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TWENTY PRACTICAL STEPS to BETTER CORPORATE GOVERNANCE

By Professor R. I. (Bob) Tricker

The frontline of governance

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Twenty Practical Steps to Better Corporate Governance

"At the end of the day, good governance is more about people than it is about procedures. So professional bodies need to ensure that there are enough people with the professional knowledge and skills to ensure that commonsense governance, and not governance by mass regulation, prevails."

Phillip Baldwin
Chief Executive
The Hong Kong Institute of Chartered Secretaries
President
Corporate Secretaries International Association
Dec 2009 — 20 March 2010

Professor R. I. (Bob) Tricker
March 2010

ABOUT CSIA

CSIA, a Geneva-registered trade body, which was established on March 2010 as an international organisation whose members comprise national bodies of professionals at the frontline of governance. It is dedicated to promoting the values and practices of governance professionals such as qualified chartered secretaries, corporate secretaries, company secretaries and board secretaries in order to help create, foster or enhance the environment in which business can be conducted in a fair, profitable and sustainable manner. To find out more about CSIA, please visit www.csiaorg.com.

PREFACE TO TWENTY PRACTICAL STEPS TO BETTER CORPORATE GOVERNANCE

It is an honour and a pleasure to write the preface to the research report "Twenty Practical Steps to Better Corporate Governance" by leading governance academic and expert Professor Bob Tricker, a long time student and proponent of good governance.

This report is the first publication of the newly formed Corporate Secretaries International Association (CSIA). CSIA has taken a little over two years from idea to reality and while this is not the place for a history of the formation of CSIA it would be remiss of me not to thank all of those involved and even more so if I failed to mention my fellow members of the Steering Committee established to form CSIA. Without the unfailing support and hard work of Tim Sheehy, Chief Executive of Chartered Secretaries Australia, Stephen Sadie, Chief Executive Officer, Chartered Secretaries Southern Africa, David Wilson, Chief Executive, Institute of Chartered Secretaries and Administrators and N. K. Jain, Chief Executive Officer and Secretary, Institute of Company Secretaries of India CSIA would still be an idea rather than a reality that represents over 70,000 governance professionals globally and so truly at the frontline of governance. It was an honour to chair the Steering Committee and subsequently to have served for a short time as President of CSIA. It is only right that I now step aside and let the newly formed Council elect a new President to lead CSIA as a fully fledged international organisation.

Corporate governance is a complex, multi-faceted subject matter involving not only legislation and regulation but also what is usually known as 'best practice', which is very much a matter of corporate culture, mind-set and education. Given the vast amount of research and published material on governance it is extremely difficult to find a fresh approach but this is something I believe Bob has achieved with 'Twenty Steps'. Bob's excellent paper draws not only upon his vast knowledge of the subject but also upon a network of governance practitioners, experts and academics that one would find difficult to replicate.

Contributors to this report include many notable experts including Professor Christine Mallin of the University of Birmingham, UK, Professor Jay Lorsch of Harvard Business School, USA and Sir Adrian Cadbury who perhaps sums up the report best in a letter to Bob, which he was kind enough to share with me, regarding the report.

So I leave it to Sir Adrian, far more qualified than I, to sing the praises of this report. In his letter Sir Adrian says "…it (the report) is the best outline of the causes of the present financial crisis and of the steps which need to be taken to prevent its recurrence which has yet been written". Quite.

Phillip Baldwin
Chief Executive
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Twenty Practical Steps to Better Corporate Governance

1. Recognize that good corporate governance is about the effectiveness of the governing body — not about compliance with codes
2. Confirm the leadership role of the board chairman
3. Check that non-executive directors have the necessary skills, experience, and courage
4. Consider the calibre of the non-executive directors
5. Review the role and contribution of non-executive directors
6. Ensure that all directors have a sound understanding of the company
7. Confirm that the board's relationship with executive management is sound
8. Check that directors can access all the information they need
9. Consider whether the board is responsible for formulating strategy
10. Recognize that the governance of risk is a board responsibility
11. Monitor board performance and pursue opportunities for improvement
12. Review relations with shareholders — particularly institutional investors
13. Emphasise that the company does not belong to the directors
14. Ensure that directors' remuneration packages are justifiable and justified
15. Review relations between external auditors and the company
16. Consider relations with the corporate regulators
17. Develop written board-level policies covering relations between the company and the societies it affects
18. Review the company's attitudes to ethical behaviour
19. Ensure that company secretary's function is providing value
20. Consider how corporate secretary's function might be developed

Lead Author:

Professor R. I. (Bob) Tricker, author *Corporate Governance: Principles, Policies and Practices*, Oxford University Press, 2009 and *Directors*, the fifth edition of the Economist Pocket Director, Profile, 2009; founder-editor of *Corporate Governance: An International Review*; and, holds visiting or honorary professorships at three universities.

“I have always regarded Bob Tricker as the father of corporate governance since his 1984 book introduced me to the words corporate governance,” said Sir Adrian Cadbury.

Other Contributors (in alphabetical order):

Sir Adrian Cadbury is widely known for his chairmanship of the Committee on the Financial Aspects of Corporate Governance (more commonly known as the Cadbury Committee) between 1991 and 1995 and the code of best practice that bears his name.

Dr John Carver, is a US-based corporate governance consultant, originator of the Policy Governance® model and author of *Corporate Boards that Create Value*, 2002 and many other related works.

Professor Gabriel Donleavy, Professor of Accounting, University of Western Sydney, Australia.

Professor William Judge, Professor of Strategic Management and E.V. Williams Chair of Strategic Leadership, College of Business and Public Administration at Old Dominion University.

Dr Gregg Li, Head of Governance and Risk Management, Aon Global Risk Consulting.

Professor Jay W. Lorsch, Louis Kirstein Professor of Human Relations at the Harvard Business School.

Professor Christine Mallin, Professor of Corporate Governance and Finance, Birmingham Business School, University of Birmingham.

James McRitchie, CEO, Corporate Governance Network.

Dr Shann Turnbull, Principal, International Institute for Self-governance.

TWENTY PRACTICAL STEPS TO BETTER CORPORATE GOVERNANCE

Bob Tricker[1]

Developments in corporate governance thinking and practice have often been responses to company collapses, corporate corruption or the domination of companies by an individual. The original UK Cadbury report followed unacceptable excesses in the Guinness and Maxwell companies.[2] The US Sarbanes-Oxley Act was a response to the collapses of Enron and WorldCom.[3] The failure of the Carrian Group led to the first corporate governance code in Hong Kong.[4]

It is not unreasonable, then, to expect some significant changes in regulation and reporting to stem from the 2007-2009 global financial crisis. Consequently, the organizers of the inaugural conference of the Corporate Secretaries International Association (CSIA) asked what are the corporate governance lessons from the global financial and economic troubles? The focus, it was suggested, should not be limited to the governance of banks and other financial institutions, but should also consider the implications for the governance of all types of corporate entity.

Serious research into the causes and effects of the financial crisis seems premature since the world is not yet out of that tangled financial forest. Instead, this paper is based on the opinions and experience of acknowledged corporate governance academics and professionals worldwide. Specifically, they were asked: "What do you think are the most important governance lessons to be learned from the events of the past two years?" Their insights have formed the basis of the practical steps that this paper recommends for directors and their advisers to review and implement as needed to improve the governance of their companies.

