you can’t challenge everything. Further, how NEDs try to address issues is relevant. They need to be tactical and some matters can more effectively be dealt with by addressing them outside the board meeting.

What experience is really necessary from NEDs? The role of a NED is to ensure that management is acting in the best interests of the company and to challenge strategy. It is important to have NEDs who can challenge the CEO. As one participant explained, “In my view, NEDs have changed. The readiness to accept what the executive is telling you is now being challenged. There is tension in the boardroom, and NEDs are mindful that their necks are on the line”.

But what is the right NED for an organisation? There is a balance to be struck between directors having relevant experience but (if they are in the same industry) avoiding conflicts. One question raised was should there be deliberate time taken to familiarise NEDs with the culture of a company? NEDs must understand the company’s culture. They must visit the company, and have dinners sitting next to management. But organisations must accept it takes time to bring the culture of a company to a NED. However, an opposing view was should NEDs even reflect the culture of a company? If a NED has embodied the culture of a company, are they independent? “When you come in as a NED, you should judge what you see in the company” expressed an existing NED. “Assess the culture of the company and identify problems. The best NEDs don’t judge very quickly - it takes 2 to 3 years to absorb a company. NEDs should take this time to absorb what they see”. And for this reason, the rotation of NEDS should be carefully managed. Not all NEDs should be appointed at the same time. Appointments need to be staggered where possible.

There is a fine line between executives and NEDs. NEDs need to be comfortable getting knee-deep in the detail in order to have the confidence to contribute but should keep their distance and not ‘interfere’. “You must forge relationships with senior executives throughout the organisation, but get the balance right” said one experienced NED. One way is for NEDs to go on committees to get under the skin of the company. Executive directors tend to welcome independent challenge from NEDs, especially where they have a specific area of expertise. As one company secretary summarised, “The role of the NED is to challenge, and the role of the executive directors is not to take it personally”.

So how much time investment should NEDs expect? Participants thought the average to be 20 to 30 days a year. However, organisations have to match the accountability of the board to what they expect from NEDs. NEDs also need to understand that during a crisis, that time commitment might increase dramatically. One participant related their experience during a crisis of working 110 days during one year.

Participants reflected that much of the value added by the board and by definition, its approach to corporate governance, is created in committees, not when the board sits as a whole. The committees a company has must reflect the future drivers of that company’s success. A number of committees are recent developments, for example ethics, regulatory affairs and technology. There is not a one size fits all approach however. Deciding which committees to have is a critical decision.
Diversity of the board
Diversity of the board, in its widest context, was seen by all to be the key element in ensuring good corporate governance. One participant explained, “An effective board is one that can collate different viewpoints. You shouldn’t have a board full of all former CEOs. The board must be independent, and it is important to stop group-think. However, there is a balance to be struck between diversity and cohesiveness”. Another continued, “We [mainly] look at experience and diversity when recruiting members of the board”. Addressing ‘group-think’ appeared to be a consistent challenge for those organisations wanting to develop a good corporate governance approach. Diversity of age, gender, cultural background (for multinational firms) and experience were all key in filling experience gaps on the board and ultimately better equipping the board to deal with challenges being faced by the company.

Stakeholder/shareholder engagement
Investors today expect, and demand, good corporate governance. The challenge is in balancing competing stakeholder interests. Companies can at times put pressure on investors for being too short term in their thinking, however, management must accept this as a natural tension. Getting the balance right between the focus on long term sustainable growth and short term results is imperative.

The focus should be both short and long term, rather than it be short term versus the long term. Investors who believe in a company will take a long term view. With the 2015 Edelman Trust Barometer showing trust levels at an all time low, it is arguable that some companies’ profitability and growth need to take a back seat for awhile and integrity and values take the front seat. How organisations ‘manage’ investors without taking time away from key board decisions is a vital skill. An active investor base is useful for most companies but should not get in the way of the running of the organisation.

