GLS Board Review and Development

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ALL PARTY PARLIAMENTARY GROUP ON CORPORATE GOVERNANCE

WHAT DOES A 21ST CENTURY BOARD LOOK LIKE?

11 March 2020 Lunch Panel Discussion at the Cholmondeley Room, House of Lords

Input By Professor Bob Garratt

I am delighted to be able to address this joint meetings of MPs and Peers. My argument is in two phases. First, that UK legislators are faced with a paradox regarding their current approach to UK corporate governance. They created this dilemma themselves in 1890 and yet seem loathe to resolve it. So they have let it fester for 130 years. Without such a resolution a post-Brexit UK will become an also-ran in global competitiveness.

One horn of this dilemma is that internationally the UK is seen to have made so many advances in the field of corporate governance practice and regulation that it is much admired, with many countries trying to emulate it. Yet the other horn shows in plain sight this unresolved rot at the centre of UK businesses law. I am talking of the interlinked board issues of defining 'the controlling mind' and 'unlimited liability'. This is why the UK public detest you for failing to legislate effectively to protect their interests, especially since 2008.

The issue was urgent enough in Gladstone's time that he called an enquiry – the Salomon Judgement of 1890 - which was meant to resolve this. It did not and has left a running sore ever since. This very week the *Financial Times* (12.03.20) raised the issue again following the acquittal, to public disgust, of the final Barclays Bank defendants on fraud charges. Mr Justice Jay did no-one any favours by leaving a judgement where "the Bank could not be held accountable for the actions of its chief executive, but neither could the chief executive be accountable for the actions of Barclays". This may be the current law but no rational member of the public could understand or agree with it.

Legislators need first to resolve this position and then ensure that sufficient legal precedent is created for the guidance of board members' future behaviours

and values, allowing clarity in the publics' mind and so restoring public trust. Few civil cases have ever been before the courts and almost no criminal cases with exception of the Ernest Saunders's case. Little has been tested in the High Court let alone the Supreme Court. There seems no political will to do so.

To ensure effective UK businesses we need to resolve this to achieve our post-Brexit ambitions. Hopefully this new parliament and government will take up the challenge,

What would the 21st Century Board look like if extrapolated from the present non-system of UK corporate governance?

If things go on as they are, we shall see an increasingly bureaucratic, over regulated nightmare blocking the future development of not just the UK's FTSE 300 organisations but also family companies, entrepreneurs, state-owned enterprises, NHS boards, civic organisations and charities. Public trust in all their directors and senior managers will continue to decline. Corporate Governance will continue to focus wrongly only on Directors, without designing a national system that specifies both the rights, but also the duties, of Owners, Regulators and Legislators. And all must then be under formal public scrutiny. We need to reframe the meaning, behaviours and context of UK corporate governance. The UK will lose its global lead in the field. It is already beginning to be overtaken in practice by other parts of the world, especially those with whom we shall need to trade more effectively in the future.

It is tragic that UK politicians in both houses passed a world class Companies Act in 2006 that was never effectively implemented. But which of the current MPs and Peers know, or care? I have asked many politicians to list for me at least 3 of the 7 Duties of a Director in the 2006 Act? Or the Purpose of a Board in relation to its Company? None have ever been able to give me a satisfactory reply. Most say that they were not around in 2006 and have no idea what was passed or why. But as we now have a new cohort of MPs and Peers it is time for them to be informed by such groups as APPGCG to go back to the basics and learn both what was enacted name and why it has failed to be implemented effectively.

What if we took a different approach and behaved as if the UK's 2006Act was real? The UK's Corporate Governance Code can be reduced to just two A4 pages.

I argue that we should now drop the existing corporate governance codes and the wildly over-complex one for financial services. We should revert to what our legislators meant in 2006. We should live by the values and behaviours of

Sections 171 and 172 of the Companies Act. The Cadbury Code was proclaimed in 1992 to great acclaim but was side-tracked into becoming a cottage industry creating more and more clauses and subsets. I argue that we are now mature enough to drop the over-elaboration and redundancy of our Corporate Governance Codes. We should focus on ensuring the future health of the company, not on increasing Compliance. You legislated for this but then dropped the ball.

The globally admired patron saint of Corporate Governance is Sir Adrian Cadbury. I am proud to have worked with him long before 1992 and the invention of the fashionable 'corporate governance' phrase. In those days we called it 'reviewing board effectiveness', a much better descriptor. But I was always critical of the Cadbury Codes in having a restrictive vision of corporate governance as being essentially financial and concerning listed companies. These are less than 5% of the organisations that bond our national society. Neither could they, or the Financial Reporting Council, debar directors. Sir Adrian was sympathetic and wrote to me in his beautiful longhand just before his death commenting on a draft of my forthcoming book '*Stop The Rot: Reframing Governance for Directors and Politicians'* saying "good luck .. and do ensure that you focus on the entrepreneurial, risk taking aspects of good governance, and not the Codes and compliance aspects that are now starting to cripple it.'

What do Sections 172 and 171 say?

I was going to say here 'let me remind you of the two key sections on which were meant to develop effective UK corporate governance'. However, I have been so alarmed at how few legislators, and company directors, now know even the basics of these key two sections that I have chosen to list them briefly here.

Section 172 reflects on the Purpose of A Board of Directors;

It is the duty, responsibility and accountability of a board to promote the long-term success of the Company. It never mentions the supremacy of the shareholders.

Remember that since January 2019 it is mandatory in the UK for companies to provide an annual report outlining the consequences of their board decisions on;

- The likely consequences of any decision in the long term
- The interests of the company's employees

- The need to foster the company's business relationships with suppliers, customers and others
- The impact of the company's operations on the community and the environment
- The desirability of the company maintaining a reputation for high standards of business conduct
- The need to act fairly as between members of the company.

Because of legislator ignorance we have the paradoxical position of many current legislators clamouring publicly for the very things on which they already passed legislation in 2006. At that time we even invented the currently fashionable concepts of 'ESG', sustainability and integrated reporting. But 14 years on we have done little about their implementation.

The board values and consequent behaviours of Section 172 are Accountability, Probity and Transparency to the stakeholders. Which board assesses these on a rigorous basis?

Section 171 reflects on The Seven Duties of a Director

- To act within the Board's constitution
- To promote the success of the company
- To exercise independent judgement
- To exercise reasonable care skill and diligence
- To avoid conflicts of interest
- Not to accept benefits from third parties
- To declare interests in proposed transactions.

The personal values and consequent behaviours of a board member under Section 1711 are Independence of Thought, Care, Skill and Diligence. Again, how many board assess these rigorously?

So my challenge to you today is how are legislators going to rebuild and live by Sections 171 and 172? You do not need new legislation. But you do need commitment and energy to create the legal precedents to make your legislation work.

You will know that you have succeeded when the public are openly asking informed questions on limited liability, the controlling mind, the purpose of a board, and the delivery of the seven duties of a director. The public must hold boards to account, not regulators.

Bob Garratt works with his wife Sally reviewing and developing boards of directors on 5 of the 6 continents. He is a practitioner and researcher whose book *The Fish Rots From The Head: Developing Effective Directors* became a best seller internationally. He is a Visiting Honorary Professor at Cass Business School, London; and Professor Extraordinaire at the Business School of Stellenbosch University, South Africa. He has just been appointed as External Examiner of the Gulf Co-operation Council's Board Development Institute for their new Director Development accredited awards.

He is currently researching informally with colleagues David Jackson and Guy Jubb the development of the ideas behind this paper.

This is a new version of his speech which incorporates his answers to questions during the discussion

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