Trust in the boardroom

a move towards sustainable governance

THE POWER OF BEING UNDERSTOOD
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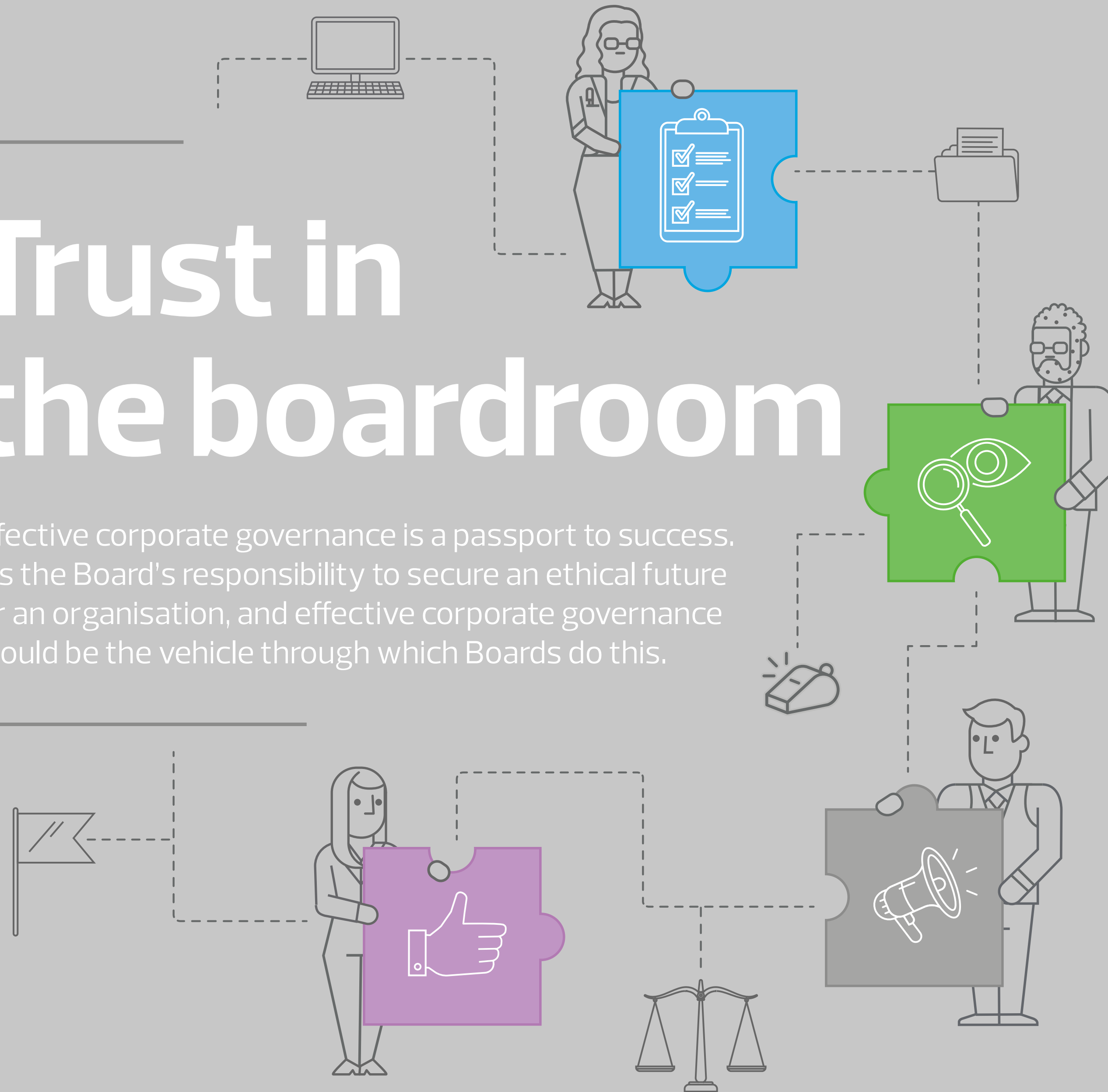


Trust in the boardroom

Effective corporate governance is a passport to success. It is the Board's responsibility to secure an ethical future for an organisation, and effective corporate governance should be the vehicle through which Boards do this.

There are lessons to be learnt from high-profile cases where organisations have fallen foul of greed, negligence or abuse of power.

Increasing market complexity has resulted in organisational collapses, loss of business, damage to public trust, job losses, and even fatalities. These events must be viewed as failures of corporate governance, where leaders did not have knowledge of what was going on or, worse, where they were aware, but failed to act with integrity.

At RSM, we researched over 200 middle market businesses in relation to corporate governance. Worryingly, but perhaps not surprisingly, only 24 per cent of organisations agreed that corporate governance was critical to achieving strategic business objectives.

Compare this with the fact that only 28 per cent of people say that corporate governance is regularly on the board agenda and it gives obvious grounds for concern. After all, the role of the Board is to govern.

In spite of the perceived apathy towards the importance of corporate governance, 57 per cent of people expect to see prosecutions for poor business practices in the future. If Boards recognise that they could be prosecuted for poor corporate governance practice, but it still does not feature on their agenda, then this disconnect between perception and reality needs addressing.

