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Board reviews: the governance box of chocolates

‘Nevertheless, there is an opportunity to look at board reviews in a different way – one influenced by what good governance looks like in a purpose-led corporate world of the 21st century rather than driven by legacies of previous corporate failure.’

Chris Stamp

ESG in quoted SMEs: Closing the gaps

‘The evidence is clear: the time for seeing ESG as a passing fad is over. It is now high on the agenda for most investors and boards, and that includes some that were highly sceptical no more than twelve months ago.’

Filipe Morais and Jenny Simnett

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Board reviews: the governance box of chocolates

Chris Stamp, Founder Member of The Board Effectiveness Guild, presents the Guild's view of the current state of board reviews and argues for a rigorous discussion about how to make them more meaningful.

Board reviews have come into the spotlight following the publication of a long-awaited report into their effectiveness. We suggest that board reviews have become like a box of chocolates – a comfort to mask stark realities and a luxury that promises much but only sometimes gives you what you want. To move forward, a more rigorous discussion is needed about how board reviews can be meaningful in the 21st century.

It is 18 years since the idea that boards should undertake an annual self-evaluation exercise was introduced into the UK Corporate Governance Code and ten years since the Code requirement was extended to include an externally-facilitated review every three years (for FTSE 350 companies at least).

Last month, The Chartered Governance Institute published its long-awaited Report[1] into independent board evaluation prepared at the request of the UK Government. You do not have to read too far into the Report before you realise that its purpose is not to give a glowing endorsement of the state of independent board evaluation. So, why is this potentially valuable element of the corporate governance framework not working as well as originally hoped? We suggest that there are a number of reasons some of which, but by no means all, are addressed in the Report.

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'They've got these chocolate assortments, you like some and you don't like others. And you eat the ones you like and the only ones left are the ones you don't like so much?'[2]

The analogy of a box of chocolates comes to mind as an appropriate metaphor for this process which we choose to call 'board effectiveness reviews'. And therein lies the first problem: there are different views on what the process should be called. The Institute argues that it is a 'board performance review' rather than a 'board evaluation'. It doesn't like 'evaluation' because it implies that the process is an assurance exercise measured against objective standards.

We would argue that 'performance' is no better as a term because performance is contextual (ask any teacher) and the Institute has not really addressed how performance is to be assessed. To be effective, a board has to adapt its performance to its context and therefore good performance in one year is not a barometer to effectiveness in another – just look at some of the stars of recent years who have performed less well in the pandemic-affected economy of 2020. Board effectiveness is a more enduring quality which requires the reviewer to take a broader, more relevant perspective.

And it's not just about terminology, it's about preferences as well. Too many boards, and particularly Chairs, have singular views of what they want these reviews to be – sometimes out of expediency, sometimes out of favouritism, sometimes out of a desire to secure the right outcome. The Report acknowledges this issue in places but does not make much effort to address this issue by building on the FRC's useful advice on externally facilitated board evaluations[3] (which would have been an obvious area for the Institute to focus its review). Instead, it suggests eight *Principles of good practice for listed companies using external board reviewers* which, with one exception (Principle 5), are no more than restating the common sense of many current reviewers.

'Life is like a box of chocolates, you never know what you're gonna get'[4]

To be fair to many listed company boards, as the Institute notes, the quality of board effectiveness review services has not always been good and their reputation has been tarnished as a result. Again as the Institute notes, there is evidence that this is rapidly improving but it has taken time. Among the early movers in the board review marketplace were the head-hunters, some of whom initially saw board reviews as a way of creating demand for their recruitment practices. The Code now requires disclosure of any connections that the board reviewer has with the company but the sense of self-interest sometimes remains. Beyond this, the issue for boards is sometimes simply that the exercise just seems a complete waste of time, particularly ones which result in long tables of questionnaire output and analysis which do not offer any new insight. This is a quality issue rather than a self-interest issue. The Report rightly seeks to address both these issues but it does not really get to grips with the fact that, at the heart of the process, there needs to be serious traction between the reviewer and the board being reviewed. Getting this traction requires three things: good engagement about the process, good definition of the areas to be considered within the review and good dialogue about the findings. These need to work together to deliver the best outcome.

Feature

‘… there needs to be serious traction between the reviewer and the board being reviewed. Getting this traction requires three things: good engagement about the process, good definition of the areas to be considered within the review and good dialogue about the findings.’

Good engagement: The Report makes much of the process by which board reviewers should engage with companies. Plenty of disclosure and process is suggested but it is all up front, before the engagement commences. The scope of a review cannot be fully developed without the reviewer finding out what is going on with the board, the company, its stakeholders and, yes, its performance. Some of this can form part of the pre-engagement discussion but it can only be done properly and fully as part of the initial stage of the project. Only after this piece of work has been completed can the scope of the review be crystallised so that there is clarity about what the reviewer is going to focus on in their interviews, observation or even questionnaires.