Effective board evaluations
The majority of participants viewed board evaluations as a positive activity. The overarching theme was that the value was in using a consistent external evaluator, allowing them time to get to understand the culture of the organisation and the challenges the board faces. One participant observed, “We find that the board being observed draws out more than just questionnaires, but letting someone observe the board may lead to non-natural behaviour. Nonetheless, it is good to do”. However, others did not see external intervention as intrusive and one participant said “I was acting general counsel for a company when the board was being observed, and there was no difference in behaviour. There is so much going on in the boardroom that there is no time to focus on someone else being there. My personal experience is that it didn’t affect the board”.

“Whether a company has external evaluators coming in will depend on whether you think external evaluations make a good board” was the view of one participant. Ultimately, the key is finding what works for an organisation and ensuring that findings are acted on. Internal and external evaluations can and should be complementary. As one participant explained, “The external evaluator is useful to evaluate the role of the chairman. Internally, it is more difficult to tease those issues out if there are any issues with the chairman”. However, the questions posed by an internal evaluator can be based on a deep understanding of the board and potential areas for development.
Culture of the organisation

Good corporate governance alone is not enough to build trust. Companies also need to get their values right and ‘set the tone from the top’ in order to be truly effective.

Participants reflected that priorities are changing. “Regulation is saying that companies must put customers first” said one. “This culture has been changing quietly, driven around publicity around banks, although companies are saying that they have always had these values and that the only change is that they are now stated externally”. However, most organisations have not been consistent in their focus. The culture and values of a company sit with the CEO, the board and downwards. The tone from the top is crucial, and the CEO must be seen to be talking about the importance of those issues that are key to the organisation. As one participant explained, “This is a management principle. You can’t change the culture. Fundamental principles of ‘customer first’, respecting the environment, etc. must be put in place to explain the way a company does business”. Companies are now having this dialogue internally. “If employees understand the behaviour expected of them, that will translate externally. My company will report its values in its annual report, but internal behaviours will just transcend externally nevertheless” was a consistent view from the participants.

However, just saying you have values is not enough. “Values are an internal mechanism. Companies should never just have ‘X’ number of values” explained one participant. They went on to say, “Values are a combination of observed behaviours, not whatever is said or written. I worry about [the trend] to publicise values. Values are like mission statements, in that they are boring when written down but that internally, they are alive. Values have to be internal and are a means for shaping behaviours”. The values of a company, to be meaningful, must be reflected in the managerial process, such as performance evaluations and appointments.

Organisations must ensure they are building a culture that is more than just the ‘bottom line’. “Employees should know where the ‘conduct’ line is which should not be crossed, such that not meeting the financial targets would be allowed if in meeting them would involve crossing that line” expressed one participant. This view was built on by another who said, “In the case of financial institutions, compliance budgets are now often outside the business, which shows its importance”. A further observation made was “the tone from the top on site visits should not be to ask about revenue straight away. If organisations wanted to put the customer first, conversations had to change”. Ensuring your message is consistent is key. As one participant explained, “We looked at the near misses in health and safety and these hadn’t been fixed as there was no budget for it. The message from the top was ‘numbers, numbers, numbers’. If safety is important to a business, we had to talk about it”. Balancing these interests is an art.

The role of the General Counsel

The General Counsel should be a key member of the top management team and offer advice not just on law and related matters but help shape discussion and debate about business issues. Because “business in society” issues pose so much risk (and in some cases opportunity), the General Counsel should have the same stature as other executive Board members. The core task of CEOs, and top senior executives (including the General Counsel), is to build a values based culture that permeates the corporation. Such a culture entails shared principles (values, policies and procedures that, not only provided insights into the execution of policies and procedures that, not only deliver business imperatives, but deliver them in a way that builds Trust.

A number of sessions were held at the forum, including Corporate Governance & High Performing Boards. The outputs from each of these sessions have been collated to produce a summary of the discussions on each topic.

For more information, please visit: www.bakermckenzie.com/trustmatters

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