Source: RSM research June 2019 middle market businesses and corporate governance

What is corporate governance?

Corporate governance is a matrix of processes, rules and practices through which an organisation is controlled.

The context

Regulators and governments have introduced many new corporate governance codes in recent years. In some cases, these are specific to certain sectors such as charities or sports but they can also affect many other types of organisations. Regardless of the difference in business area, similarities can be found in the way that they are governed, including a compliance element which tries to hold organisations and Boards accountable for their decisions and actions. Yet it is critical that they are not viewed as a tick box exercise. Effective corporate governance is not achieved solely by putting measures in place but by also assessing and responding to how effective those measures are in ensuring integrity and improving corporate culture.

In this regard the role of the Board is twofold. They have to set the tone by conducting themselves within the spirit of the code, whilst also monitoring whether the right behaviours are being displayed throughout the organisation. This ‘tone at the top’ should help the Board to understand real views of staff and develop methodology and incentives to maintain standards.

This requires a cultural and behavioural shift that helps to position tone at the top as more of a priority for Boards and senior leadership.

Looking forward

It is important to remember that all Boards are (or should be) in a position to challenge and should exercise that right. Therefore it is critical to equip them with the tool and the mindset to do so. This guide will go some way to aid that.

Without an effective corporate governance framework people, as part of a workforce or a Board, can be motivated to act for different reasons – sometimes without considering the ramifications. Establishing a clear, transparent and honest approach to conducting business and people management is critical to earning the respect and loyalty of stakeholders and employees alike.

RSM have been advising Boards and organisations on effective governance and good decision making for many years. Working with The Governance Forum, RSM have contributed to a four-pronged methodology that focuses on the main principles of good governance. These are a reflection of the various corporate governance codes now in place that aim to help organisations to frame their thinking around effective governance.

Marc Mazzucco, RSM
Head of Risk, Governance and Compliance Advisory

1. Compliance

Regulatory compliance represents an organisation’s adherence to laws and guidelines relevant to its business.

2. Transparency

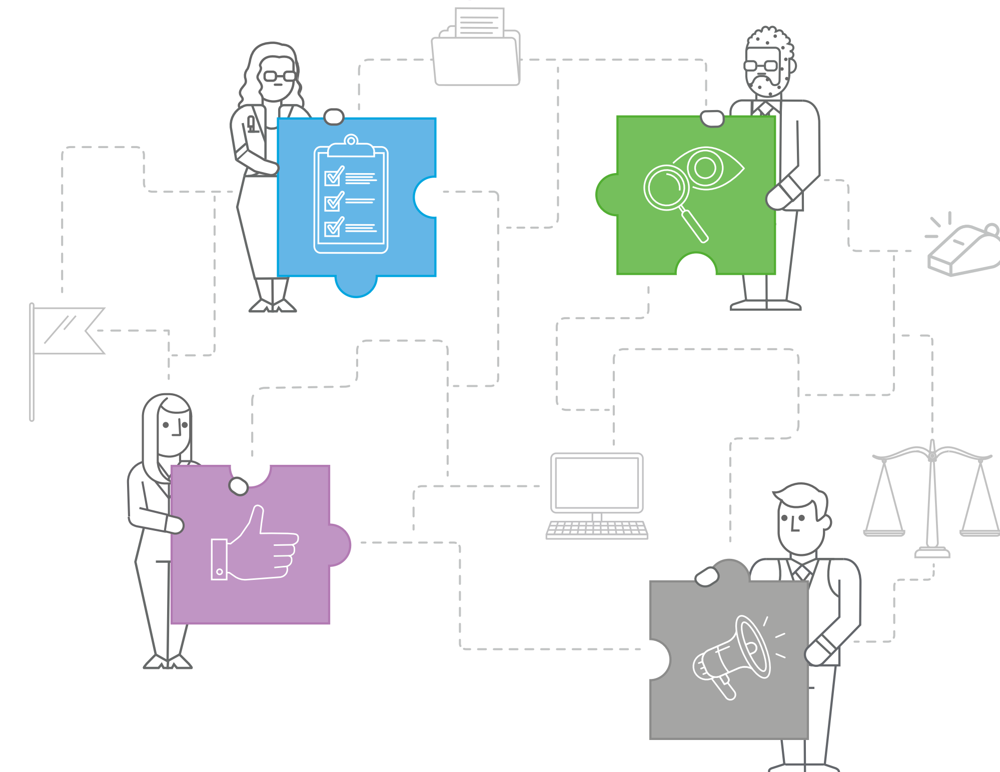
A business must offer transparent ways of working, to ensure that its approach, management of people and use of finances and other resources are clear.

3. Behaviour and skills

Organisations are run and maintained by people. Encouraging and rewarding the right behaviours is critical to ensure a sustainable and ethical future.

