GOVERNANCE

December 2022 Issue 340

Risk reflections

'It is of paramount importance that boards and ExCos use this opportunity to embed better risk-return discussions, more robust business case processes and integrate risk discussions in performance reviews to be able to demonstrate their stewardship of the business and efficient use of capital.'

Hans-Kristian Bryn

Board effectiveness reviews – Part 2

'Board member interviews are not cosy chats – often the greatest insights an interview (on both sides) can come from moments where the temperature drops and there is some tension in the air. Noticing that tension, finding the right way to explore what underlies it, and what a board can learn from it, is part of the necessary skill set of a board reviewer.'

David Archer and Chris Stamp

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News

UK Board Index 2022

UK boards are reshaping themselves with fresh skills, qualifications and perspectives and grasping the ethnic diversity challenge, according to the *2022 UK Spencer Stuart Board Index*. Now in its 27th edition, the Index is a comprehensive review of board composition and governance practices of the top 150 FTSE companies.

Sustainability

Regulators, investors and customers are increasingly holding companies to account for their behaviour and impact on society. Boards across all sectors are responding by establishing committees covering topics such as sustainability, climate change, decarbonisation, human rights, labour standards, good citizenship, workforce engagement and diversity, equity and inclusion. Forty-six boards have committees overseeing environmental and social topics: 16 overseeing corporate social responsibility; 19 overseeing sustainability; and 11 overseeing ESG. Eighty-two per cent of ESG committee Chairs are women.

Diversity

There has been significant progress on board ethnic diversity, 87 of the FTSE 100 meeting the Parker Review target of at least one director from a minority ethnic background. Sixty-one per cent of these directors are non-UK nationals. However, the proportion of minority ethnic directors in board leadership roles remains small. Fifteen per cent of all directors who disclosed their backgrounds have identified as minority ethnic and only 39% of minority ethnic directors are UK nationals. Twenty-seven per cent of new directors are minority ethnic and 58% of first-time directors with a minority ethnic background are women. Eighty-eight per cent of first-time directors with a minority ethnic background are in an executive role in addition to their directorship; only 12% have a portfolio career.

Women form the majority of non-execs on FTSE 150 boards for the second year running and 60% of new board appointments went to women. Forty-six per cent of companies have reached the 40% target for women on boards and 26 boards have reached gender parity.

First-time directors

There has been a significant increase in the proportion of newly-appointed non-execs taking on a board role for the first time. Forty-eight per cent of new directors are first-time directors and 54% of those are women. Ninety-one per cent of first-time directors have experience in the same industry as the board they have joined.

Board leadership

Board leadership remains predominantly male. There are 20 women who Chair boards, 16 female CEOs and 25 female CFOs. Fifty-one per cent of boards have at least one woman in the Chair, CEO, SID or CFO role. However, no boards have a woman in all four roles, whereas men occupy all four positions on 73 boards. Twenty-eight per cent of SIDs are women.

‘There has been a significant increase in the proportion of newly-appointed non-execs taking on a board role for the first time.’

Board committees

FTSE 150 company boards continue to have a wide variety of committees and 15% have a stand-alone risk committee (predominantly financial services companies). Forty-eight per cent of audit committee members are women and 46% of audit committee Chairs are current or former CFOs. Fifty-nine per cent of remuneration committees are chaired by women, as are 33% of audit committees. Women account for 52% of remuneration committee members and 48% of audit committee members. Ten per cent of remuneration committee members and 13% of audit committee members have self-identified as having a minority ethnic background.

Overboarding

The dangers of overboarding continue to concern investors and proxy voting advisors. Sixty-five per cent of non-execs have additional listed company board commitments and 33% balance their board responsibilities with executive positions elsewhere. Twenty-five per cent of Chairs hold at least one other public company board Chair role and 18% hold one other FTSE 350 Chair role. Thirty-five per cent of CEOs and 26% of CFOs hold an outside board directorship.

Remuneration

After an average 10% reduction in total remuneration for Chairs in 2021 due to the pandemic, pay has returned to 2019 levels. However, the average additional fee paid to SIDs has dropped by 3%. Average total Chair remuneration has increased by 9% in 2022 to reach £404,915, 3.5 times that of the SID and 5 times that of the non-execs. The average base fee for a non-exec reached £72,051 in 2022 and total remuneration for non-execs (excluding Chairs) averaged £98,460.

