The Non-Executive Directors' Handbook

FIFTH EDITION

NON-EXECUTIVE
DIRECTORS' ASSOCIATION
Developing Trusted Professionals

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Foreword

Non-Executive Directors ('NEDs') play a key role in ensuring the effective governance of businesses, charities and not-for-profit organisations and public sector bodies. Business is a force for good. It makes a vital contribution to the success of the economy in many ways including through the payment of taxes and job creation.

It is a privilege and an honour to be a Non-Executive Director but that comes with duty and responsibility. These duties and responsibilities are becoming ever more demanding in an increasingly complex and challenging world.

Trust in business as I write is low. Too often public trust is undermined by the failures and behaviour of a small minority of inadequate organisations. This results in increasing expectations of boards and directors, whose role in earning respect, building trust and preserving reputation is essential to UK competitiveness.

The responsibility of Non-Executive Directors is heightened by the UK's well-deserved global reputation for the highest standards of corporate governance. These standards are underpinned by well-developed codes and guidelines which are regularly updated in light of new experience. This Non-Executive Directors' Handbook provides a comprehensive guide for NEDs at each stage of their career.

Yes, it is aimed at informing action, but it is people, culture and behaviours that really matter. Boards need to ensure alignment between these three elements of leadership and focus on company purpose, values and strategy.

The diversity of background, experience, perspective and thought that comes from diversity of ethnicity, gender, sexual orientation and nationality is the greatest source of value, and advantage in any boardroom. It's also the best means of quality challenge and support in times of adversity.

Different perspectives in the Boardroom are immensely valuable. So too are ones from other stakeholders and ensuring Non-Executive Directors have effective processes for engaging and listening to employees and wider society is as important as those for engaging shareholders and customers.

Self-reflection and the ability to respond to feedback is critical to the role of a Non-Executive Director. There is no room for complacency in today's boardrooms. Directors should continuously seek to evaluate and strengthen their individual and collective impact to better develop company resilience and transformation.

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Effective boards require leaders with emotional intelligence and excellent communication skills, as well as technical expertise.

A Non-Executive Director has a great opportunity, and fundamental duty, to contribute to the future success of the enterprise and to maximise the benefit for all the stakeholders. The challenges of climate change, technology, instant communications, and trust will ensure that the role will be more demanding in the years to come. The benefit of this Handbook, as a reference point for doing the right thing and being up to date, is ever more evident.

Paul Drechsler CBE

Chairman Bibby Line Group and the NED Awards

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About the Non-Executive Directors' Association (NEDA)

The Non-Executive Directors' Association (NEDA) is an organisation dedicated to non-executive directors (NEDs). The Association promotes and supports the day-to-day needs of NEDs at all levels – aspiring, new and experienced.

The objective of NEDA is to provide member NEDs with a comprehensive range of practical support, education and advice, in association with a number of key partner organisations, including the Institute of Chartered Secretaries and Administrators (ICSA).

NEDA provides direction to NEDs in three essential areas.

Knowledge: In an increasingly complex environment, NEDs must have proper knowledge of their duties and responsibilities. NEDA helps NEDs share their knowledge and experiences while also supplying them with the information and tools to stay up to date.

Performance: NED performance is critical, not just for the organisation but also for their personal reputation. NEDA helps NEDs appreciate best practice.

Independence: NEDs need to be, and need to be seen to be, independent in order to provide the appropriate level of challenge, advice and support. NEDA helps NEDs understand what is meant by true independence and acts as a sounding board for complex issues.

For more information, and to join NEDA, visit www.nedaglobal.com.

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Acknowledgements

Brian Coyle is a writer and editor for a range of professional and business topics, following a long and distinguished career that has also included a main board directorship of a listed training company and an examiner in corporate governance for the ICSA. He has been a writer for a number of professional bodies including the ICSA, ACCA and CIPFA, as well accounting and other technical content for books published by Emile Woolf International. He has worked on reviewing, editing and updating the Non-Executive Directors' Handbook for the previous three Editions published by ICSA (the 2nd, 3rd and 4th Editions).

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CHAPTER ONE

The role of the non-executive director

1 *Board dynamics and the role of non-executive directors*
2 *Corporate governance*
3 *The main areas of corporate governance*
4 *The regulation of corporate governance*
5 *The UK Corporate Governance Code: comply or explain*
6 *NEDs and effective corporate governance*
7 *Boardroom behaviours and effective boards*
8 *Checklist: a framework for effective boards and corporate governance*

OVERVIEW

Non-executive directors (NEDs) are appointed to the boards of companies to fulfil a number of different roles. The presence of NEDs on unitary boards such as those in the UK is intended to improve board effectiveness and contribute to better corporate governance.