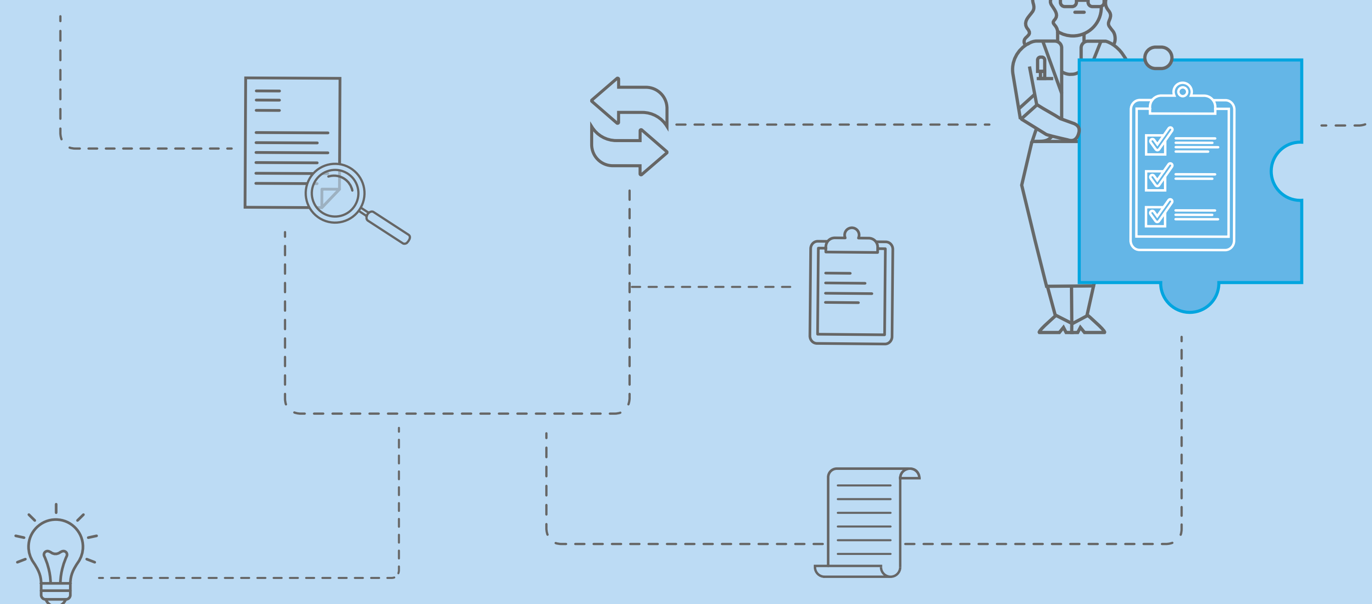
4. Impact

Decisions have consequences and Boards need to be equipped to make those consequences positive and sustainable.



Compliance

Regulation, legal standards and compliance are inevitable when it comes to operational accountability. Regulators have introduced legislation and minimum standards that must be adhered to.



Codes can be frustrating and complex but they are in place to help baseline and improve the ethical foundation of organisations, ensuring they are resilient should something go awry.

Making organisations accountable to their stakeholders should be the most effective way of ensuring a sustainable and future-proofed operation. However, organisations must ask themselves whether their approach to corporate governance compliance is geared towards implementing and supporting the right behaviours on behalf of the stakeholders (including employees), or whether they have adopted a 'because we have to' approach. Boards need to accept that the regulatory requirements must not be the only consideration, because what looks good on paper, might not always be sufficient or happening in practice.

A **wisely governed** organisation approaches compliance with legal advisory oversight and considers:

1. **Design** – consider the architecture of what has to be done;
2. **Feasibility** – whether the law both requires and allows the governance style proposed; and
3. **Implementation** – deliver the content support needed from process, documentation, training and monitoring to achieve compliance successfully.

"On many organisation's websites we can see compliance statements that are presented as in alignment to specific codes but they are brief, generic and uninformative. This shows that organisations are, in many cases, just ticking the compliance box. Or worse, that they are claiming unachieved levels of compliance. What we should be seeing are statements that are clear and specific, with messaging that is based on genuine sentiment."

Carolyn Brown, RSM
Legal Partner

The various new codes, including the 2018 UK Corporate Governance Code, put the relationships between companies, shareholders and stakeholders at the heart of long-term sustainable growth. We can see a similar trend in Section 172 of the Companies Act 2006, which, from 2019, was extended to 'a duty to promote the success of the firm'. But in many cases, if not all, these governance codes only have 'comply or explain' enforcement. This gives organisations the opportunity to outline how code principles have been applied or explain why not. Arguably, this does not go far enough and gives organisations and Boards an escape route from best practice. It raises the question of how effective a piece of regulation can be if you can simply explain away non-compliance. This puts an even greater emphasis on the need for organisations to prioritise inherent cultural and behavioural shifts in their search for effective corporate governance, using these codes and regulations to frame that thinking.

This is not to suggest that compliance isn't important, because it is and should remain a key component of any governance framework. But when taken in isolation it can appear daunting and unnecessary. It may also encourage the wrong assumption that good governance means ticking boxes, which is a far from the truth. Organisations must consider how they are implementing change and measuring what the impact is and should be.

Who does **Section 172** of the Companies Act 2006 impact?