In 2009, Professor Jay Lorsch[5] and colleagues at the Harvard Business School interviewed 45 directors of major US corporations about their reactions to the global financial crisis. Their research paper[6] argued that recent boardroom failures differed from the previous corporate failings. Enron, WorldCom, and other corporate collapses were rooted in management malfeasance and fraud, leading to the US Sarbanes-Oxley Act. However, recent corporate governance problems, the researchers found, were primarily attributable to the growing complexity of the companies that boards governed.

The Harvard research found a strong consensus among directors that the key to improving boards' performance was not government action but action by each board. Moreover, they emphasised that companies and boards differ. Each board needs to develop structures, processes, and practices that fit the company and its business needs; "one size fits all" was viewed with scepticism.

[1] He is author *Corporate Governance — Principles, Policies and Practices* (Oxford University Press, 2009) and *Directors*, the fifth edition of the *Economist Pocket Director* (Profile, 2009). Professor Tricker is also the founding editor of the research journal *Corporate Governance — An International Review and a* visiting or honorary professor at three universities.

[2] Sir Adrian Cadbury, *Financial Aspects of Corporate Governance*. 1992. Available at: http://www.ecgi.org/codes/documents/cadbury.pdf.

[3] Public Law 107-204, 116 Stat. 745. Enacted July 30, 2002. Available at: www.thomas.gov.

[4] Available at: http://www.hkex.com.hk/consul/cpbefore2005.htm.

[5] He is the Louis Kirstein Professor of Human Relations at Harvard Business School, a member of the editorial board of *Corporate Governance: An International Review,* and author (with Colin B. Carter) of *Back to the Drawing Board: Designing Corporate Boards for a Complex World* (Harvard Business School Press, 2004) and several other books.

[6] Jay W. Lorsch, Joseph L. Bower, Clayton S. Rose, and Suraj Srinivasan, *Perspectives from the Boardroom — September 2009*. Posted on the Harvard Law School Forum on Corporate Governance and Financial Regulation. Available at: http://blogs.law.harvard.edu/corpgov/2009/09/18/perspectives-from-the-boardroom%E2%80%942009/.

The Harvard paper[7] identified six areas for improvement:

- Clarifying the board's role
- Acquiring better information and a deeper understanding of the company
- Maintaining a sound relationship with management
- Providing oversight of company strategy
- Assuring management development and succession
- Improving risk management

Each of these issues is covered in the twenty practical steps to better corporate governance, which follow below.

REGULATORY REFORMS BEING CONSIDERED WORLDWIDE

Before embarking on these practical steps, however, we should recognize that international bodies, governments, and regulatory authorities worldwide have already been reviewing their corporate governance requirements in response to the global financial crisis.

The corporate governance principles published by the Organisation for Economic Co-operation and Development (OECD) are designed to assist countries in developing their own corporate governance codes.[8] The OECD's Steering Group on Corporate Governance re-examined the adequacy of these principles in light of the global economic problems. The real need, it felt, was to improve the practice of the existing principles, although further guidance and principles will be published in due course. In two seminal papers,[9] four broad areas were identified as needing attention: board practices, risk management, top-level remuneration, and shareholder rights.

In the United States, changes to regulatory procedures for listed companies under consideration include: obligatory (though non-binding) shareholder votes on top executive pay and payments on appointment and retirement; annual elections for directors; the creation of board-level committees to focus on enterprise risk exposure; and, the separation of the CEO role from that of the board chairman, as called for in most corporate governance codes. Rules that allow shareholders to nominate candidates for election to the board, delayed by the Securities and Exchange Commission, are now likely to be implemented.[10]

In the United Kingdom, the Financial Review Council did not find evidence of serious failings in the governance of British businesses outside the banking sector. But it has proposed changes to the UK Corporate Governance Code to improve governance in major businesses. The proposed changes are intended to: enhance accountability to shareholders; ensure that boards are well-balanced and challenging; improve a board's performance and deepen awareness of its strengths and weaknesses; strengthen risk management; and, emphasise that performance-related pay should be aligned with the company's long-term interests and risk policy.

[7] *Perspectives from the Boardroom 2009, ibid.*

[8] OECD, *Principles of Corporate Governance*. 2004. Available at: www.oecd.org/daf/corporateaffairs/principles/text.

[9] Grant Kirkpatrick, The Corporate Governance Lessons from the Financial Crisis. February 2009. Also, Corporate Governance and the Financial Crisis: Key Findings and Main Messages. June 2009. Both publications are available at: http://www.oecd.org.

[10] "A chill in the boardroom," *Economist*, London 10 December 2009. Available at: http://www.economist.com/business-finance/displaystory.cfm?story_id=15065509.

The existing UK Combined Code is to be re-named the UK Corporate Governance Code,[11] and the main proposals for change are:

- Annual re-election of chairman or the whole board
- New principles on the leadership of the chairman, and the roles, skills and independence of non-executive directors and their level of time commitment
- Board evaluation reviews to be externally facilitated at least every three years
- Regular personal performance and development reviews by the chairman with each director
- New principles on the board's responsibility for risk management
- Performance-related pay should be aligned to the company's long-term interests and its risk policy
- Companies to report on their business model and overall financial strategy

Professor William Judge,[12] writing for this report, commented that the global financial crisis was caused by many failures in the global governance system. He believed that corporate governance mechanisms were contributors to the cause and have not yet been rectified to avoid a repeat in the future. "Solutions require a systemic approach," he wrote, "which implies that an international coordination mechanism is needed. It appears to me that the EU and the USA are toying with options during the crisis, but national sovereignty keeps getting in the way of global integration. Some multi-nationals could take the lead here, but they need to focus on global welfare, not their own welfare at the forefront. International NGOs could take the lead, but so far none seems up to the task."

THE ONGOING "RULES VERSUS PRINCIPLES" DILEMMA

As corporate governance evolved over the past twenty or thirty years, the so-called Anglo-Saxon approach (unitary boards — with executive and non-executive members) was frequently contrasted with the continental European approach (two-tier boards separating supervisory and executive responsibilities) or Asian approaches (Japanese *keiretsu*, Korean *chaebol*, and Chinese family-orientated company boards). The distinctions reflected different cultures and company law jurisdictions.

But in recent years, a schism has emerged within the Anglo-Saxon approach. In the United States, corporate governance has increasingly become enforced by regulation and the rule of law. The US Sarbanes-Oxley Act, which was a response to the collapses of Enron and WorldCom, reinforced federal and state demands for corporate governance conformance by law. However, in the United Kingdom and other jurisdictions where company law has been influenced over the years by UK common law (including Australia, New Zealand, South Africa, India, Singapore, and Hong Kong), compliance is based on voluntary compliance. Here, listed companies conform to voluntary codes of principle and best practice, reporting that they have complied or are explaining why they have not.

The "rules versus principles" dilemma seems likely to be amplified by the ongoing global financial crisis.

[11] *Proposed reforms to the UK Corporate Governance Code*, FRC PN 287, 1 December 2009. Available at: http://www.frc.org.uk/corporate/reviewCombined.cfm.

[12] Professor William Judge, Old Dominion University, Norfolk, Virginia, is the editor of *Corporate Governance – An International Review.*

TWENTY PRACTICAL STEPS TO BETTER CORPORATE GOVERNANCE

In the light of these developments, we can now review the ideas generated by our panel of corporate governance experts. Their insights are distilled into some practical steps that boards might take to review and improve their corporate governance. Of course, boards and the companies they direct vary considerably; hence, some of the steps will be more relevant to some than to others. But, overall, the insights are likely to highlight opportunities for improvement.