Concerns about corporate governance – and the potential consequences of poor governance – have evolved over time, and relate to matters such as leadership and effectiveness of the board of directors, the reliability of financial reporting and auditing, corporate disclosures, risk management, executive remuneration, relations with shareholders and other stakeholders in the company, and corporate citizenship.

Countries have their own laws, regulations and guidelines for corporate governance. Most countries with established stock markets have a voluntary code of corporate governance.

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1 BOARD DYNAMICS AND THE ROLE OF NON-EXECUTIVE DIRECTORS

Non-executive directors are directors without executive responsibilities in their companies. Their role differs in some ways between countries, as well as between types of company. Some countries (such as Germany) have two-tier board structures, with non-executive directors in a supervisory board and executives in a management board. In unitary board systems, there is a single board composed of executive and non-executive directors, but the relative numbers of the two types of director can vary. Non-executive directors are appointed to the boards of companies to make them function more effectively, but the influence of NEDs on the board depends to a large extent on the relationships and dynamics between the executive and non-executive directors.

The role of executive directors

It could be argued that a unitary board needs only two executive directors in its membership: the chief executive officer (CEO) and the finance director or chief finance officer (CFO). The CEO provides a link between the board and the executive management team, as leader of the executive team, and is therefore accountable to the board for management performance. The finance director provides expertise in accounting and finance, an aspect of the company's affairs that can drive much of the board's decision making.

Executive directors have a balancing act to perform between their responsibilities as directors and their responsibilities as executive managers, which are different. The FRC's *Guidance on Board Effectiveness* (revised July 2018, which provides guidance on applying the principles and provisions of the UK Corporate Governance Code) stresses that executive directors have the same duties as other members of a unitary board and that their duties extend to the business as a whole, not just that part which is covered by their executive roles. In the boardroom, they should take the wider view of their responsibilities.

The role of non-executive directors

Non-executive directors should contribute to the effectiveness of the board in companies of different types and size, but their contribution can be particularly valuable in companies where there is separation of ownership of the company from control, and the members of the board own a relatively small proportion of the total number of shares in issue. NEDs must work together with their executive colleagues as a board of directors to lead the company, but at the same time NEDs

must also act in a monitoring role, protecting the interests of the shareholders against the risk of excessive self-interest by executive management.

There are four broad roles for non-executive directors:

(1) They contribute to the formulation of company strategy. As members of the board, they should 'offer constructive challenge (and) strategic guidance'. If they bring specialist knowledge to the board in areas such as digital and cyber security activities, they should also offer specialist advice.
(2) They should review the performance of executive management in meeting their agreed goals and should 'hold management to account'.
(3) They should monitor the integrity of the financial information produced by the company, and satisfy themselves that the systems of internal control and risk management are robust and defensible.
(4) They have responsibilities for deciding appropriate levels of remuneration for executive directors and, given the emphasis on broader stakeholder engagement, other senior management and employees. They also have an important role in the appointment and removal of executive directors, and in succession planning.

The relationship of NEDs with their executive colleagues is therefore complex: part colleague and part policeman. This need to combine different responsibilities makes the role of the NED a difficult one to perform well and successfully.

The effectiveness of boards and the role of NEDs: brief history of reports and guidance

The effectiveness of a board of directors, and the quality of leadership that it provides for the company, depends largely on the effectiveness of the NEDs in performing their roles. Poor corporate governance is most likely to exist when NEDs do not perform effectively. In the UK, the government commissioned an independent review of the role and effectiveness of NEDs, published in 2003 as the Higgs Report. The Higgs Report included guidance for NEDs and the board chair. This guidance was adopted by the Financial Reporting Council (the FRC, which took on responsibility for the UK Corporate Governance Code) and issued as 'Good Practice Suggestions from the Higgs Report', more commonly known simply as the 'Higgs Guidance'. The Higgs Guidance, which was subsequently reviewed by the FRC in 2006, included guidance not only on the role of the board chair and NEDs, but also on the duties of the remuneration and nomination committees of the board and pre-appointment due diligence checks for new directors.

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The 'Tyson Report on the Recruitment and Development of Non-Executive Directors', published by the London Business School in 2003, followed up on aspects of the Higgs Report that dealt with board diversity. This report suggested that companies, when looking for NEDs to appoint to their board, might draw on broader pools of talent with varied and complementary skills, experience and background (including gender diversity) to enhance board effectiveness.