Organisations with:

- A turnover of £36m or above; or
- Balance sheet assets above £18m; or
- More than 250 employees

> Genuine corporate governance is an intent to do the right thing on behalf of both the shareholders and employees, and to drive that mindset to underpin both Board decisions and implementation.

Carolyn Brown, RSM
Legal Partner

To demonstrate compliance consider the following:

Processes – having robust processes in place will lay a solid foundation so people know what to do.

Documentation – whilst it might seem onerous, it does help. Having relevant controls, policies and approaches properly documented leaves little to interpretation and provides clear instruction in the event of things going wrong. Risk management is just one part of the corporate governance agenda and yet 17 per cent of respondents said senior executives in their businesses were either devoting very little attention to risk management, or respondents were unsure as to exactly what was being done.

Compliance must also be considered in the context of other measures that have been introduced such as the Good Work Plan and Modern Industrial Strategy. These plans have been designed to help deliver 'fair and decent work', clarity in employment law and engaged workforces.

Source: RSM research June 2019 middle market businesses and corporate governance

Knowledge is key when it comes to understanding, choosing and implementing a corporate governance code.

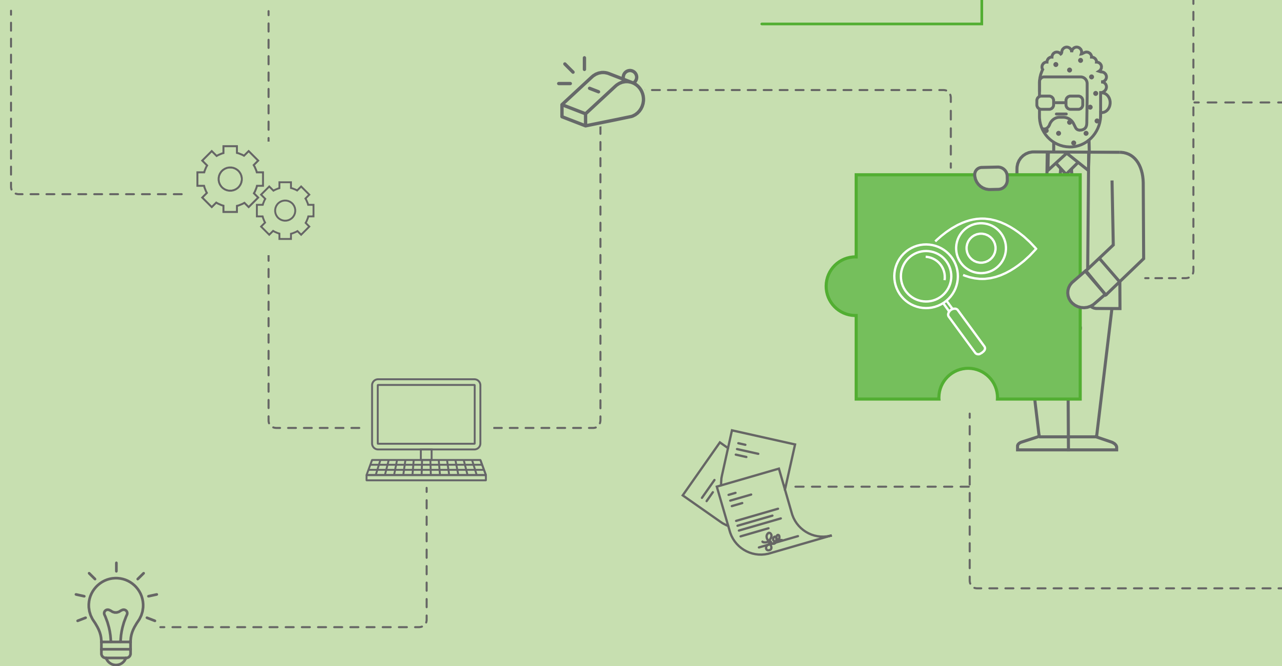
1. Is there a code which must be applied due to the sector or nature of the organisation?
2. Is the infrastructure in place to implement the requirements?
3. Are the right staff in place to ensure governance codes are understood?
4. What are the penalties for failing to meet the codes and how could this impact the organisation?

Key considerations

- Pick the right code for you and understand what that means.
- Approach all compliance with legal advisory oversight.
- If you make a public statement then make sure it is accurate.
- Do not approach compliance in isolation nor as a tick box exercise.

Transparency

If a Board's role is to govern and set the strategy for success, agreeing what success looks like must therefore be the first step.



Section 172 of the Companies Act 2006 defines success as promoting the interests of shareholders while taking account of stakeholders. This places stakeholder engagement as a critical element to success.

Most organisations are required to disclose meaningful, integrated reporting on its governance dependent on various criteria. The Board need to do this in a transparent manner to prevent making key decisions based on poor business intelligence.

Selective transparency can be fatal. If shareholders, stakeholders and key decision makers are not given a full and honest picture, things can go very wrong. Not only does this have a huge effect on a business, but it also calls into question operational and leadership integrity.

Sustainable organisations know exactly what is going on in day-to-day operations, enabling informed, confident decision making. It is vital that leadership takes a step back to understand what reporting should reflect, and to whom.