1. Recognize that good corporate governance is about the effectiveness of the governing body — not about compliance with codes

Corporate governance is concerned with the way that power is exercised over corporate entities. All corporate entities need governing — listed companies, wholly-owned subsidiaries, subsidiaries with minority interests, family-dominated companies, joint ventures, not-for-profit entities, and the rest.

Corporate governance needs to be distinguished from management: management runs the enterprise, while the governing body ensures that it is being well run and is heading in the right direction.

Several commentators for this paper mentioned the need to be clear on the board's role. A unitary board has responsibilities for approving the corporate strategy and ensuring that it is properly translated into policies and plans for management action (sometimes called the performance roles) and also overseeing management activities and ensuring accountability (sometimes called the conformance roles). The challenge to boards is to balance their conformance and performance responsibilities.

Professor Jay W. Lorsch[13] and his Harvard team called for the clarification of the board's role, emphasizing the need to balance conformance with performance aspects of the board's work. They found that "some boards have taken compliance with corporate governance laws, regulations, and codes so seriously that it dominates. Others see the importance of focusing on substantive business matters." But they foresaw dangers if directors tried to micro-manage the company or interfered in management matters.

Gareth Pearce and Mark Cleland[14] wrote that "an awareness of corporate governance is one thing; getting things done about it is quite another." They called for boards to reflect on strategic corporate governance to ensure that the company's corporate governance policies contributed to the achievement of its business objectives.

2. Confirm the leadership role of the board chairman

In the modern complex corporate scene, the chairman has a fundamental leadership role, verifying that the structure, membership and processes of the board and its committees are appropriate. By working closely and sensitively with the CEO the chairman links the board with management. Of course, the chairman needs to plan, manage and lead directors' meetings, and ensure that the board is formulating strategy and governing risk appropriately. Also, in large public companies, the chairman is sometimes the public face of the company. In addition, chairmen need to plan, manage and lead directors' meetings.

[13] Lorch's biographical information available at: http://drfd.hbs.edu/fit/public/facultyInfo.do?facInfo=bio&facEmId=jlorsch.

[14] Pearce is Assistant Editor of *Chartered Secretary, London* and Cleland is Managing Director of Capita Company Secretarial Services. Their comments appeared in an editorial to *The Governance Partnership*, which was published as a supplement to the ICSA magazine, Autumn 2009. Available at: www.icsa.uk.org.

Sir Christopher Hogg[15] has written that "the principal lesson of the financial crisis is that those on boards must think deeply about their individual and collective roles and responsibilities." He added that the chairman has a vital role to play in ensuring that the executive have the appropriate freedom to manage the business but also accept the importance of opening themselves to challenge and earning the trust of the entire board.

"The need for leaders who know how to make a difference in the world has never been greater than it is today", wrote Dean Jay Light[16] of the Harvard Business School. "The need extends beyond business to the social, government, and non-profit sectors as well... qualities that are fundamental to good leadership (include) judgment that leads to sound decision-making, an entrepreneurial point of view, the ability to listen and communicate effectively, a deep sense of one's values and ethics, and the courage to act, based on those values and ethics."

Proposed changes to the renamed UK Corporate Governance Code,[17] already mentioned, include new principles on the leadership role of the chairman, and suggestion of the annual re-election of the chairman or the whole board.

In his seminal work on chairmanship,[18] Sir Adrian Cadbury identifies the principles to which, he believes, chairman and boards should work. "Openness is one of them — the need to be open to ideas and open in explaining the company's actions and intentions. Openness is particularly important in dealing with people. Balance is another of them — the duty to weigh up the consequences of decisions on all those who will be affected by them, and to hold the scales between the demands of today and the needs of tomorrow. A third principle is the well-established one that rights and responsibilities go together. Chairmen, therefore, have responsibilities to their boards, as do boards to their chairmen."

3. Check that the non-executive directors have the necessary skills, experience and courage

Sir Christopher Hogg,[19] whose insights were mentioned at step 2, added that non-executives must have the skills, experience, and courage to provide a proper challenge to executive management.

Professor Mallin,[20] writing expressly for this report, drew attention to the potential problem of executive directors who were vested with too much power, which they could exercise in a way that was detrimental to the company.

On the other hand, respondents to Professor Lorsch and his Harvard team reported that they felt that recently, boards (in the United States) had become more effective, the number of independent directors had increased, and more "real professionals" were adding value to the board. Their report also emphasised the importance of ensuring management development and succession.

[15] Sir Christopher Hogg, Chairman of the Financial Review Council, the UK's independent regulator responsible for promoting confidence in corporate reporting and governance.

[16] Dean Jay Light, *Harvard Business School Annual Report 2009*. Available at: http://www.hbs.edu/about/annualreport/2009/.

[17] *Proposed Reforms to the UK Corporate Governance Code*, FRC PN 287, 1 December 2009 Available at: http://www.frc.org.uk/.

[18] Sir Adrian Cadbury, *Corporate Governance and Chairmanship – A Personal View*, Oxford University Press, 2002 (page 242).

[19] Sir Christopher Hogg, Chairman of the Financial Review Council, the UK's independent regulator responsible for promoting confidence in corporate reporting and governance.

[20] Professor Chris Mallin, of the University of Birmingham Business School is the author of *Corporate Governance*, Oxford University Press, 3rd edn. 2009, and *International Corporate Governance — A Case Study Approach*, Edward Elgar, 2006. She has been editor of *Corporate Governance — An International Review*.

4. Consider the calibre of the non-executive directors

Professor Mallin felt that the importance of the role of independent NEDs had been reinforced by recent problems. She emphasised the importance of "the appointment (or in a number of cases, the lack of appointment) of independent non-executive directors, who have both the experience and skills to gain useful insights of the business and the self-belief to question the proposed actions of the board where required."

Professor Judge, also writing for this report, mentioned the need for ethics in the boardroom. "Self-regulation, in the form of personal ethics and social connectedness, is required," he wrote. "Business schools need to emphasize this more in selection and training of students. The concept of stewardship is essential, but it cannot be legislated or regulated. Boards need to become much better stewards of other's money."

Overall, it seems important to ensure that the independent outside directors have sufficient intelligence, integrity, personality, and knowledge to stand against an over-powerful CEO and other directors from the executive suite.

5. Review the role and contribution of non-executive directors

Sir Adrian Cadbury,[21] writing for this report, suggested that the role of NEDs is the most significant general issue to arise from the financial crisis. "With the banks, they were criticised for not restraining a headstrong CEO and failing to question the risks their companies were taking. They surely should have questioned what processes Royal Bank of Scotland had gone through before acquiring ABN AMBRO and indeed the strategy of aiming to be the largest UK bank. What does that tell us more generally about the kind of NEDs we need on our boards and what we expect them to do there?", he asked.

Professor Mallin emphasised the importance of sound induction and relevant training for independent non-executive directors. She also questioned whether there should be limits on how many directorships outside directors might hold.

The proposed changes to the UK Corporate Governance Code[22] included new principles on the roles, skills, and independence of non-executive directors and their level of time commitment.

6. Ensure that all directors have a sound understanding of the company

Professor Lorsch cited the global financial saga as evidence of the complexity of business today and the difficulty that directors have had in understanding the businesses they were directing. "As a practical matter, it is difficult, if not impossible, to find directors who possess deep knowledge of a company's processes, products and industries but who can also be considered independent."

Many outside directors do seem to need more industry and market knowledge. But that raises an apparent paradox: the more knowledge directors have of the business, the less independent they become. Total independence may imply total ignorance.