Workforce engagement

Forty-seven per cent of boards have designated a non-exec to be responsible for workforce engagement. Sixty-six per cent of these are women and 40% are non-UK nationals. No FTSE 150 company has yet chosen to appoint an employee as a board director.

For the full Board Index go to: https://bit.ly/3B4ht2E

News

Risk in focus 2023

Geopolitical and macroeconomic uncertainty is the newest and most dynamic risk rising up the agenda, according to a recent business risk report. The Report, *Risk in Focus 2023*, has been published by the Chartered Institute of Internal Auditors, in partnership with 13 other Internal Auditor Institutes across Europe.

While cyber security remained the number one risk businesses face, human capital risk moved into second place. Other top six risks included digital disruption, new technology and artificial intelligence (AI) and climate change. However, the risk that has increased the most, according to Chief Audit Executives (CAEs), is geopolitical and macroeconomic uncertainty. Despite this, only around one in ten are spending any major time or effort auditing the impacts of this risk on their business.

Cyber and data security

Cyber security and data security remained the number one threat for CAEs and internal auditors said they spent most time and effort working on this. Ransomware has been a major threat in 2022, and is difficult to mitigate, and 'killware' attacks have increased, targeting critical infrastructure. There has been more of a shift to hackers targeting third-party suppliers with less mature security systems. Maturation of business models around cyber crime is also becoming a major threat. Despite the severity and urgency of cyber security and data security risk, many CAEs said boards often lacked sufficient knowledge or interest in such threats.

Human capital

Human capital, diversity and talent management ranked as the second highest risk to business. The pandemic has fuelled new challenges and accelerated longer running trends, including skills shortages as many workers have retired and younger people are favouring education or alternative career routes. The psychological wellbeing of employees has moved higher up the agenda and businesses must also tackle wage inflation. They must create a core, purposeful and diverse culture to accommodate hybrid working and inclusion, while remaining highly operational and productive.

Geopolitical uncertainty

Chief audit executives ranked macroeconomic and geopolitical risk as the third most pressing threat, up from seventh place last year. In the first quarter of 2022, as a result of the war in Ukraine, sanctions risk was a major area of focus and this is a risk that is likely to grow in 2023 and beyond. Such events could indicate a permanent change in the nature of emerging risks. Internal auditors in some sectors supported their businesses in maintaining up-to-date risk assessments and strengthening controls for screening suppliers and shareholders.

'Human capital, diversity and talent management ranked as the second highest risk to business.'

Digital disruption and AI

Chief audit executives ranked digital disruption and new technology as the fifth most pressing risk, down two places from 2022. But in three years' time they said it would rank as the second biggest area of internal audit effort. Many businesses have trialled AI processes and this highlighted where data systems needed improvement and how AI might be used better in future. While internal auditors are turning their attention to AI systems, they must also ensure that their organisations have got the basics right for digitalisation. However, rocketing inflation, pay increases and supply chain disruption threaten to stall such projects.

Climate change

Climate change moved from eighth to sixth place in the risk rankings and is expected to move to third place in three years' time. While internal auditors are shifting more resources into climate change assignments, it ranks only 11th place in terms of where they spend their time and effort. Most CAEs were taking a blended approach to auditing particular environmental issues, although some departments had yet to start full-scale, real-life auditing. For those that have started, one of the biggest challenges has been to up-skill their teams or attract and retain high-quality staff. Too much emphasis is currently placed on reporting rather than how an organisation's governance model should work effectively to integrate sustainability goals without it being relegated to a box-ticking exercise.

Recommendations

There is a perfect storm of high-impact, interlocking risks intensifying with a looming recession and an accelerating cost of living and businesses must work with their internal audit functions to navigate more risky, uncertain and volatile times ahead. Recommendations of areas of focus include:

- assessing whether assumptions made about key risk areas are still valid and fit for 2023;
- focusing on systemic risks that create vulnerabilities across the organisation simultaneously and ensure risk assessment and risk management provides the board with clear oversight; and
- assessing whether there are effective mechanisms and resources in place to disseminate information about new cyber threats and countermeasures throughout the business.