Organisational design means aligning an organisation's structure, people and processes to its strategy. It is critical to understand what needs to be achieved, then find support and interventions to make that happen.

How are transparency and business resilience connected?

Building a business that is resilient is more important now than it has ever been. There are complex operating environments that rely on constantly evolving technologies, global market places with different pressures and risks, as well as increasing workforce challenges. If a business has not considered what could go wrong – how can they possibly deal with it if it does?

of people surveyed stated that there was no formal **whistleblowing** process in place.

Foreseeing and predicting change and shocks in the market is difficult and sometimes impossible, but a workforce is on the front line so ignoring their concerns or not giving them the mechanism for escalating their concerns is a cavalier and (arguably) dangerous attitude that can seriously impact an organisation's ability to be resilient. It is difficult to see how a Board is supposed to govern an organisation effectively if they cannot rely on its employees to raise their concerns.

The simple introduction of a whistleblowing (or Speak Up) helpline and similar processes can go a long way to enhancing transparency and can sometimes stop containable issues from escalating.

The key for Boards and senior leadership is to respond appropriately to these concerns and to encourage transparency rather than assign blame. The impact of not doing so can be severe, affecting how secure people feel at work, whether they feel encouraged to make the right decisions and in extreme cases, even questioning whether they feel personally accountable for their own actions.

Operational and governance transparency also need to be applied to an organisation's entire network. Governing an entity without considering its supply chain and third-party relationships is poor practice.

> "A workforce is on the frontline and ignoring their concerns is dangerous."
>
> **Matt Humphrey, RSM**
> Partner

Large projects and initiatives often go wrong when the governance of those relationships are not properly monitored. The market has seen instances where fully outsourcing functions without adequate checks and balances, or not properly managing inefficiencies have been fatal or at least, very expensive.

Key considerations

- Horizon scan to remain current in your resilience.
- Build business continuity plans.
- Assess third party relationships.
- Consider organisational design.

Corporate governance guidance is founded in the **Nolan principles.** Despite being introduced in the 1990s by the government to improve standards of behaviour in public life, there is little doubt that these principles are still as critical to effective governance as they ever have been.

Selflessness – act in the public interest.

Integrity – do not have obligations or relationships that influence behaviour for anything other than that which you are employed to do.

Objectivity – only appoint and remunerate on merit.

Accountability – be accountable and be open to scrutiny.

Openness – be transparent in decisions and action taken.

Honesty – be clear regarding private interests and resolve conflict to protect stakeholder interest.

Leadership – lead by example.

Behaviour and skills

If a Board and workforce is exhibiting the right behaviours and is equipped with the right skills, effective corporate governance and success should easily follow.

Whilst change can be daunting, people are the engine room of any organisation and must be shown and bought into what the business expects of them.

Championing tone at the top is critical, and so it makes sense to begin with an organisation's Board. It is key to structure the Board with the right diversity of talent to enable constructive challenge, ensuring the organisation tackles emerging issues and trends in the right way. Boards must ask themselves whether they have the right people at the top, and if not, then they must act to correct this. Boards cannot expect to deal with a diverse range of issues, if they themselves are not diverse.

Diversity is more than gender or ethnicity. It also needs to extend to a diversity of background and specialisms or skills, ensuring a socially mobile Board whose perspective is holistically constructed. The makeup of a Board can demonstrate what an organisation is prioritising at any one time. It is not unreasonable to suggest that a Board solely made up of financial specialists will champion financial performance over all other metrics of success, potentially leaving itself exposed to other business challenges and threats.

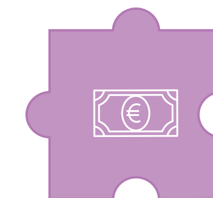
Boards must ask themselves how they ensure social diversity is happening, how they can monitor it and how they can enact key change. By creating a culture where the Board is not afraid to evolve and challenge itself, this mentality will be more likely to permeate through the organisation to the wider workforce. Best practice tells us that remuneration should be tied to reinforcing the right behaviours both at a workforce and Board member level.

Boards need to consider:

1. what skills are required to do this;
2. what training is in place to disseminate expectations;
3. what cultural norms are in place.
4. make sure their own behaviours are reflected by their workforce;
5. have a grasp on what motivates staff to act in the right way; and
6. understand how they can monitor behaviours.

“An unintended consequence of transparency has been a race to the top with salaries, because if we did not know what everyone else is earning perhaps we would not be so greedy ourselves.”

Robin Ellison
Chair, Carillion Pension Scheme

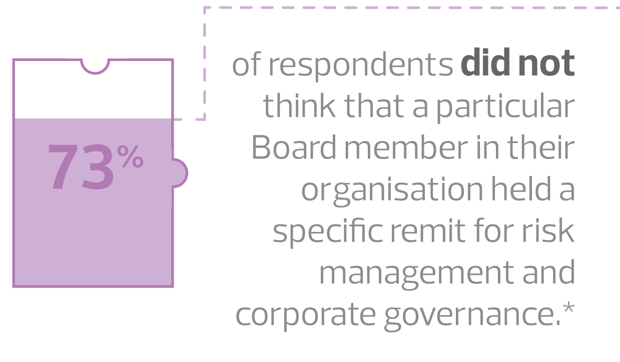


Our research of over 200 respondents showed that just over 50 per cent of organisations have clearly stated that there is an individual or designated committee charged with directing the corporate governance agenda.