It seems important to confirm that independent, non-executive directors are not so independent that they do not understand the business. All directors need to understand how value is added in the business, where it is exposed to risk, and what are its financial, market and operating strategies. This implies more than a brief induction programme. All directors need regular and frequent updating as changes occur in the business. They need to appreciate their company's place in the competitive market as well as the economic, social, and political context in which the company operates worldwide.

[21] Cadbury, op.cit.

[22] *Proposed Reforms, op.cit.*

7. Confirm that the board's relationship with executive management is sound

Professor Lorsch reported that some directors they interviewed had emphasised the importance of maintaining a sound relationship between board and management. Directors need to have confidence in the CEO. But they also need to appreciate the business challenges that the company faces.

They need information to understand the business situation but should not interfere in management decisions. This needs an appropriate balance. A boardroom environment needs to be created in which top management sees directors asking probing questions as good not bad. The chairman's importance, as we saw at step 2, is obvious.

8. Check that directors can access all the information they need

Professor Lorsch and his Harvard team identified "unprecedented challenges in ensuring an adequate and accurate flow of information from the lower level to the upper levels of management and to the board. Directors, who were largely dependent on management for an accurate and transparent flow of information, found overseeing such organizations challenging, particularly given their limited time."

Most boards have a board-level information system that produces routine papers for items on the agenda. Directors need more. They need knowledge about the business, the risks it faces, the challenges it meets, and problems that managers have.

Routine board papers provide directors with information that someone else has decided they need. But directors do not all need the same information. They differ in their knowledge, experience, and skills. Consequently, their information needs are different. Briefings, presentations, visits, individual development programmes, regular updating sessions, and so on can all provide directors with information. But that calls for an imaginative chairman and company secretary. Above all, directors need to be able to find answers to questions they have. Staff support for directors may be vital to enable access to such information.

David Wilson[23] has suggested that non-executive directors need to be better briefed – "in the way, for example, that a cabinet minister is briefed before cabinet meetings." The company secretariat should also be well-resourced to support directors. He also emphasised that "directors need to make efforts to bridge the knowledge gap and take advantage of personal development and learning opportunities."

Dr Gregg Li,[24] writing for this report, suggested that director-level information systems can now use directors' i-Phones, i-Pads, and Kindles to keep them informed. Linked by tele-conference, boards can have a virtual meeting anywhere any time, he suggested.

9. Consider whether the board is responsible for formulating strategy

Boards vary in the extent to which they delegate responsibility for strategic thinking to the CEO and the top management team. In listed companies, with a majority of non-executive directors, the tendency may be for executive management to propose corporate strategies to the board, but for the outside directors to have the ability and sufficient knowledge to challenge and test management's strategic proposals before giving approval. However, in a company with a majority of executive directors, the tendency may be for strategic developments to be initiated and developed in the boardroom.

In any case, there is no doubt that the final responsibility for strategy formulation lies with the board. The directors must agree on the strategic direction of the business: that is why they are called directors. Every director needs to understand, accept, and be committed to the company's strategic direction. Chairmen need to ensure that every director understands the company's strategic profile, fully appreciates the strategic risks to which the company is exposed, and is committed to the companies' strategies.

[23] David Wilson is Chief Executive of the Institute of Chartered Secretaries and Administrators, which is based in London. More about ICSA is available at: http://www.icsa.uk.org.

[24] Dr Gregg Li is Head of Governance and Risk Management for Aon Global Risk Consulting, and author of the distance learning program *Corporate Governance* for Hong Kong Open University.

One of the main findings of the research by Professor Lorsch and colleagues at the Harvard Business School was that providing oversight of company strategy was a major weakness in some boards.

Haris Syed[25] wrote that "governance is often regarded as a 'supra-business' concept which is separate from strategy." In his opinion, "a governance strategy should be part of a company's overall strategy aligned with both the competitive strategy (which markets to compete in) and corporate strategy (how to compete in those markets). In this way, corporate strategy keeps in line with business developments."

The proposed new UK Corporate Governance Code[26] calls for companies to report on their underlying business model and overall financial strategy.

10. Recognize that the governance of risk is a board responsibility

Strategic risks are potentially a company's most serious, yet are typically the least understood by directors. In the global financial crisis, many boards in the financial sector apparently failed to understand their firms' exposure to risk. As C. Fox wrote, "in early 2007 few senior managers thought they were betting on the viability of their banks. It appears they did not understand the risks and were using risk assessment with tools which were inappropriate. Boards may not have expended the necessary time and energy, and/or lacked the expertise to ask the right questions."[27]

A study for the Financial Services Authority, the UK regulator, conducted by three of the Big Four accounting firms into the activities of three failed British banks, whilst not uncovering any illegal activities, raised a number of issues about risk management and corporate governance. Iain Dey[28] reported that the findings indicated a breakdown in communication at all three banks which kept board directors in the dark on risks being run by their company executives.

Professor Judge, also commenting for this report, wrote that he believed that executives, owners and outside directors failed to properly evaluate risk prior to this crisis, and executive incentive systems encouraged excessive risk taking leading up to the global financial crisis. "Boards did not ask enough questions about downside risk; and auditor's failed to report problems to boards. Part-time outsiders do not have the time or expertise to govern properly." He also suggested that top management compensation schemes often failed to take into account the risk that directors had exposed the company to by their decisions."

But the failure at board level to anticipate companies' exposure to strategic risk is not limited to financial institutions. Many companies seem to be quite good at managing operational level risks, that is covering hazards within the enterprise, and management level risks, that is managing risks that might occur from the firm's activities. Companies have systems in place to recognize and handle such exposures.

Sir Adrian, commenting for this report, believed that the lessons on risk (in the UK Walker Report)[29] could have been applied more generally. "A message from the report seemed to me to be that the governance structures and processes were OK but needed to be managed better."

[25] Haris Syed, director and founder of corporate advisory practice Edge Governance, writing in the *Chartered Secretaries Journal* 2009. See: www.edgegovernance.com.

[26] *Proposed Reforms, op.cit.*

[27] Christopher Fox, "Accountants Point Fingers at Failed Corporate Governance as Cause of Financial Crisis," The Association of Chartered Certified Accountants (ACCA), October 27, 2008.

[28] Iain Dey, *Sunday Times* (London) 3 January 2010.

[29] Sir David Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations*, 26 November 2009. Available at: http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf.

Many companies seem to be weak in recognizing and more in responding to strategic risk, in other words responding to threats that come from outside the organization. Consider, for example, the effects of an existing competitor or new entrant unexpectedly launching a new product or service that invalidated yours, or if government introduced tariff barriers, financial controls, or immigration curbs. What if the overall IT system failed through fraud, spying, or mischief? Or, what if a predator made a hostile approach or, in the financial field debt was recalled? What would be the effect of reputational loss following an adverse law case?

Drawing on his experience in risk management, Dr Li noted that "fear drives risk management, but many of us are no longer sensitive to fear that we see everyday. Combine fear with the need for face saving (particularly in Asia), the first action is to cover up. The second is to try to solve it ourselves. In the meantime, the board is kept in the dark... until it is too late. Management needs to acquire a new culture and a practice to inform boards of bad news. Top management should be more proactive in how we inform the board of potential dangers. Conversely, boards need to get a better handle on requiring the establishment of a risk profile, updating of this; establishment of a risk management policy, and better information."

He pointed out that at Northern Rock, Lehman Brothers, and in other corporate collapses "the patient had about two weeks of life after the trauma. A panic situation is stressful and takes a lot out of the board." He suggested that boards should have contingency plans, with core issues and guidelines in place, for when a strategic risk materialises.