For the full Report go to: https://bit.ly/3iuFQ33

International

Route to the top

The group of CEOs appointed over the last year included the highest share of first-time CEOs in three years, suggesting that boards may be more open to taking a risk for the right experience, according to a report from Heidrick & Struggles. *Route to the Top 2022* examines the latest data and trends in new CEO appointments to the largest companies in 25 markets around the world from 1 July 2021 to 30 June 2022.

CEO appointment trends

Overall, the rate of appointments held relatively steady over the last year compared to the previous year. However, it is noticeably down compared to two years ago in most of the markets studied. Also, there are significant differences from country to country, with most showing a larger slowdown: out of the 25 markets, only four made more appointments this year than last.

There has been a shift toward appointing CEOs internally (64% were internal appointments), suggesting a heavier reliance on internal succession planning processes and a focus on developing talent to reduce uncertainty. There are significant differences regionally: North American companies made 78% of their CEO appointments internally, while for Middle Eastern and African companies 56% and 54% of current CEOs, respectively, were promoted internally.

‘Boards are broadening their understanding of what makes a successful CEO.’

CEO experience

In the face of increased expectations of the CEO role, many boards are changing their criteria for the background and experience required for new CEOs, even when drawing candidates internally. The latest cohort has brought both more diverse C-suite experience (other than traditional CEO or CFO experience) and backgrounds that do not include C-suite experience. Instead experience more frequently includes roles such as head of division, regional leader, executive vice president, general manager and managing director.

Boards are broadening their understanding of what makes a successful CEO. The CEOs appointed over the past 12 months included a significantly higher share of first-time CEOs. In fact, incoming CEOs included the highest share of first-time CEOs in three years (69% of appointments), suggesting that boards may be more open to taking a risk for the right experience.

Diversity and demographics

Despite an overwhelming percentage of executives who consider diversity to be more important to their organisation now than three years ago, the number of both women and racially and ethnically diverse CEOs among the Fortune 100 remains low, at roughly one in four. Thirteen per cent of new CEO appointments were women and out of 18 women CEOs appointed over the last year, seven are based in Europe, six in Asia Pacific, three in Africa and two in North America. There are significant regional differences, with African markets leading on gender balance and Latin American and Middle Eastern markets trailing.

There is also slow but steady progress on non-national CEOs and those with cross-sector experience. Asia Pacific markets have the largest share of CEOs who are non-nationals and the Middle East has the highest share of CEOs with cross-border experience. When it comes to cross-sector experience African companies lead the field and North American companies rank last.

Routes identified

Five routes to the top were identified:

- straight to CEO (34%),
- direct report to the CEO (25%),
- long tenured (18%),
- other senior leader (16%),
- founder (4%).

Many companies focus on bringing an external CEO straight into the role or appointing someone as a direct report to the CEO as part of their succession planning. However, the shift toward appointing CEOs internally suggests that more companies are focusing on their internal succession planning. That said, only 18% of the CEOs are long tenured. Of those appointed directly into the CEO role the highest share (10%) is women, suggesting that many companies are still struggling to develop gender-diverse talent pools for succession planning. Thirty-eight per cent of those appointed straight into the CEO role had been a CEO before. Head of division is a much more common route for internal appointments.

Looking forward

An increasing number of boards are looking at CEO succession through the strategy and scenario planning lens, putting in place contingencies for different contexts and time horizons, from CEOs who will retire in the role at a planned time to emergency CEO succession options. Leadership development should be seen as key in shaping and retaining leaders. Boards should drive CEO succession planning deeper into the organisation, developing a larger internal pool of strong potential leaders. This may motivate potential internal candidates to stay with their companies.

For the full Report go to: https://bit.ly/3XU94so

Global News

Executive opinion survey

Environmental and cyber risks have been overshadowed by short-term economic concerns for G20 business leaders, according to recent data from the World Economic Forum. Executives across 122 economies were asked to identify the risks considered the biggest threats to their country over the next two years. The survey results show that interlinking economic, geopolitical and societal risks are dominating the risk landscape, as businesses continue to address immediate concerns around significant market turbulence and intensifying political conflict.

Rapid and/or sustained inflation was the most commonly cited top risk, 37% identifying it as a top concern, followed jointly by debt crises and the cost-of-living crisis. Geo-economic confrontation was identified as the top risk by two countries. Other respondents cited the potential for State collapse and lack of widespread digital services and digital inequality as top concerns.