In 2010, the FRC published the *UK Corporate Governance Code*, and also commissioned the Institute of Chartered Secretaries and Administrators (ICSA) to consult on whether additional guidance was needed on sections of the Code relating to leadership and board effectiveness. This review of the Higgs Guidance became the Guidance on Board Effectiveness, which was first published in 2011. Revised in 2018, it built on the original guidance and now offers a broader perspective with direct links to the UK Code covering: board leadership and company purpose; the division of board responsibilities (including the role of non-executives); board composition; succession and performance evaluation; audit, risk and internal control; and remuneration.

A government-commissioned report by Lord Davies on 'Women on Boards', published in 2011, made a strong case for greater diversity on boards, and recommended in particular that there should be a greater proportion of women on the boards of FTSE 350 companies and that in FTSE 100 companies, at least 25% of board members by 2015 should be women. The 2012 revision of the UK Corporate Governance Code introduced a provision that new appointments to the board should be made with due regard for diversity of membership, including gender. In 2016, a subsequent report was published, known as the Hampton Alexander Review, stating as an aim that by 2020, one-third of board positions in FTSE100 companies should be held by women. The Davies Report and subsequent developments are discussed in Chapter 3.

Independence of NEDs and board effectiveness

Most or all NEDs should be 'independent'. This refers to independence from the management of the company, a major shareholder or any other board colleague. An independent NED should be able to make judgements that they consider to be in the best interests of the company, without being subject to undue influence. Independence of NEDs is a requirement for an effective board, and is an important issue when deciding the composition of a board. Independence is considered in more detail in Chapter 4.

A balanced board

In the UK, it has been argued that an effective board needs suitable balance between executive and independent NEDs, and between the board chair and the chief executive officer. In a balanced board, there is a suitable range of skills and experience, and no individual or small group should be able to dominate the board's decision-making. The UK Corporate Governance Code contains principles and provisions relating to the composition and balance of the board, which are described in Chapter 5.

2 CORPORATE GOVERNANCE

The introduction to the UK Corporate Governance Code states that corporate governance is about what the board of the company does and how it sets values for the company, and as such it must be distinguished from company management by full-time executives. The Code quotes the definition of corporate governance provided in the report of the Cadbury Committee (1992): 'Corporate governance is the system by which companies are directed and controlled.'

The Code goes on to state the following.

- Boards of directors are responsible for the governance of their companies.
- The role of shareholders is to appoint the directors and the external auditors, and to satisfy themselves that an appropriate governance structure is in place.
- The responsibilities of the board include setting the strategic aims of the company, providing the leadership to put them into effect, supervising management and reporting to the shareholders on their stewardship of the company.
- The actions of a board are subject to laws, regulations and resolutions by shareholders at company general meetings.

Sir Adrian Cadbury defined corporate governance in much broader terms, to include the responsibility of companies towards society:

> Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society.
>
> Sir Adrian Cadbury, Global Corporate Governance Forum, World Bank, 2000.

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At the heart of corporate governance is the relationship between the directors of a company and the equity shareholders. This can be compared with the agency–principal relationship. The board of directors of a company can be seen as the agent of the company, acting on behalf of its principal (the shareholders). The agent must act in the best interests of the principal, and should be accountable to the principal for its stewardship of the company's assets.

In practice, this 'ideal' relationship between the directors and the shareholders does not always function as effectively as it should. The aim of the guidelines, rules and regulations on corporate governance is to improve the quality of governance, so that the directors fulfil their obligations to shareholders. In doing so, they should improve the performance of the company and meet the needs of its shareholders more successfully.

3 THE MAIN AREAS OF CORPORATE GOVERNANCE

Corporate governance emerged as an issue in the 1980s, initially in the UK. During the 1980s there were several financial scandals affecting major UK companies, such as the collapse of Polly Peck International and the business empire of Robert Maxwell. In each case the collapse was unexpected, and was subsequently attributed to misleading financial reporting and dominant chief executives.

It was apparent that some company CEOs and chairs were dominating companies, and running them as personal empires. Others were simply running companies in their own personal interests, rather than in the interests of the shareholders.

There was also concern that some companies might be 'window dressing' their published financial statements. In spite of the fact that company accounts were audited and the auditors stated that they gave a 'true and fair view', the financial picture presented by the accounts could not necessarily be relied on. There were suspicions that external auditors might not be sufficiently independent of senior management in their client companies, and that they might be allowing companies to get away with questionable financial reporting practices.