He also floated the idea of creating an emergency response team trained to handle crises, working with the media, flushing the board with relevant information, taking command over sensitive information, and initiating actions. Such a team would need to be well coordinated, trained and have the authority to mandate necessary changes. It could consist of directors, governance experts, and perhaps "alternate directors" standing by, people who can be brought in fresh for the fight.

Boards face four choices in managing risk. They can:

- Avoid the risk by not undertaking that activity
- Transfer the risk to a third party through insurance, hedging, or outsourcing
- Reduce the risk with preventive controls, such as duplicate systems or training
- Accept the risk to generate shareholder value, which is the basis of business

Boards need to understand where value is added in their business. Directors need to appreciate the strategic risks to which their company is exposed, and recognize the potential effect and the likelihood of them occurring. Boards need to accept that the governance of risk is a board responsibility. Board-level policies for enterprise risk management are needed, with appropriate systems in place. The board may delegate the main effort to a risk management standing committee of the main board or to subcommittee of the audit committee (although the responsibilities of that committee have already been expanded). A catastrophe recovery plan might also be useful.

Directors responding to the research study by Professor Lorsch and his Harvard team recognized the importance of improving risk management. So does the new UK Corporate Governance Code[30] which includes new principles on the board's responsibility for risk management.

[30] *Proposed Reforms, op.cit.*

11. Monitor board performance and pursue opportunities for improvement

Boards need to be aware of their own strengths and weaknesses. Many corporate governance codes now call for regular board level performance evaluations as a principle or recommendation. Similarly, a regular assessment of the contribution to the board of each director is required.

Again the proposed changes to the UK Corporate Governance Code[31] include a new principle that board evaluation reviews should be externally facilitated at least every three years. Further, the proposed code calls for the chairman to hold regular personal performance and development reviews with each director.

Dr Li wrote that, "board review is a good feedback mechanism and many Western boards are doing this and in some codes it is mandatory. In Asia, instead of having formal performance review of the board, which can be seen as too robotic, a few boards have started to set their first board meeting of the year as a time for reflection. They simply ask each director to identify "three highs" or three good things or practices that they should continue to do; and "three lows" or three things that they should do less of." He emphasised the importance of boards having regular health check, adding, "I guess directors are looking for more signals, easy to understand ones. A corporate governance index for internal use, calibrated against some industry norm, might be useful."

12. Review relations with shareholders — particularly institutional investors

A crucial element of corporate governance is the responsibility of the governing body to be accountable. In the case of a limited company, that accountability is to its shareholders, regulators and other legitimate stakeholders. Company law, supplemented by listing rules and corporate governance codes in the case of listed companies, determines the nature and extent of that accountability.

Companies typically have a duty to treat all shareholders equally. Where a listed company is dominated by family shareholdings or a holding company, its responsibilities to the minority shareholders are particularly important. The challenge here is to police related-party transactions, facilitate transparency, and ensure equitable treatment. Where a listed company is widely held, with significant institutional shareholdings, its relations with the institutional shareholders become important. The challenge, then, is to engage with them, listening and, where appropriate, responding to their comments, without disclosing price-sensitive insider information, or locking them into the corporate governance of the company. Good communication is not enough: it provides the map but does not guarantee reaching the destination. In addition to reporting, boards need to be listening.

Sir Christopher Hogg has written[32] that we have seen that, "in order for UK corporate governance to be strong, boards must embrace the spirit of the (corporate governance) Code and shareholders must play their part. The Code is made up of strong principles that require careful thought and application to the circumstances of each company. The Code is not a set of rules to be applied unthinkingly. It demands that boards seriously and self-critically assess their performance and openly explain themselves to shareholders. And their assessments must be considered equally seriously by major shareholders if the board's efforts are to be sustained."

Sir Adrian Cadbury, commenting for this report, wrote that, "the UK Treasury Committee Report was critical of institutional investors, saying that they had failed in one of their core tasks, namely the effective scrutiny and monitoring of the decisions of boards and executive management in the banking sector, and holding them accountable for their performance. Does this have wider implications?"

[31] *Ibid.*

[32] *Ibid.*

Professor Mallin called for boards to give more attention to the "voice" of shareholders. She called for boards to critically assess their performance, and openly explain themselves to shareholders. "Their assessments must be considered equally seriously by major shareholders if the board's efforts are to be sustained." The board's relationship with institutional investors should recognize a "stewardship" role for institutional investors, she said, with a "say on pay" becoming more widely adopted in other countries as it is in the UK.

Boards of all companies need to assess their performance critically, and those assessments need to be taken seriously by shareholders, particularly institutional shareholders who can take action when necessary. Companies' corporate governance policies should confirm the board's commitment to be accountable to shareholders — all shareholders — balancing the siren song of short-term profits with longer-term corporate growth, while ensuring compliance with regulatory and stock exchange requirements. The challenge is that the needs and expectations of shareholders are seldom homogenous.

13. Emphasise that the company does not belong to the directors

This step will not be necessary in many companies. But the recent history of corporate governance collapses suggests that, in some companies, the directors, particularly executive directors, acted as though the company was a private fiefdom and their arrival in the executive suite entitled them to whatever benefits they felt they deserved. Even where directors own all the shares, the company still needs to recognize its contractual responsibilities to creditors, customers, and employees.

Companies belong to their shareholders for whom the directors act as stewards. That has been the classical, legal model of the corporation since the mid-19th century. However, since the early years of the 20th century in public companies, the growing complexity of corporate activities and the spread of the shareholder base have meant that power shifted from the shareholders' general meeting to the board meeting.

The potential for abuse arises where overly powerful CEOs are supported by the executive directors in their management team, and are unrestrained by ineffective and possibly incompetent outside directors, who owe their board position to the nomination and continuing approval of that CEO.

The proposed UK Corporate Governance Code[33] offers several new principles which should address such abuses of power in the UK as, for example, the emphasis on leadership by a chairman who is not also the CEO; the concern for the roles, skills and independence of non-executive directors; and, the focus on performance-related pay.

14. Ensure that directors' remuneration packages are justifiable and justified

Of all the issues to arise from the global financial crisis, the apparent abuse by directors of their privileged position by awarding themselves massive remuneration packages unrelated to performance, have attracted the most interest and derision from the media and the public. Some director's remuneration and severance payments have seemed at times to reward failure.

This dilemma has not been restricted to financial institutions. Robert Monks,[34] a commentator on the American corporate governance scene, provided a devastating account of corporate greed, with hugely inflated CEO salaries and the wholesale exclusion of shareholders from governance. He suggests that this is symptomatic of a greater threat — the corporate takeover of the political process.

[33] *Ibid*.

[34] Robert A G Monks, Corpocracy, John Wiley, New Jersey, 2008. Monks is the founder of the Corporate Library, a venture capitalist through the LENS Fund, and director of 10 publicly traded companies. He is the author, with Nell Minow, of *Corporate Governance*, Blackwell Publishing, 3rd ed 2005.

Professor Mallin pointed out that "executive remuneration packages seem often not to be related to the company's performance, nor to that of the individual director." This, she felt, resulted in over-generous payments or payments for poor performance, or indeed both. She questioned the role of remuneration committees, suggesting that some had contributed to the problem. "How might the situation be ameliorated?", she asked.

This is a corporate governance issue that will have to be addressed in many regulatory jurisdictions. The proposed changes to the UK Corporate Governance Code call for performance-related pay to be aligned to the company's long-term interests and its policy on risk. Expectations are running high in many countries for greater transparency and confirmation that top-level remuneration packages are justified.