Despite mounting environmental pressures and rising environmental regulation over the last 12 months, environmental issues were seen as a significantly lower risk than in 2021. That said, natural disasters and extreme weather is a top ten concern in emerging markets, whilst aggregate responses from advanced economies prioritise failure of climate-change adaptation.

Although there is the growing threat of cyber attacks on critical infrastructure, cyber and digital risks and other technological risks ranked among the least commonly cited top five risks this year. This was particularly so for executives based in advanced economies, although lack of widespread access to digital services and digital inequality appeared in the top five for respondents in Latin America and the Caribbean, South Asia and Sub-Saharan Africa.

The findings also highlight marked regional variations between advanced economies and emerging markets. While economic risks associated with rapid and/or sustained inflation were identified as the top risk by respondents in Europe, Latin America and the Caribbean and East Asia and Pacific, societal concerns associated with the cost-of-living crisis dominated in the Middle East and Africa and Sub-Saharan Africa. In Central Asia and South Asia interstate conflict and debt crises topped concerns respectively.

Inflation, affordability and national debt-related risks featured prominently in top five risk rankings for executives globally. Conflict-induced commodity concerns also appeared in the top risk rankings across regions, along with other geopolitical risks that feature in various manifestations, depending on regional contexts.

Sustainability expectations

Businesses and many of their biggest investors globally are at odds over the action needed on sustainability – a clash of opinion that threatens to stifle access to capital for many organisations and could hinder progress on decarbonisation, according to the latest EY Global Corporate Reporting Survey. The survey canvassed the views of 1,040 chief financial officers (CFOs) and other senior finance leaders and 320 institutional investors globally and looked at their expectations and goals in relation to sustainability investment and reporting.

Long-term v short-term

More than three quarters of investors say they believe companies should invest in improvements relating to ESG matters, even if it hits short-term profits. Only 55% of business leaders hold the same view. Fifty-three per cent of companies believe their efforts to drive long-term investments are, in fact, impeded by investor pressure to show short-term gains. Twenty per cent of the finance leaders went as far as to say that investors are ‘indifferent’ to long-term investments, including those relating to sustainability.

Greenwashing concerns

Investors are also highly critical of the approach businesses take to disclosing important information on sustainability activity. Almost all investors surveyed (99%) say that ESG reporting is a crucial part of their investment decision-making, but 76% feel that organisations are ‘highly selective’ about the information they provide, raising concerns about greenwashing. Eighty-eight per cent believe that companies only disclose when they are forced to do so. Where businesses do make long-term investments in sustainability, 80% of investors say that they often fail to explain their rationale, making such investments hard to evaluate.

Room for improvement

Many businesses do recognise that there is room for improvement in their approach and there is some common ground between businesses and their investors. They agree that key issues to be addressed include: the weaknesses of current reporting standards and the lack of requirements for supporting evidence; the separation of ESG reporting from mainstream financial reporting; and the lack of forward-looking disclosure.

The survey outlines steps that organisations can take to strengthen confidence and also highlights two priorities: improving sustainability reporting designed to meet expectations; and elevating the role of finance leaders and the finance function in reporting.

Global News

Dutch areas of focus 2023

Dutch corporate governance and sustainability platform for institutional investors, Eumedion, has published its focus letter for 2023, sent to executive and supervisory directors of Dutch listed companies. In recent years, climate-related disclosures and performance have been the focus and much work still needs to be done. Many companies have yet to establish Paris-aligned Net Zero transition plans and objectives that are externally verified. The letter focuses on two areas: natural capital: policies and targets for the protection and restoration of biodiversity and ecosystems; and transparency on human rights: effectiveness of management and mitigation strategies.

Natural capital
Focus on climate-related disclosures and Net Zero transition plans has been broadened to include disclosure of policies and targets for the protection and restoration of biodiversity and ecosystems. Biodiversity loss and ecosystem collapse can have a severe impact on the ability of companies to generate long-term value and therefore on the performance of institutional investors' investment portfolios. Companies should identify, measure and assess the dependencies and impacts of their company on biodiversity and ecosystems, including any risks and opportunities. This assessment should be done for the company's own operations and for the whole value chain and should be clearly reported on to external stakeholders. If the dependency and/or the impact is material, companies should disclose their policy to mitigate negative impact or create positive impact, including the company's KPIs and short-, medium- and long-term targets.

