Creating Value for Stakeholders

Chairs, NEDs and CEOs increasingly realise that a company has to be about more than maximising profits. Criticaleye looks at how a Board can set an agenda which appeals to multiple stakeholders

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Every time a company fails, accusatory fingers are pointed at the Chair and non-executive directors, especially if it's a Plc. The questions come thick and fast: How could they have been unaware of what was going on? Who was holding the CEO and leadership to account? Why did they not have proper systems and controls in place?

Take a stroll through the graveyard of corporate failures and you'll hear a familiar tale. Whether it's Enron and Lehmann Brothers in the US or Equitable Life and Carillion in the UK, Boards are chastised and then auditors come under intense scrutiny, as in the classic case of Enron, which saw the break-up of the professional services firm, Arthur Anderson.

At Criticaleye's Non-executive Director Retreat 2018, held in association with EY and Brewin Dolphin, attendees discussed the measures Boards ought to take to prevent catastrophic collapses, as well as why they keep happening. It was felt that a breakdown of trust had occurred between companies, shareholders and other stakeholders.

Guy Foster, Head of Research at investment management and financial planning firm Brewin Dolphin, said: "In my mind, a lot of the reforms to corporate governance that we are seeing are about how you get a group of broader stakeholders onside as a company seeks profit maximisation."

Gaining that agreement continues to be a work in progress, particularly in the context of wider society. He added: "Capitalism is the right way to allocate resources, but it needs to be done efficiently and in a way that leaves no stakeholders behind."

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In the summer, the Financial Reporting Council (FRC) released its latest reforms to the UK Corporate Governance Code. The stated aim of the new guidelines is to put the relationships between companies, shareholders and stakeholders at the heart of long-term sustainable growth in the UK economy.

Tom Beedham, Director of Programme Management at Criticaleye, said: "Openness between the executive and non-executive directors is of paramount importance if a Board is to be successful. This has to be backed up by accurate and transparent information, set within an environment where people are not afraid to ask difficult questions, or even obvious ones.

"Companies repeatedly run into trouble because of poor quality data, a lack of effective controls and too many egos around the table. Fortunately, it looks like we are seeing positive changes, and improvements are being made."

The revised Code urges Boards to put greater emphasis on values, culture, forward-thinking, engagement with shareholders and the workforce, as well as Board composition, primarily with the introduction of a nine-year tenure limit for independent Chairs and directors. **Sir Win Bischoff**, Chair of the FRC, said: "One of the main changes we've introduced is to go back to principles rather than provisions. Provisions are something that a company secretary can sign off on and tell the board they have been done, whereas principles deserve deep and proper consideration by the Board as a whole."

Sir Win cited the work of Joseph Bowyer, Professor Emeritus at Harvard Business School: "He puts forward the notion that Boards and management cannot be the agents of shareholders, not least as multiple shareholders have very different objectives. He disagrees with the primacy of shareholder return. His view is that the prime responsibility of Boards is the health of the company and not the wealth of shareholders."

This point also fed into how companies currently set about measuring and communicating value to stakeholders. **Hywel Ball**, Managing Partner at EY for Assurance, UK&I, and Head of Audit, UK, told the audience about the Embankment Project for Inclusive Capitalism, where over 30 global companies have gathered together to test and validate a new long-term value framework.

Hywel said: "We started working on this back in 2015, and there are four big drivers: the growth of intangibles; the loss of trust in institutions; the proliferation of data; and finally, the >

investment disconnect between the remit of pension funds and asset owners – so how fund managers were driving corporate behaviour. This gets quite quickly into shareholder primacy issues.

"We worked with businesses, academics and investors to create a framework for long-term value – so looking at how a company could better articulate its long-term value creation for all its stakeholders."

Venturing Beyond the Boardroom

The big corporate failures serve to highlight how knowledge held deeper within the business, or even by keen observers outside it, can fail to reach those performing a governance role.

Sarah Bates, Chair of Polar Capital Technology Trust and a former FTSE 100 Chair, noted that "Carillion has shaken all of us". She told the audience that there was plenty of information available, such as short selling, but the warning signs were not heeded and therefore the problems went ignored.

She argued that Chairs and NEDs have an obligation to probe deeper into organisations to understand what is happening. "If everyone is telling you it's alright, that's the point when you start to worry, ask and prod. Developing your networks around the company is crucial – making sure everyone can talk to you and you're not remote; that you think about the business model and how it works.

"It's being independent, but listening very carefully and trusting your judgement and common sense."

> *" Ultimately businesses are not brought down by their auditors; they are brought down by management and Boards not being on top of things "*

In other words, it falls on the shoulders of Chairs and NEDs to be communicating and building relationships both internally, with employees, and externally, such as with customers and suppliers. There continue to be too many instances where a crisis occurs and, after the event, it becomes apparent that there was a lack of awareness among the independent directors.

Sir Win said: "Ultimately businesses are not brought down by their auditors; they are brought down by management and Boards not being on top of things. I consider myself financially literate, but I didn't know what reverse factoring meant and that it has the ability to show cash in the way Carillion did, totally legitimately.

"I wonder how many of the non-execs knew what was represented on the balance sheet – there was a note to the balance sheet – but ultimately it comes down to the NEDs. Auditors should be more sceptical, but auditors do not bring down companies."

Corporate governance and regulation will only do so much. The onus is very much on Boards to fully discuss and be cognisant of how an organisation operates and to take the right actions when difficult situations arise. As **Hywel** put it: "When you look at your business model, you must ask yourself whether you truly understand what's creating value. Are you following that through to the risks and controls and checking them?"

After all, a healthy business must be in everyone's best interests. ■

Click on the following link to watch Barend van Bergen of EY explain how Project Embankment can change how Boards think about the issue of long-term value.

To find out more about Criticaleye's 2019 Non-executive Director Retreat, click here.

Featuring Commentary From:

Hywel Ball
Managing Partner
Assurance
EY UK&I

Sarah Bates
Chair
Polar Capital
Technology Trust

Tom Beedham
Director
Programme Management
Criticaleye

Sir Win Bischoff
Chair
FRC

Guy Foster
Head of Research
Brewin Dolphin

Contact the contributors through:
www.criticaleye.com