15. Review relations between external auditors and the company

In the original 19th century concept of the corporation, the audit committee was drawn from among the shareholder members of the company. But growing scale and complexity meant that the audit function became professionalized. The independent external auditors now play a fundamental part in corporate governance processes.

The collapse of Arthur Andersen, then one of the five big international audit firms, following the Enron debacle, has swung the spotlight onto the role that external auditors play in the corporate governance process.

Dr Turnbull, writing for this review, expressed concern about close relationships between directors and their external auditors. This concentration of power in unitary boards can lead to conflicts of interest and increase the likelihood of unethical outcomes, he claimed.

The need for external auditors to be, and be seen to be, independent of their clients has become a focus of attention since Arthur Andersen was found to receive more consultancy fee income from Enron than their audit fee, and many of the Enron finance staff had previously been Andersen auditors. It is vital that external auditors provide a genuinely objective judgement on the report of the directors to the company's members. The response in some jurisdictions has been to restrict the non-audit work that auditors do for their clients and to require reporting of such fees.

Modern corporate governance codes place a major responsibility on the audit committee, a subcommittee of the main board. Its original function was to provide a link between the board and external auditor to ensure that the inevitable close relationship between the finance function and the auditor did not mean that issues of valuation, reporting, and control were resolved without the directors being aware. More recently, the role and responsibilities of the audit committee have expanded. In many companies today, they have become a dominant feature in the corporate governance process. As we saw at step 10, some companies have added the responsibility for enterprise risk management to their audit committee.

Since audit committees are comprises of independent outside directors, it has been suggested that they have become more like a European supervisory board. However, a contrary view suggests that, provided all directors have access to the minutes of audit committee meetings and can raise questions in full board meetings, the board is fulfilling its responsibilities.

Nevertheless, all directors should see the routine auditors' "management letter", which reports on their audit in detail. The board also needs to confirm that directors know sufficient about the relations between the finance function and the internal auditors to meet their duties to shareholders. The external auditors should meet with the main board periodically and be available at meetings of shareholders.

16. Consider relations with the corporate regulators

Society allows companies to be incorporated and operate with limited liability. In response all companies are regulated by the state. Private companies have to conform to the companies' law and regulation required by the states in which they operate. Public companies, in addition, have to ensure that they fulfill the demands of the securities regulators and the listing requirements of the stock exchanges on which their stock is listed.

As Gareth Pearce and Mark Cleland commented, "…there seems to be a renewed enthusiasm for companies to engage with shareholders and regulators alike."

In the past, relationships with company registrars and stock exchange listing committees tended to be left to specialist functions — the company secretary, the finance department or the lawyers. Following the global financial crisis, boards need to recognize that these relationships can have strategic importance. Directors need to be aware of the thinking of their regulators and ensure that their own corporate processes and reporting practices are evolving appropriately. The board also needs to be aware of changing expectations of their stock exchange authorities, ensure that they are able to respond to new demands and, perhaps, develop a closer relationship.

17. Develop written board-level policies covering relations between the company and the societies it affects

As we are seeing, new expectations about the governance of organizations are emerging following the global financial crisis. The original corporate governance codes, dating from the early 1990s, were voluntary. At the time, they were derided by some company chairman as being no more than expensive, box-ticking exercises. But since then, three significant changes have taken place. First, corporate governance compliance has increasingly become mandatory, enshrined in regulation or, in some cases, law. Complaints now tend to be about the compliance costs and not about the need for corporate governance codes. Second, risk analysis and risk management have become an integral part of the corporate governance process, as we discussed at step 10. Third, and most recently, corporate social responsibility and sustainability have been added to the corporate governance portfolio.

Does a company have a social responsibility? Is its real duty to create wealth, by pursuing business effectively for the benefit of customers, providing a sound reward to investors, whilst obeying the laws of the states in which it operates? This was the view held by most business people until the 1970s, and no doubt is still held by some today. In other words, it was argued that the state's role was to provide the legal framework to regulate companies' behaviour in relation to the rest of the community, and the duty of the company to obey these laws while satisfying market needs, providing employment, and creating wealth.

Archie B. Carroll (1979)[35] suggested that corporate responsibility can be considered at four levels:

- Economic responsibility — first and foremost the social responsibility to be profit-orientated and market-driven
- Legal responsibility — to adhere to society's laws and regulations as the price for society's licence to operate
- Ethical responsibilities — to honour society's wider social norms and expectations of behaviour over and above the law in line with the local culture
- Discretionary (or philanthropic) responsibilities — to undertake voluntary activities and expenditures which exceed society's minimum expectations

Many companies now accept that their responsibilities go far beyond the generation of wealth while staying within the laws of the states in which they operate. Such thinking is now widely called corporate social responsibility (CSR) and recognized as part of companies' corporate governance responsibilities.

[35] Archie B. Carroll, "A Three-Dimensional Conceptual Model of Corporate Performance." *Academy of Management Review*, 1979 4(4), 497 - 505. Available at: http://www.jstor.org/pss/257850.

Some jurisdictions now require companies to recognize their CSR responsibilities. The UK Companies Act 2006, for the first time, specifically included CSR responsibilities within the formal duties of company directors:

> "A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:
>
> (a) the likely consequences of any decision in the long term
> (b) the interests of the company's employees
> (c) the need to foster the company's business relationship with suppliers, customers and others
> (d) the impact of the company's operations on the community and the environment
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
> (f) the need to act fairly as between members of the company"

The previous common law in the UK required directors to act in the company's best interests, which effectively meant in the long-term interest of the shareholders, typically maximising shareholder value. The new law spelled out a statutory duty to recognize their decisions' effect on a wider public.[36]

A CSR policy is, basically, a summary of the firm's attitudes to the impact it has on its stakeholders, the communities and the environment in which it operates. Obviously, every company is different and must develop its own CSR policy and programmes in the context of its own corporate governance methods, including its corporate strategies and policies, and its management supervision and accountability systems.

In some companies, CSR reporting has become an integral and important aspect of corporate governance practices and is a requirement in some jurisdictions. Companies typically report their CSR policies and their performance on employee welfare, customer relations, environment, ethical standards and sustainability in specific reports to shareholders, stakeholders, regulators, the media, and other interest groups. In most cases, such information appears both as published reports and on the company's web site.

The challenge facing boards, as they develop CSR policies, is that it is not possible to optimize benefits to all stakeholders at the same time. The "bottom line" of profit provides a single measure of achievement. The "triple bottom line" with profit, social responsibility and environmental acceptability as the goals produces inevitable conflicts for directors to resolve.

As a practical step towards better corporate governance, boards might review their CSR policies covering relations between the company and the stakeholders affected by its activities. Written board-level policies can help to promulgate these polices throughout the organization and among the stakeholder groups.

18. Review the company's attitude to ethical behaviour

In the previous step, we considered companies' CSR responsibilities. Inevitably, this raises questions about the ethics of corporate behaviour. Companies are not moral beings. They do not have consciences. The morality of companies has to be supplied by their directors. The global financial crisis has drawn attention, not least by the media, to moral issues facing companies.

[36] Adapted from Bob Tricker, *Corporate Governance — Principles, Policies and Practices*, Oxford University Press, 2009.

Writing for this review, Professor Gabriel Donleavy[37] has focused on the issue of ethics at board level. "Corporate governance," he wrote, "can be aped, as with Enron and Andersen, because corporate governance is a matter of form rather than substance. It is not designed to make greedy robbers into fit and proper professionals. Sarbanes-Oxley mandating of financial literacy in at least one member of the main board's audit committee suggests things were already desperate in 2004 — now they are worse. It is like Abraham being told by God to find at least 10 good men in Sodom and Gomorrah before He will consider saving either from destruction."