Good definition: Whilst there are often a number of topics that should always be considered in every board review because they are fundamental to effective governance, the context of the company has to be a primary consideration in identifying the issues to be probed in the review. The Code is not helpful in this regard by ambiguously making board reviews the prerogative of the nominations committee and over-emphasising board composition as the central purpose of such reviews. Such emphasis seems to downplay really important considerations such as the board’s engagement with strategy or risk which are central to any board’s effectiveness.

Good dialogue: The Report devotes useful attention to the dialogue between the reviewer and the board, and disclosure of the outcomes from the process. Requiring companies to report fully on the findings and outcome of the process may help encourage dialogue but it does not mandate it. It is for this reason that Principle 5 of the Institute’s *Principles of Good Practice*, which requires signatory companies to provide reviewers with an opportunity to present their findings to the whole board, is actually very helpful.

‘Everyone knows the boat is leaking, everyone knows the captain lied … everyone wants a box of chocolates.’[5]

As with many aspects of the Code, board reviews were introduced in response to a corporate governance failure. The 2003 Code changes were the consequence of Enron and other corporate failures and the 2010 changes were prompted by the global financial crisis. The Government’s approach which gave rise to the Institute’s review was the direct result of the corporate failures of Carillion, BHS and others. Corporate failure has been the defining narrative for the evolution of board effectiveness reviews or put another way, it gives the corporate world a sense of comfort that it has taken action to avoid previous failings. But is this not simply shutting the stable door after the horse has bolted?

The Institute observes that the purpose of reviews is ‘to provide reassurance that the board takes its responsibilities seriously’ rather than ‘assurance as to the future performance of the board and the company’. Either way, there is a truth that needs to be acknowledged – board reviews will never be the remedy for poor corporate performance – neither historic nor prospective. A good board review will probe important issues and should be able to give stakeholders a sense that the board is engaging well with its duties; beyond that, nothing is guaranteed. Nevertheless, there is an opportunity to look at board reviews in a different way – one influenced by what good governance looks like in a purpose-led corporate world of the 21st century rather than driven by legacies of previous corporate failure.

If there is a fundamental point that the Institute seems to have missed in its Report, this seems to be it. Bob Garrett recently discussed the future role of company boards within this context of corporate purpose and made the point that s 172 of the Companies Act has been in place to ensure that directors act in the interests of all stakeholders since 2006[6]. But he notes, it has rarely been used to require directors to account for how they account for stakeholder interests in their decision-making. This is now changing with new reporting requirements. However, until robust legal and shareholder remedies are enforced, there is no point in board effectiveness reviews being expected to be the stick for driving responsible board behaviours. A better approach, therefore, would be to re-position board effectiveness reviews to support boards in becoming more effective decision-makers in the context of a broader stakeholder dialogue. The additional processes and guidelines of the Institute’s new Codes of Practice do not do much to help this repositioning and board effectiveness reviews look destined to remain a governance box of chocolates.

The Board Effectiveness Guild is a group of independent board reviewers who have come together to enhance the value of the board effectiveness reviews by sharing best practice and contributing to the wider debate on excellence in corporate governance.

https://theboardeffectivenessguild.co.uk/

1. *Review of the effectiveness of independent board evaluation in the UK listed sector*, The Chartered Governance Institute, 2021
2. *Norwegian Wood*, 2011, Haruki Murakami
3. *Guidance on Board Effectiveness*, FRC, July 2018, p 30
4. *Forrest Gump*, 1986, Winston Groom
5. *Everyone knows*, 1988, Leonard Cohen
6. *What are company boards for now?* Bob Garrett, RSA, 26 June 2020

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the US, as big tech companies like Google, Facebook and Amazon face greater scrutiny and anti-trust investigations.

Conclusion

Whether Ant's IPO suspension sows more confusion over China's regulatory practices or signals a step toward genuine reform remains to be seen. Either way, this incident is a warning to all Chinese technology companies to remain compliant and to beware regulators' intolerance toward cutting corners.

China's anti-trust enforcement is sure to shake other Chinese internet giants like Tencent, Meituan and JD.com and may possibly hurt China's economy and investors' interest and faith in Chinese companies for the time being. However, in the long-term, a well-regulated economic environment is essential, especially as China's economy – the second largest in the world – transitions to the digital era and plays a greater role in the global economy. If China suspended Ant's IPO to demonstrate its commitment to a higher standard of regulations, it may have come just in time – not only to prevent systemic and credit risks, but also to sustain and strengthen Chinese companies and the country's entire economy.

Lyndsey Zhang is a business strategist, entrepreneur and founder of BoardEpoch and Boardroom&Beyond, and a thoughtful adviser on corporate governance for Board of Directors around the world. Her company specialises in producing inspiring podcast episodes and educational articles sharing only the best corporate governance practices and ESG strategies and promoting leading companies in today's global ESG movement. www.boardroomandbeyond.com She can be reached at: Lyndsey.zhang@boardroomandbeyond.com

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