Transparency on human rights
Companies should already have robust procedures in place to identify, manage and prevent adverse human rights impacts material to their business. They should also provide meaningful disclosures on these practices and account for the effectiveness of their human rights management and mitigation strategy. However, in general, whilst Dutch listed company annual reports do contain details about various due diligence measures and procedures, very few companies discuss the effectiveness of those procedures. Companies are relatively silent on the measures taken to verify whether suppliers comply with the company's code of conduct and on the steps taken to mitigate adverse human rights impacts. Companies also have no detailed disclosures regarding their decision processes for continuing or discontinuing operations in countries or areas in conflict and/or where endemic human rights issues have been identified.

Remuneration report standardisation

The European Commission has published draft Guidelines on standardisation of remuneration reports (the Report) under the revised European Shareholder Rights Directive. The aim of the non-binding Guidelines is to help companies disclose clear, understandable, comprehensive, consistent and comparable information on individual director's remuneration.

Key principles
Companies are required to produce a remuneration report annually to explain how their remuneration policy has been implemented in the most recent financial year under review. To ensure that the Report is comprehensive and comparable across the EU, presentation should be standardised. Reports can be tailored to companies and areas where there is nothing to report can be omitted, though explanations as to why areas have been omitted should be given.

A comprehensive overview of all the remuneration awarded or due during the reported financial year should be provided. It should be clear, concise, meaningful and understandable. This principle should be borne in mind by companies when deciding whether to include additional information not explicitly required by the Directive.

The Report should be a stand-alone document, however cross-references can be made to relevant background information published elsewhere, where appropriate, to avoid unnecessary duplication. The Report should be made available online and free of charge, as should sources that are hyperlinked.

All monetary amounts should be presented as gross figures, including the taxes paid by directors on their remuneration, but not taxes or contributions paid by the company, if any. For that reason it may be helpful to include narrative to explain numbers and provide context for the users of the Report.

Companies should provide sufficient insight to allow readers of the Report to understand the link between the remuneration awarded or due and the performance achieved. They must also provide information on how the performance criteria were applied in the reported financial year.

Different remuneration arrangements can apply to members of administrative, management or supervisory bodies and chief executive officers or other directors. Distinction should be made between: directors with different functions; executive directors; directors in different situations (eg retired/active directors); and directors in relation to their role(s) in the reporting company, and, if that is the case, in relation to their role(s) in other companies belonging to the same group.

Feature

Risk reflections

Hans Kristian Bryn reflects on the way the risk landscape has changed since September 2022 and argues that this is not a time to think about risk management from a compliance perspective.

Since I published my autumn risk reflections in September 2022, Liz Truss is no longer in office and the new Prime Minister is Rishi Sunak, COP27 has had significant media attention and many tech companies have announced sizeable workforce reductions. Equally, we are seeing inflation and interest rates at levels that we haven't experienced for a long time, and many forecasters are predicting a sustained recession.

All of these factors are firm indications that the business context facing boards and ExCos are fundamentally different from the one in which they wrote their last annual report. In recent client projects to assess Principal and/or Key Risks, it is clear that the volatility and uncertainty facing clients is even more pronounced than what we have seen over the last 18–24 months. This underscores the need to ensure that non-linear and scenario based approaches are used to ensure risk management serves both to protect and enhance value as an integral part of planning and decision-making.

In my autumn risk reflections, I touched on the impact of disruptive forces such as inflation and the ability to recover the cost increases from customers, severely elevated levels of geopolitical risk, and the prevailing energy crisis. Recent client engagements have also highlighted a host of other risks but also opportunities to take advantage of these disruptive forces to restructure/redefine the value propositions and business models. However, one of the observations that concerns me is that a better risk perspective is not an integral part of articulating strategies but is developed in response to a change and/or update in the strategic direction. It would seem logical, in particular in a situation with exceptionally high uncertainty and volatility, to have a fundamental discussion about the risks facing the business and its business models concurrently with evaluating strategic options and choices.

In terms of specific risks that should be getting more attention, I would highlight three key risks:

1. People risk

- This is a broad risk and it covers the ability to attract, develop and retain the critical skills and competencies required to succeed going forward.
- The availability and cost of labour – the war for talent is leading to real workforce availability issues and wage inflation in the short-term given the high levels of employment.
- Balancing wage inflation, political uncertainty and cost.
- Industrial relations – in the UK we are seeing increased levels of industrial action and this hardening of the industrial relations climate is also evident in key parts of continental Europe.
- Workforce management – retaining organisational knowledge and memory, key competencies and rightsizing the workforce.
- Workforce expectations post-Covid – the definition and delivery of effective hybrid working models.