What are business ethics? Broadly, they can be considered to be the application of morality to establish principles and rules of acceptable behaviour in business situations. Although some ethical standards are more or less universal (for example, not to steal), ethics are, in fact, culturally determined. Managerial behaviour that might be acceptable in a company in America might not be acceptable in Japan.

In some cases a business issue can be unlawful as well as ethically wrong. Take the case of employing child labour. Most people would agree that this is ethically wrong. The children should be in school and not exploited in work. In many countries, it is also against the law, but not in all. In some impoverished places, it might be argued that the children are working to allow their families to eat. In such cases, the chief executive and the directors of a company would face an ethical dilemma whether to buy products from a country knowing that children had been employed in their manufacture. They would have to decide, and that is an ethical issue.

The beliefs and values of families, communities, and societies influence the ethical norms that determine what are considered acceptable ethical behaviour. Companies also develop norms of acceptable ethical behaviour. This is the challenge that directors face at this step towards better corporate governance.

Some boards try to articulate their company's ethical policies, outlining the sort of company they want it to be, describing the way they expect their employees to behave. They produce board-level polices defining the ethical stance they expect in corporate behaviour. These policies are communicated, induction training is provided, and the policies are regularly reviewed and updated as situations change. Formal lines of communication are developed to ensure compliance. Whistle blowing policy and procedures are created.

As another step towards better corporate governance, directors might review their company's attitude towards ethical behaviour and consider whether any changes are needed in the light of recent developments.

19. Ensure that the company secretary's function is providing value

The original Cadbury Report,[38] back in 1992, suggested that "the company secretary has a key role to play in ensuring that board procedures are both followed and regularly reviewed. The chairman and the board will look to the company secretary for guidance on what their responsibilities are under the rules and regulations to which they are subject and on how those responsibilities should be discharged. All directors should have access to the advice and services of the company secretary and should recognize that the chairman is entitled to the strong support of the company secretary in ensuring the effective functioning of the board."

However, practices vary between countries. In many jurisdictions, the company secretary is formally a company officer with specific duties determined by company law. But, in some countries, the company secretary need not be a company employee, he or she may work for an outside agency or partnership, and in others the post can be held by a company. Following the 2006 Companies Act in the UK, private companies there can decide not to have a company secretary.

[37] Professor Donleavy is at the School of Accounting, College of Business, University of Western Sydney, Australia.

[38] Cadbury, op.cit.

In the United States, the company secretary is typically known as the corporate secretary. The American Society of Corporate Secretaries & Governance Professionals suggests that their duties and responsibilities include organizing meetings of the board, board committees, and shareholders; maintaining the corporate records and stock/share holder records; and, liaising with the securities markets. Significantly, it further states that the company secretary should be "the primary liaison between the corporation's directors and management."[39]

Within companies, practices also vary. In some, the company secretary is a full-time, highly influential company officer; in others, the role may be undertaken by the accounting or legal function; and, in yet others an external professional firm or company registrar agency is used to meet the minimum filing requirements.

Research has shown[40] that, predictably, the effectiveness of the company secretary's work is much dependent on the core competencies and personal characteristics of the incumbent.

The demands and opportunities for better corporate governance, following the global financial crisis, reinforce the important contribution that the company secretary can make to the company and the board. Clearly, the company (corporate) secretary can play a significant part in taking many of the steps to better corporate governance just discussed: in advising the board on its structure, membership, and processes; in improving directors' access to the information they need, in exploring relations between the company and its shareholders, regulators, auditors, and other stakeholders; and, in developing business ethics. Boards might consider the role currently played by their corporate secretary and whether it should be expanded.

20. Consider how the corporate secretary's function might be developed

Professor Donleavy wrote that, "company secretaries can learn not to be like accountants, whose insistence on the high moral ground of faithful observance of fair value accounting (FVA) was destroyed by the SEC's suspension of it, after Congressional pressure, on the basis that in a bear market FVA losses were mere paper — which was, of course, not what they said about paper profits from FVA in the bull market. This has damaged the accountants' professional credibility more than anything else in my lifetime, and converted quite a few accounting academics to the critical perspectives paradigm."

"Corporate secretaries have a historic opportunity to step into the integrity breach left by the FVA debacle, coming within 6 years of the collapse of Enron and its auditor Arthur Andersen," Donleavy continued. "Secretaries can emerge as umpires, referees and even judges between the legislative style pressures of the shareholders in AGM mode and the exec directors in executive mode. In becoming the third arm of governance, they can police the law, achieve independence of both board and of stockholders and be the focus of public trust renewal in the company sector of society. We have seen in micro scenarios, company secretaries who dominate chairs, boards, directors, and governors/stockholders. Right now, this may be preferable to the executive (bad agent) or demagogic (irrational market hysteria) alternatives." But the opportunities for a more professional and infinitely more valuable contribution are apparent.

Dr John Carver,[41] writing for this report says that, "it seems to me that corporate secretaries have more opportunity to influence corporate governance in a modernizing direction than academics and lone voices."

[39] Available at: http://www.governanceprofessionals.org/society/The_Corporate_Secretary_-_Duties_and_Responsibilit.asp?SnID=2062524111.

[40] Bob Tricker, Jessica Leung, and Kelly Lee, *The Company Secretary in Hong Kong's Listed Companies*, The Hong Kong Institute of Company Secretaries, 1995.

[41] Carver is a US-based corporate governance consultant, originator of the Policy Governance model and author of *Corporate Boards that Create Value*, 2002 and many other related works. Policy Governance is a registered service mark.

Phillip Baldwin[42] recently wrote about the role of corporate secretaries and their professional bodies in improving corporate governance. "Where corporate secretaries hold pivotal board-level positions, advising chairmen and the other directors on corporate governance matters, they are potentially in a position to ensure sound governance and to influence ethical behaviour at board level. But the contribution of corporate secretaries to corporate governance varies between companies and between jurisdictions."

"The opportunity is there for the corporate secretary to be responsible for ensuring sound corporate governance practice, to be the repository of governance knowledge and advice, and to be the source of the company's conscience ensuring corporate integrity takes precedence over short term gain and personal benefit. But the company secretarial function is developing in many companies."

"Moreover, the professional bodies that represent corporate secretaries around the world tend to qualify and regulate their members, oversee the practice of the profession, and ensure that standards are maintained. But not all these professional bodies recognize a responsibility to develop corporate governance at the societal level. In some jurisdictions the legal and accounting professions have taken the lead in advising corporate regulators, governments, and society on developments to corporate governance practices. But the corporate secretarial professional bodies could be, and in some countries are, recognized as the leading profession in the practice of corporate governance and lead governance reform."

Baldwin argued that, just as company secretaries are responsible for ensuring high standards of corporate governance within companies, their professional bodies have a moral duty to speak out on matters of governance at the corporate and socio-political levels. "Chartered secretarial professional bodies have a unique contribution to make to the major governance issues of the day, but sadly there has been a reluctance among such bodies to make their voices heard."

David Wilson said at the 2009 ICSA Company Secretaries Conference[43] that, "…company secretaries are perfectly placed to lead the way on improving corporate governance." Citing ICSA's work on corporate governance since the financial crisis, especially its contribution to the UK Combined Code and Walker reviews, its efforts in Europe and the establishment of the Hermes Transparency in Governance Awards, he claimed that company secretaries were now at the forefront of matters of governance and corporate disclosure. "Efforts made over the past year have put the company secretarial community in 'pole position' in the corporate governance debate."