During the 1990s, attention in the UK switched to directors' remuneration and concern that senior executives were being remunerated in ways that did not provide sufficient incentives for them to work in the best interests of companies' shareholders.

During the 2000s, risk management emerged as a governance issue, with concerns that company boards were insufficiently aware of the risks to which their companies were exposed and that systems of internal control and business risk management were not sufficiently robust. Worries about inadequate risk management

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seemed to be justified by the collapse or near-collapse of several banks during the banking crisis of 2007–08.

More recently, senior executive remuneration has re-emerged as a controversial governance issue, with criticisms of large increases in senior executive remuneration and the widening pay gap between top executives and other company employees. For example, in February 2018, shareholders were influential in getting the chief executive of housebuilder Persimmon to give back £30 million of a £110 million bonus, and in July 2018, shareholders in Royal Mail voted down the remuneration report at the company's AGM. Remuneration issues are discussed in Chapter 7.

Ethical issues and social and environmental issues are also considered in the context of corporate governance and company reputation.

Figure 1.1 sets out the areas of concern about corporate governance that have emerged over time.

In the UK, recognition of the role of NEDs has developed with the perception that successful companies need an effective system of corporate governance to which NEDs can contribute. Experience seems to show that when companies get into serious difficulty, there is usually some evidence that poor governance and ineffective leadership by the board have contributed to the problem.

Leadership provided by the board Role of the chair Role of the board Responsibilities of the CEO and executive team	**The effectiveness of the board** Composition, skills and experience of board members NED interaction and support Board performance
Accountability Financial and narrative reporting The strategic report External audit	**Risk management and internal control** Risk appetite, opportunity and reputational risk The control environment Risk monitoring and reporting
Remuneration of directors and senior executives Levels of pay Incentive schemes and rewards Rewards for failure	**Relations with shareholders and other stakeholders** Dialogue and communications Corporate citizenship Shareholder activism
Corporate ethics, reputation, social and environmental issues Corporate culture Lack of protection for whistle-blowers Corruption and bribery	**Strategy and governance** Strategic objectives The business model Performance management

Figure 1.1 Issues in corporate governance.

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4 THE REGULATION OF CORPORATE GOVERNANCE

In most countries, including the UK, corporate governance is regulated by a combination of laws and other regulations, codes and guidance, and self-regulation or industry body oversight. In the UK, various aspects of governance are regulated by statute law, such as the Companies Act 2006. Listed companies are also required to comply with rules of the United Kingdom Listing Authority: Financial Conduct Authority (FCA) Listing Rules, FCA Disclosure and Transparency Rules and FCA Prospectus Rules.

Voluntary self-regulation is through codes such as the UK Corporate Governance Code, but with requirements for companies to disclose which governance code they apply.

- It is a requirement of the London Stock Exchange Listing Rules that companies with a premium listing must comply with the principles and provisions of the UK Corporate Governance Code (revised July 2018), and describe how they have applied the Code (and explain the reasons for any non-compliance).
- Every AIM company is required, as part of the London Stock Exchange rules, to state on its website which recognised corporate governance code it has decided to apply, and to explain how it complies with that code (together with reasons for any non-compliance). AIM companies that do not apply the UK Corporate Governance Code are likely to adopt the Corporate Governance Code of the Quoted Companies Alliance (QCA) (revised April 2018).
- The Companies (Miscellaneous Reporting) Regulations 2018 require companies with a turnover of more than £200 million and a balance sheet of more than £2 billion, or companies with more than 2,000 employees, to disclose in their directors' report and on their website which recognised corporate governance code they apply and how they have done so, or to state that they did not apply any code.
- In December 2018, a new governance code, the Wates Governance Principles for Large Private Companies was issued. This sets out six governance principles and supporting guidelines for large private companies. Application of these principles by large private companies will enable them to meet their requirements under the Companies (Miscellaneous Reporting) Regulations 2018.

Many other countries have similar voluntary codes of corporate governance, although the details and content can vary substantially between countries. The

corporate governance codes of each country are accessible via the website of the European Corporate Governance Institute (see Directory).

Confusingly, regulations and codes of practice may sometimes appear to overlap. For example, the Disclosure and Transparency Rules include requirements for an audit committee (or similar body) for all listed companies, and the UK Corporate Governance Code also includes provisions relating to audit committees.