From a risk management perspective, it is easy to say that these are risks factors that should *only* be addressed by the CHRO. However, this is an example of a risk that is having strategic, operational and financial implications. Hence, the CHRO needs to define an acceptable level of risk and work in close partnership with other functions and business units to devise country/site specific solutions and mitigations to local manifestations of these risk factors. Also, the success in managing the risk or exploiting the opportunity would significantly affect the success of the strategy, resilience of the business and future viability.

2. ESG

The customer and stakeholder expectations are changing rapidly and could cause significant disruption to companies that are not putting effort and capital into innovation, product, supply-chain and business models. However, there is still a tendency for businesses to see ESG as a compliance issue rather than an existential strategic issue that can define the future viability of a business and its purpose. As such, the board and ExCo agendas should reflect the need to manage volatility and uncertainty arising from a lack of implementation of commitments that have been made, but also include a robust review of the extent to which the organisation in question is grasping the opportunity to anticipate changing customer expectations and requirements, developing innovative solutions that generate competitive advantage and creating incremental value.

3. Cost of financing and capital allocation

The availability of debt financing and the cost of debt are increasing risks for many corporates – in particular those with high leverage or high ambitions for inorganic growth. There is therefore a market expectation that businesses can demonstrate that they have a robust process for prioritising the use of capital, maximising returns (on a risk adjusted basis) and using capital, as a scarce resource, effectively. In many areas, be that digital, systems/IT and disruptive innovation, there is evidence to suggest that business cases are not firmly

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Feature

Gender diversity beyond the headlines

Michelle Tessaro looks at the latest Cranfield Female FTSE Board Report which finds that the issue is not so much having women at board level as developing the executive pipeline.

If we want to get more women into leadership roles, we need to stop talking about getting women onto boards. This is the revelatory conclusion we come to in this year's Female FTSE Board Report.

What do we mean by that? Well, of course we don't mean it literally – that we shouldn't any longer talk about increasing female representation at the highest levels of UK business. But we do urgently need to shift the narrative.

Two decades of progress?

Since Cranfield School of Management launched the Female FTSE Board Report in 1999 under the leadership of my co-author, the eminent Professor Sue Vinnicombe CBE, we've come a long way.

In 1999, only 6.7% of board directors on the FTSE 100 were women. Today, in 2022, that figure stands at 40%.

Back then, it was assumed – and that assumption persisted even up to and beyond the Davies Reviews from 2011–2015 – that, if we could only increase the number of women at the top, that it would 'trickle down', and improve gender diversity at all levels.

Unfortunately, that hasn't been the case.

Beyond the headlines

What we have seen over the years is that the rising numbers in the headline figures are masking the same invidious inequalities.

Many companies in the FTSE 350, in order to meet government targets that, although voluntary, are obviously good for business to be seen to be taking seriously, have appointed women to non-executive directorships. There has been pitifully little progress in appointing women to the executive ranks, and to the role of board Chair, where they can have a really active role in decision-making, making a difference for those below them.

We've set voluntary targets. We've considered quotas. We've provided practical steps that businesses can take to improve their gender diversity, including suggesting 100 women each year in our Women to Watch Report for the past 13 years that would be ideally suited to a board position on one of these companies. We've changed the numbers, but we haven't materially changed what is going on behind the scenes.

Disrupting the narrative

In the Report, we talk about how we believe it is time to turn primary attention away from increasing gender diversity on boards, in favour of urgently addressing this lack of 'trickle-down' progress.

We've included a special report looking at how we believe the executive succession planning process can be improved by bringing it under the remit of a more robust and regulated nominations committee and increasing board oversight of its progress against targets aimed at increasing gender diversity.

Effecting big change

Identification and development of professionals for promotion to executive levels can be a 10- to 15-year process. To ensure a gender-balanced pool of diverse talent when it comes time to choose a new CEO, we need to make sure women aren't pushed out or choosing to opt out early on in their careers.