CONCLUSIONS

The major themes that emerged from the inputs of the panel of corporate governance experts were of the many opportunities for better governance to emerge from the ongoing global financial and economic crisis.

The steps that companies and their boards could take towards better corporate governance included recognizing that good corporate governance is about the effectiveness of the governing body — not about compliance with codes; reviewing board processes including the chairman's leadership role, the balance and style of the board, the calibre and contribution of the outside directors, and monitor the board's performance; and improving directors' knowledge of the business and ensure they have the information they want. Other steps involved ensuring that directors' remuneration packages are justifiable and justified; reviewing relations between the company and shareholders, particularly institutional investors, and with auditors, regulators, and other stakeholders; and, ensuring that the company secretarial function is providing value.

The steps led to the final conclusion that the corporate secretarial profession had a unique opportunity to contribute to the development of better corporate governance worldwide.

[42] Baldwin, Chief Executive, The Hong Kong Institute of Chartered Secretaries. HKICS journal CSj November 2009.

[43] See www.chartered secretary.net and www.icsa.org.uk.

A POSTSCRIPT

Our panel of experts raised some longer term policy issues, mostly at the level of governments, regulators, or academia. Though not directly related to the theme of this report on the practical steps individual companies might take, they do seem worth recording.

THE NEED FOR BETTER CORPORATE GOVERNANCE THEORIES

Many of the experts commented on the failure of theory to understand, explain or predict corporate governance issues and financial economic behaviour. Indeed, more of the experts commented on this issue than any other.

Professor Lorsch and his Harvard colleagues found that some directors felt under pressure to produce short-term shareholder value rather than act as stewards for the long-term success of the company. They criticised agency theory for its emphasis on directors being agents for their shareholders, which could work against directors' legal duty to act in the long-term interests of the company.

Professor Judge also recognized failings in current theories of corporate governance. "Commonly accepted economic and financial theory especially macroeconomics, have proven to be largely a sham prior to and during the global financial crisis. We need much more robust theories of financial markets and governance than agency theory. Interestingly, developing markets fared better than developed markets, systemic risk was not diversified away. Behavioural finance and institutional theory offer some fresh new insights into these problems. There are many interesting new theoretical challenges". He added that "all economic systems must balance economic efficiency with social equity. The global financial crisis illustrates that the financial sector emphasizes financial returns over financial risk, and social equity is not on the radar screen. As a result, governments must step in and regulate the financial sector much more aggressively."

Dr Carver called for the development of a theory of corporate governance. "I fear there'll be quite a gap between lessons that *can* be learned and lessons that *are* learned. The history of corporate governance is to engage in a flurry of post-crisis reforms, but reforms that simply add more patchwork solutions. Practices have, thus far, grown like Topsy more than from conceptual coherence. Governance sorely needs more than simply reshuffling the deck no matter how well-intended and intelligent the shuffles. What should be learned is that the system by which a board acts on behalf of owners, with concern for all stakeholders, and with an authoritative though empowering relationship with management — like all modern technologies — should be based on a sound theory of governance, not on a never ending sequence of piecemeal adjustments."

Professor Donleavy, writing for this review, also noted the failure of theory. "All theoretical models are vulnerable to imperfect implementation. Economic models, like the capital asset pricing model, are especially vulnerable because they are mathematical, so they depend on assumptions that the real world fails to deliver. In the global financial crisis, the derivative portfolios were rated, traded and valued as *if* portfolio theory's assumption of mean variance efficiency held for all traded packages — it probably held for none. The invention of the supposed risk free asset has led to the false notion that risk, even systematic risk, can be eliminated or sold off. In fact taxpayers became like Lloyds' names, carrying unlimited liabilities for government's capture by the banking community of unaccountable plutocrats."

Dr Turnbull also saw a need for the development of a theory of corporate governance. "Contrary to popular opinion," he writes, "the principal cause of the global financial crisis was not sub-prime mortgage defaults but a failure of corporate governance."[44] With public policy makers seeking more comprehensive and tougher regulation, Dr Turnbull called for a fundamental rethink about underlying flaws inherent in the Anglo-Saxon structure of corporate governance and regulation. In some of the financial institutions, he noted, others both inside and outside the organizations foresaw problems. Too much power, he believes, is vested in unitary boards, which cannot adequately and reliably control a complex organization. He called for network governance with distributed intelligence, decision making and controls.

DIRECTORS' DUTY VERSUS LEGAL LIABILITY

James McRitchie drew attention to a growing clash that he saw in the United States between the needs and duties of directors to manage risks and attorneys who advise "don't ask; don't tell" to minimize corporate liability in any future litigation.

"Accounting principles for reporting environmental liabilities", he wrote, "include subjective language such as 'to the extent material', 'when necessary for the financial statements not to be misleading', and 'encouraged but not required'. At the same time, section 302 of Sarbanes-Oxley (SOX) requires the CEO or CFO to certify the financial statement 'fairly presents' the company's financial condition, regardless of whether the financial statement is technically in compliance with generally accepted accounting principles. Directors are caught between a rock and a hard place. If they report only 'known minimum' liabilities, they risk violating SOX. However, a 'fair presentation'," could be used as evidence in court and raise possible settlement costs." We need to move, McRitchie suggested, from "don't ask, don't tell" to a careful weighing of the evidence and accounting standards that provide for more in the way of disclosure.

CAN BOARDS BE ADEQUATELY INFORMED BY MANAGEMENT INFORMATION SYSTEMS?

Dr Turnbull argued that in large, complex organizations, a single hierarchical management information and control system inevitable summarises and condenses data so that directors lose essential information. Moreover, management, being responsible for such single communication channels, have a vested interest in presenting their side of the story. He suggested that, just as journalists cross check references with independent sources and law courts seek collaboration from witnesses, directors need access to competitive sources of information such as feedback from customers, employees, and other internal and external stakeholders to get alternative views on the story being reported by management to cross-check accuracy. He cites HP, Shell and the Electric Safety Agency in Canada as examples of organizations using stakeholder councils to provide board information.

"And yet, despite the potential condensation and loss of information at board-level, directors can still be overwhelmed by information and task overload", he commented.

[44] In a paper with Michael Pirson "Can Network Governance Reduce Risks for Financial Firms Too Big to Fail?" Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1533920.

THE CONCENTRATION AND ABUSE OF POWER

Dr Turnbull was also concerned about the concentration of power in unitary boards, which can lead to conflicts of interest and increases the likelihood of unethical outcomes. He cited the determination of director-level remuneration, close relationships with external auditors, and the position of so-called 'independent' directors as examples of this concentration and potential abuse of power. "The problem of unitary boards is that they have absolute power to manage their own conflicts of interest", he wrote." Dr Turnbull suggests the spreading of governance power throughout an organizational network. The supervisory and executive board in the German corporate governance model is an example of a first step in this direction, he commented. "In the John Lewis partnership, a successful UK retailer, employees vote for board representation and can voice concerns directly with directors." As the constitution of the John Lewis Partnership proclaims: "The Partnership operates on democratic principles and as much sharing of power among its members and representatives as is consistent with efficiency."

A CHALLENGE TO THE RATING AGENCIES

Professor Judge felt that rating agencies had failed to evaluate risk properly. "There needs to be a wholesale revision of ratings agencies and the national and international debt rating system." He commented "In the 'race to the bottom', governments failed to maintain necessary boundary conditions. In essence, the rules of the game keep getting watered down in the hunt for national financial competitiveness in the global economy. Governments need to talk to each other more and erect more firm boundary conditions for financiers to operate."

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