5 THE UK CORPORATE GOVERNANCE CODE: COMPLY OR EXPLAIN

The UK Corporate Governance Code is the responsibility of the Financial Reporting Council (FRC). It has evolved over a number of years, beginning with the Cadbury Code in 1992, followed by the Greenbury Committee recommendations on remuneration in 1995 and recommendations of the Hampel Committee in 1996. The Hampel Committee recommended that the corporate governance guidelines for listed companies should be brought together into a single code, and the first version of the Combined Code on Corporate Governance was issued in 1998. The Code has undergone substantial revisions since then, most recently in 2018, which incorporated a response to the UK Government's consultations on corporate governance with a restructuring of the main principles and provisions and a new focus on company purpose, stakeholder engagement and corporate culture.

The UK Code sets out the main principles of good corporate governance, together with some detailed provisions about how the principles should be applied. The QCA Corporate Governance Code for small and mid-size listed companies consists of principles and their application, and a section on roles and responsibilities. The Wates Corporate Governance Principles, for large private companies, similarly consists of principles and guidance on how they should be applied.

The UK Code is voluntary, but the UK Listing Rules (rule LR 9.8.6) require companies to disclose, in their annual report and accounts, that the company has:

- applied the principles of the UK Corporate Governance Code;
- complied with all the relevant provisions of the Code, or if it has not complied with all the provisions, it has provided an explanation of which provisions were not complied with, and the reasons for the non-compliance.

This approach is known as 'comply or explain'. The QCA Code and Wates Principles prefer the use of the term 'apply or explain', on the grounds that 'comply' might encourage a box-ticking exercise to following the rules, which is not the intention. It is interesting to compare the high-level principles set out under the three-tier structure now in place (see Table 1.1).

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Table 1.1 The UK Code, The QCA Code and Wates Principles

UK Corporate Governance Code 2018 Main headings (areas covered)	The QCA Corporate Governance Code 2018 Key principles	The Wates Principles 2018 Key principles
1. Leadership and purpose (success of company + wider stakeholders and workforce + culture) 2. Division of responsibilities (chair + board + NEDs) 3. Composition, succession and evaluation (board appointments + committees + performance). 4. Audit, risk and internal control (audit, assurance and reporting + company position + risk management and controls) 5. Remuneration (policies and practices + executive remuneration + independent judgement)	**Deliver growth** 1. Strategy and business model 2. Needs and expectations of shareholders 3. Stakeholders and social responsibilities 4. Effective risk management **Maintain a dynamic framework** 5. Balance on the board led by the chair 6. Board experience, skills and capabilities 7. Board performance evaluation 8. Corporate culture based on values 9. Structures and processes **Build trust** 10. Corporate communication	1. Purpose (values + strategy + culture of the company) 2. Composition (effective board + board balance and skills + valuable contribution evaluated) 3. Responsibilities (board accountability and responsibility + decision-making processes) 4. Opportunity and risk (promotion of long-term success and risk oversight) 5. Remuneration (executive pay aligned to long-term success) 6. Stakeholders (engagement with material stakeholders, including the workforce)

EU Company Reporting Directive

The EU Company Reporting Directive contains similar requirements. All quoted companies in the EU are required to include a corporate governance statement in their annual report and accounts. This statement must refer to the corporate governance code applied by the company (which country's code has been used) and whether and to what extent the company has complied with this code. In the UK, this requirement is included within the Disclosure and Transparency Rules.

Implications of 'comply or explain' rule for listed companies

It is important to stress that the rules for stock market companies apply to **disclosure** of compliance or non-compliance with the guidelines or provisions of a corporate governance code. Premium listed companies are required to apply all the principles of the Code, but as previously noted, **compliance** with the UK Code provisions is voluntary. Non-compliance would be acceptable provided that

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the directors of a listed company believe that, given the circumstances of their company, this is in the best interests of the company. However, they must explain the reasons for any non-compliance in the annual report and accounts, and they must not be in breach of any of the Code principles.

Non-compliance may be due to the circumstances of the company, such as its small size or its complexity. The Code is flexible and companies must simply provide a good and sensible reason for any non-compliance – the concern for some time has been that 'boiler-plate' text is used rather than explaining the company's own perspective, some of which is framed around the fear of giving away commercially sensitive information.

In the UK (more so than in the USA), there is also a concern that if corporate governance rules are applied rigidly, companies will adopt a 'box-ticking' approach to compliance, and the intended benefits will be lost.

6 NEDS AND EFFECTIVE CORPORATE GOVERNANCE

In the UK, the role of NEDs is closely associated with contributing to board leadership, advising on corporate strategy, holding the executive to account on finance, risk and control areas, and achieving best practice in corporate governance.