This isn't going to happen by taking accommodative approaches to organisational structures, systems and processes, when so much of how UK companies manage and develop their people continues to quietly favour men – especially when it comes to high-profile leadership roles.

We need disruptive practices that intentionally develop gender diversity in the talent pipeline through new approaches to recruitment, selection and promotion.

'It is time that we turn our primary attention away from increasing gender diversity on boards to addressing, in an urgent way, the shocking lack of progress in gender proofing executive succession planning.' *Female FTSE Board Report 2022*

There are some great examples of companies engaging in disruptive practices that are really making a difference – things like reducing the number of essential criteria in job descriptions for top executive roles – to encourage more women to apply.

We want to see more companies directly tackle biases in how they manage and develop their talent, in particular how women are evaluated for promotions and leadership opportunities. Deciding who gets promoted is based on a myriad of considerations, but for senior level appointments leadership potential becomes increasingly important. Unfortunately, the evaluation of leadership potential is still subject to unconscious

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Feature

Board effectiveness reviews – Part 2

David Archer and **Chris Stamp** continue to look at maximising the value of external board effectiveness reviews.

In the last issue of *Governance* we discussed two aspects of how you can maximise the value of an external review of your board by – *Getting planning and scoping right and Choosing the best approach* to running the review. In this edition we explore two more important areas that underpin the success of an external board review – *Asking the right questions* and *Developing a good action plan*.

These four areas to consider when the designing and commissioning a review all arose from a webinar run jointly by *Governance* and the Board Effectiveness Guild in October this year.

Asking the right questions

In our previous article we talked about how to get a review built on the right foundations. This means setting the terms of reference to focus on the value that the board needs from the review, beyond a simple check of compliance with an appropriate governance code, and then agreeing an approach to data gathering that will address those needs. But at the heart of the review process, and a critical enabler of success, is the set of questions the reviewer asks in interviews with board members, and how those questions are asked.

The most useful board member interviews are far more than data gathering – they are an early but active part of the performance improvement process that results from the review. So good interview questions need to stimulate reflective conversations that start an ongoing process of dialogue between the board and reviewer. This means designing questions that are forward looking and explore what the future strategy of the organisation is likely to demand of its governance. Which in turn may require the board to develop its future capabilities, focus, information requirements or other ways of working.

The work starts before the interviews themselves by ensuring that board members understand what they are about – and perhaps more importantly what they are not. Board members need to come into an interview knowing that this is not going to be an audit or an interrogation. The reviewer will not be trying to catch them out or expecting them to know all the 'rules' in a governance code that they need to follow. Effective questions are designed to explore how board members address the principles of good governance, as expressed in the appropriate code for that organisation, not to measure compliance with a set of detailed provisions.

A good place to start is often to ask some open questions about where a board member believes the board has been 'at its best' in the last 12 months – and what board strengths enabled that performance (be it the way a meeting was run, a paper was produced, a dissenting view was expressed, or the range of skills and resources that members contributed). This then opens the door to explore occasions where the board had struggled or behaved badly. Which can naturally lead on to a conversation about the future strategy of the organisation, what the governance consequences of that might be and where this might build on some of the board strengths or expose the weaknesses discussed earlier.

A common thread running through the design of an effective set of review questions is the need to tease apart board members' desire to discuss current business problems and potential solutions (which is not the focus of a review) from the underlying issues of governance such as capability, access to information, decision-making process, and accountabilities (which is).

Board member interviews are not cosy chats – often the greatest insights an interview (on both sides) can come from moments where the temperature drops and there is some

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bias and stereotypes, where men are given the benefit of the doubt and women receive scepticism.

A collective effort

Businesses need to approach improving gender diversity in their talent pipeline as they would any other change initiative – set the change agenda, make it a strategic priority, and champion its execution through setting ambitious targets and holding themselves to account through the oversight of their board. Only by putting gender diversity on an equal footing with other strategic objectives are we going to see companies really changing their ways.

Ultimately, though, it comes down to a will to change. For those CEOs not prepared to lead the way, it will be up to those around them – board Chairs, investors, customers, and their peers in the FTSE 350 – to apply the necessary pressure to move diversity from a 'nice-to-have' to an absolute imperative for business survival and success.