This 50 per cent is in stark contrast to the 72 per cent of people who said that corporate governance **was not regularly** on the Board agenda. This could suggest two scenarios:

1. boards and organisations are publicly committing to corporate governance promises but in reality, are not practicing that commitment; or
2. corporate governance is being delegated to people not on the Board.

This is a critical point. High profile blame which puts the ethical standards of an organisation under the spotlight, coupled with a lack of transparency, can have enduring and in some cases, irreversible reputation ramifications. Boards need to ask themselves whether the business as a whole can prevent that, and how.



of respondents **did not** think that a particular Board member in their organisation held a specific remit for risk management and corporate governance.*

“Ultimate responsibility for corporate governance needs to sit with an independent person, most likely the Chairperson.”

Marc Mazzucco, RSM
Head of Risk, Governance and Compliance Advisory

of people felt that future **ethical scandals** were likely to prompt more labour disputes and result in higher levels of staff churn.*

Key considerations

- Champion tone at the top to set the example.
- Ensure the Chair of the Board is driving the integrity agenda.
- Deliver any training and education for the Board and wider organisation.
- Appoint experienced and independent Directors to the Board.

Source: RSM research June 2019 middle market businesses and corporate governance

A sustainable business must have a sustainable succession plan. Boards are in place to strategise but they also need to be evaluated on their ability to future proof the organisation. How should Boards start to do this?

1. Is the Board prioritising short term gains over longevity?
2. Has the Board got the skillset necessary to devise and implement the strategy the organisation needs?
3. Does the Board have a good grounding and understanding of relevant legal and regulatory requirements and of risk management?
4. Who is the Board appointing as Non-Executive Directors and is the right appointment criteria being applied?
5. How long does it take for Non-Executive Directors to be on-boarded?
6. How long does it take to escalate and deal with urgent issues?
7. Is the Board mindful of the need to identify and/or recruit future leaders and Board members?
8. How well will the Board perform against a Nolan principle assessment?

Impact

Boards, the workforce and their shared culture should all work together to have a positive impact on everyone involved in the organisation and the community.

The impact of corporate governance mechanisms can be difficult to measure. Often, they are not investigated until something goes wrong. Boards need to measure continuously, potentially either through impact testing or scenario planning.

Boards need to know who and what they are influencing in order to understand the impact of their approach to effective corporate governance. We outline some of the numerous stakeholder groups below and highlight core considerations for Boards.

Workforce
Do they feel engaged, listened to and happy to work there? One of the first rules of engagement in effective employee communication is to be personal. People crave bespoke reassurance; a soothing of their own ego, no matter how large or small; encouragement that is tailored to their own ability, performance and ambition. It makes them feel engaged. Employee engagement simply doesn't work if it's deployed in a one-size-fits-all sort of way.

Customers/the public
Do they feel the organisation is delivering against its promises and is 'brand loyalty' high?

Environment
Does the organisation have a positive impact on the environment or is it contributing for example, unnecessarily to energy waste. Is the organisation mitigating its environmental impact through sustainable practices?

Community
Does the organisation positively contribute to the communities it operates in and is there a formal corporate social responsibility plan?

Profits
Is the organisation profitable enough to enable it to continue operating?

Future of the company
Is the organisation sustainable in the medium and long term?

Suppliers
Are payments made in reasonable time to secure sustainable relationships?

Recruitment
Are there any indicators in the recruitment process that the approach to corporate governance is having an effect? Is there equal opportunity for all?

By mapping stakeholder and influencer relationships, Boards can break down the type of engagement and activity that each stakeholder group needs to ensure effective governance.

Organisations do, however, need to measure effectiveness and impact, along with deciding what metrics can and should be used to do this.

Formal employee engagement schemes can make a real difference to the level of transparency your organisation can demonstrate, as it gives workforces the chance to convey their genuine perceptions on their working lives to the Board. This understanding of employee sentiment can enable a Board to have a positive impact and make a real cultural difference.

There are a number of ways organisations can **measure effective governance** outside of standard compliance with regulation and codes, but these should all hinge on how they view success. Metrics could include:

- consistently high employee engagement levels/feedback scores;
- effective escalation of employee and stakeholder concerns, with no hesitancy in dealing with the root cause;
- short payment terms for all suppliers (reducing debt);
- a genuinely diverse and socially mobile workforce;
- increasing levels of community engagement, through formal or informal schemes; and
- a narrowing or absence of gender pay gap or ethnicity pay differentials.

To get the best from staff and to ensure that your business performs, Boards should listen to every part of it. This will give the most informed idea of true organisational culture, so it is critical to utilise HR teams to tap into this insight.

- Enable employees to escalate concerns – ensure causes are addressed, rather than the symptoms.
- Foster an environment for continuous listening. Whilst employee engagement surveys can be good, they tend to be infrequent and take time to digest results – instead of giving a snapshot of sentiment at that particular moment. Continuous listening allows for real time solutions and a higher level of responsiveness. This is of particular relevance when organisations are going through periods of change such as acquisitions, mergers or investments.
- Empower your senior leadership, Boards, managers and those with line management responsibility to access these anonymous results. This may prevent smaller issues from escalating.
- Be honest with the business. Proactively addressing issues is a good thing.

Establish a **stakeholder advisory panel** to build a communications bridge between the Board and the people it impacts the most. In committing to open and honest communication, Boards will be taking steps towards ensuring integrity has a voice.

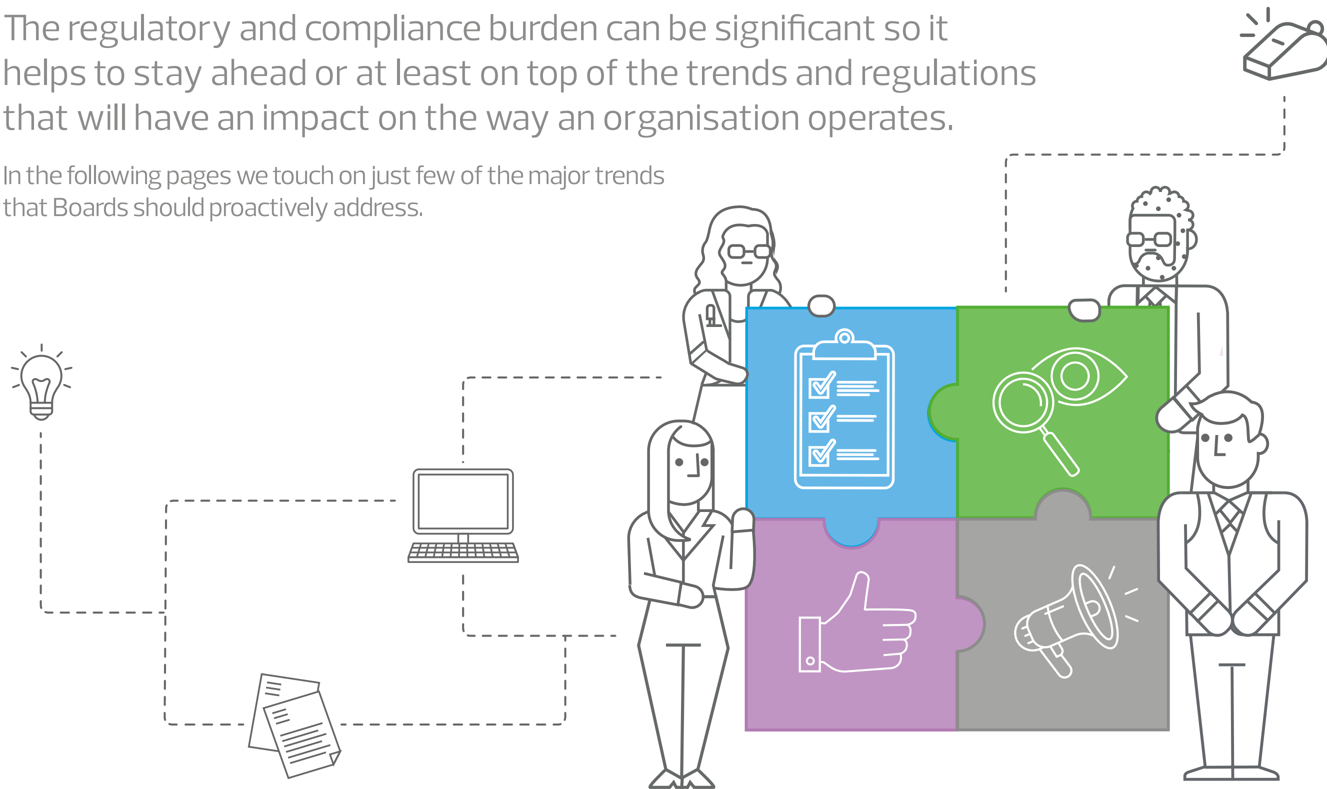
Key considerations

- Map your stakeholders.
- Listen to them.
- Choose the right metrics to measure success.

Future proofing your organisation

The regulatory and compliance burden can be significant so it helps to stay ahead or at least on top of the trends and regulations that will have an impact on the way an organisation operates.

In the following pages we touch on just few of the major trends that Boards should proactively address.



The General Data Protection Regulation

GDPR has been a well-publicised development in the EU's approach to data privacy security, but organisations need to ensure that it is not approached in isolation or as a one-off project. Compliance is an ongoing challenge, and in the context of some recent fines, it will be critical for Boards to ensure they have the right processes in place to protect their organisations. Some of the most significant assurances include:

- personal data processing and data inventories that are up to date, not historic or static;
- contracts that include terms for sharing and processing of personal data – including who is liable for the protection of that data;
- response processes for data subject requests that satisfy minimum requirements;
- ongoing staff awareness and education;
- data process policies and procedures including privacy notices; and
- breach notification and incident management processes that satisfy minimum requirements.

"GDPR isn't going away. Organisations must ensure ongoing compliance and robustness of measures are in place, to embed good data governance."