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Feature

tension in the air. Noticing that tension, finding the right way to explore what underlies it, and what a board can learn from it, is part of the necessary skill set of a board reviewer. But well-designed interview question sets are part of a cycle of interactions with board members in 1-to-1 meetings about board observations which build trust and enable greater honesty. This in turn increases the likelihood that any recommendations coming from the review will be supported and implemented because they are seen to have emerged from a process of joint discovery.

And finally …

The best questions to ask in a particular board review depend on the circumstances of that board – but some good questions to end an interview with can be:

- If you had a magic wand, what would you most want to get out of this board review process to enhance the future performance of the board?
- Is there anything you were hoping I would ask in this interview but haven't – and on the other hand is there anything you were hoping I wouldn't ask but that I now probably should!?

Developing a good action plan

This final phase of any board review is, arguably, the most important because, if no action is taken as a result of the review, the usefulness of the whole exercise will be diminished. It can seem sometimes that once the key findings and recommendations of a review have been presented to the board or body concerned, that is seen as the end of the process. As a consequence, the need for a follow-up plan is either ignored altogether or simply tacked onto the process as a somewhat nebulous afterthought. By contrast, the recommendations should provide a springboard for a value-adding action plan that is owned by the board. Put another way, a review without an action plan is a wasted opportunity.

So, how can the action plan be used to really enhance the value of a board effectiveness review? The short answer to this question is that action plans should be given time, effort and space for appropriate execution in the period following the review itself. It is often helpful to treat the action plan as a mini-board project in its own right and follow the principles of any good project plan in its execution. The facilitator of the board review will be well-placed to set the planning off on the right path if they are given the opportunity to explain the rationale behind their recommendations and help the board decide on which recommendations it wishes to adopt and how they will be implemented. This requires dedicated time and attention on the part of the board concerned not just at the board meeting at which the recommendations are discussed but also in follow-up meetings.

Ownership and delegation are also important principles in getting the best out of the action plan. Ownership of the plan may be different from the responsibility for executing one or more of the recommendations; however, these should be discussed and agreed together so that there is a clear shared understanding of roles and responsibilities in the action plan. Whilst the Chair and Secretary may be the primary players in owning and executing the action plan, it is helpful in embedding collective responsibility if other directors or trustees and members of the management team also take responsibility for parts of the plan.

Taking the project management principles further, it is important that there is a real clarity about the plan with, wherever possible, each element being Specific, Measurable, Achievable, Relevant and Timebound (SMART). The recommendations in any review report worth its salt should make this easier by themselves being SMART, however where this is not the case, it will be helpful to translate the recommendations into one or more clearcut steps. Each action should have an owner and a timeline for completion. Most actions don't usually involve additional cost or expense but the appropriate resources should be allocated where necessary. It can be beneficial and efficient to align the board action plan with other initiatives being overseen by the board. For example, running the board review so that the recommendations are presented at the same time as the annual business planning and budgeting or strategic review exercise can create an alignment of actions which gives them more impetus and shared ownership.

Finally, there should be periodic follow-up activity to ensure that the actions are being implemented within the desired timeline. To this end, it can be really helpful to include an evaluation of the outcomes of the action plan as an input into the next board review exercise to ensure that they have been completed and that the desired outcomes have been achieved.

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They are both founder members of The Board Effectiveness Guild, a group of experienced and independent board evaluators who have come together to enhance the value of board effectiveness reviews by sharing best practice with each other and contributing to the wider debate on excellence in corporate governance. Find out more at www.theboardeffectivenessguild.co.uk/

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anchored in a clear articulation of the use case and purpose for deploying the capital.

In summary

This is not a time to think about risk management from a compliance perspective. It is of paramount importance that boards and ExCos use this opportunity to embed better risk-return discussions, more robust business case processes and integrate risk discussions in performance reviews to be able to demonstrate their stewardship of the business and efficient use of capital. Only in this way can they continue to manage unwanted volatility and generate true strategic and performance upside. Boards should therefore continue to focus on the key steps that I set out in my autumn risk reflections:

- Use stress testing of strategies and business models to get a better handle on resilience and agility.
- Demand even more robust risk analysis in business cases.
- Encourage management to view disruption from a value creation perspective.
- Evaluate risk appetite in relation to the changed risk profile and balance sheet strength.

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Designed and printed by WithPrint
Riverside Studio, Gills Lane, Rooksbridge, Somerset, BS26 2TY
www.with-print.co.uk

ISSN 1358-5142

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