Sheila Pancholi, RSM
Partner

ePrivacy Regulation

The ePrivacy Regulation or EPR is not in place yet but will replace the ePrivacy Directive (2002).This will be mandatory for all EU members in the same way that GDPR is. It will also impact on all organisations dealing with consumers in the EU. The terms have not yet been finalised, but it is key that organisations keep it in mind when thinking about their digital strategies.

Its remit will cover:

- unsolicited marketing;
- cookies; and
- services such as internet browsers and internet messaging services.

The EPR aims to ensure privacy in all electronic communications, introducing more stringent rules for digital advertising. It empowers users to adjust their security settings at web browser level, rather than having to accept terms on every webpage.

Organisations will need to consider:

- auditing the current arrangements for digital platforms to be sure it adheres to the stipulations; and
- whether this will impact the way an organisation operates – i.e. revenue generation.

The UK Stewardship Code

The UK Stewardship Code assesses the relationship between investors and organisations to help improve sustainable returns for shareholders. This should be a key consideration for corporate governance. The FRC encourages all institutional investors to report if and how they have complied with the code. This can include:

- publishing a statement on their website;
- telling the FRC when they have done so; and
- assigning responsibility to someone internally.

> This is new ground but organisations need to start thinking about how this will impact the way they work. Will these measures impact how they can generate revenue?

Steve Snaith, RSM
Partner

Safeguarding

Safeguarding, or a lack of adequate procedure and escalation has been well publicised in recent years. Protecting people, whether they are vulnerable or employee stakeholders needs to be one of the main roles of a Board. Steps to be taken should include:

- education – all stakeholders should know exactly what is expected of them in relation to safeguarding;
- the development of well-documented policies and procedures;
- vetting staff to ensure that they are the right people for the job;
- the introduction of adequate mechanisms for the escalation of concerns; and
- ensuring that there is adequate training in place.

> Investors are a core stakeholder for organisations that need them. They need to share the values and integrity of those they are investing in.

Richard Smith, RSM
Head of Risk Assurance

Modern Slavery

Modern Slavery impacts all organisations. As recently as 2016 'an estimated 40.3 million people [were] in modern slavery'*, organisations need to ensure that it is not happening anywhere in their supply chain or network.

The Modern Slavery Act 2015 seeks to address and prevent modern slavery and human trafficking in the UK and in the supply chain of UK organisations. It covers the offences of slavery, servitude, forced or compulsory labour and human trafficking. Applicable to organisations with a global turnover of £36m+, the legislation is an important tool in the pursuit of effective corporate governance (albeit any organisation should be applying the same ethical approach to conducting business). Basic steps to complying with the Modern Slavery Act 2015 include:

- carry out a workforce contract audit;
- complete a payroll audit;
- appoint a modern slavery champion;
- vet employment agencies;
- review relationships; and
- assess supply chain for slavery.

*https://www.ilo.org/global/topics/forced-labour/lang--en/index.html

Social mobility and the Equality Act 2010

Promoting equality in the workplace has to be one of the cornerstones of effective and ethical corporate governance. Denying any employee, or prospective employee or worker, their right to equal opportunity in the workplace is unlawful under the Equality Act 2010.

The Equality Act has specified nine areas that are termed as protected characteristics. These are listed below in no particular order:

1. Age
2. Sex
3. Race
4. Disability
5. Pregnancy
6. Marital status
7. Sexual orientation
8. Gender reassignment
9. Religion or belief

Discriminating against workers because of any of the nine characteristics is against the law.

The Bribery Act

The Bribery Act 2010 has transformed the legal framework in relation to corruption and bribery, in the UK and overseas, by introducing new, chargeable offences. It has introduced a clearer regime for tackling bribery that applies to all businesses based or operating in the UK. As such there are clear links to the cultural integrity that effective corporate governance (and legal compliance) demands.

This isn't new legislation, but it still remains relevant. Exposure to fraud and bribery can significantly undermine an organisation's integrity and ability to function.

Tim Merritt, RSM
Partner

Ethnicity pay

Following the recent spotlight on gender pay equality, the government is turning its attention to equality on ethnicity pay for obvious and just reasons. Whilst still at the consultation stage, regulations demanding organisations publish information on their ethnicity pay gaps could bring challenges.

Some organisations do not currently record the ethnicity of their workforce. This means that they will be unable to comply. Boards and senior leadership therefore need to think about this now so that they are ready and able to be transparent when the time comes.

Energy and carbon

The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 require large unquoted companies and Limited Liability Partnerships (LLPs) to report on their energy consumption and greenhouse gas emissions within their annual report and accounts.

The qualifying conditions are met by a company or LLP in a year in which it satisfies two or more of the following requirements:

- turnover £36m or more;
- balance sheet total £18m or more; or
- number of employees 250 or more.

In addition, quoted companies whose equity share capital is officially listed on the main market of the London Stock Exchange; or is officially listed in a European Economic Area State; or is admitted to dealing on either the New York Stock Exchange or NASDAQ continue to be required to report greenhouse gas emissions.

This publication explores just some of the issues needed to secure effective and sustainable corporate governance. For more information visit our website or contact **Marc Mazzucco**.

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