The role of NEDs in corporate governance has changed since their importance was first recognised in the Cadbury Code, which included a recommendation that a minimum proportion of board members should be independent NEDs. Independent NEDs are now expected to fulfil roles that were not expected of them 25 years ago.

- They are expected to provide a counterweight, so that a balance of power in the board is achieved, in which executive directors are not dominant and all-powerful.
- They provide the committee membership for the audit and remuneration committees and for a majority of the nomination committee.

The burden of expectation on NEDs, if anything, continues to grow.

NEDs need to be aware of their responsibilities and what they are expected to do. To carry out their responsibilities effectively, they should be kept well informed, and they have a duty to ask for the information they need, if they do not have it.

The existence of a code of corporate governance, setting out guidelines for recommended best practice, might suggest that the role of NEDs is concerned mainly with compliance. This is not the case. Although NEDs are involved with the application of best practice in corporate governance, they are also directors of the company, with a duty to govern the company in the best interests of the shareholders.

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NEDs sit on the board with executive directors, share the same responsibilities as directors, and work with their executive colleagues to provide strategic leadership and participate in making major decisions for the company.

For the relationship between NEDs and executive directors to work, there has to be a mutual recognition of what each group brings to the board table. The Guidance on Board Effectiveness section on the division of board responsibilities discusses the role of NEDs. It highlights how important it is for NEDs to show an appropriate level of commitment to their companies, and to develop and refresh their knowledge and skills to ensure they continue to make a positive contribution to the board. Being well informed about the company and demonstrating a strong command of key business issues will 'generate the respect of the other directors'.

7 BOARDROOM BEHAVIOURS AND EFFECTIVE BOARDS

Measures in the UK to improve corporate governance standards have been intended to reduce the probability or frequency of major corporate failures due to poor governance. It might have been supposed that this risk was reduced by the requirement for UK listed companies to comply with a governance code or explain non-compliance, and by providing official guidance to companies on a range of governance issues (such as the role of the chair and NEDs, audit committees and monitoring the effectives of internal control). However, in 2008 the UK was badly affected by the global crisis in the financial services industry, and emergency measures were needed from the government to rescue a number of banks – Northern Rock, Bradford and Bingley, HBOS, Lloyds and the Royal Bank of Scotland. Sir David Walker headed a review into the reasons for the banking failures, and one of the issues to consider was whether the various banking failures were attributable to continuing weaknesses in corporate governance within the banking industry.

In 2009, ICSA submitted a report to Sir David Walker (which was copied to the FRC) entitled 'Boardroom Behaviours', in which it suggested that the system of corporate governance in the UK was not 'broken', but its effectiveness had been undermined by a failure to observe some basic principles of boardroom behaviour. Some of the comments in this ICSA report have relevance to the role of NEDs within the board.

The report suggested that best practice in boardroom behaviour is characterised by:

- a clear understanding of the role of the board;
- an 'appropriate deployment of knowledge, skills, experience and judgement';

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- independent thinking;
- the questioning of assumptions and established views;
- a challenge that is 'constructive, confident, principled and proportionate';
- rigorous debate;
- a supportive decision making environment;
- a common vision; and
- achieving successful closure on individual items of board business.

The extent to which these desirable boardroom behaviours can be delivered depends in turn on:

- the characters and personalities of the board directors and how they interact with each other;
- a balance in the relationship between key members of the board, notably the chair and CEO;
- the culture of the board and the company; and
- the environment in which board meetings are held.

The ICSA report argued that the absence of formal guidance on boardroom behaviour was a weakness in the UK corporate governance system. Effective corporate governance depends not only on sound governance structures but also on appropriate boardroom behaviour.

CASE EXAMPLE

Carillion and Board Behaviour

In 2018, outsourcing company Carillion unexpectedly collapsed. A report by Parliament's Business, Energy and Industrial Strategy (BEIS) and Work and Pensions Committees commented on boardroom behaviour at the company.

'The perception of Carillion as a healthy and successful company was in no small part due to its directors' determination to increase the dividend paid each year, come what may. In the company's final years, directors rewarded themselves and other shareholders by choosing to pay out more in dividends than the company generated in cash, despite increased borrowing, low levels of investment and a growing pension deficit. Active investors expressed surprise and disappointment that Carillion's directors chose short-term gains over the long-term sustainability of the company. We too can find no justification for this reckless approach.

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'Corporate culture does not emerge overnight. The chronic lack of accountability and professionalism now evident in Carillion's governance were failures years in the making. The board was either negligently ignorant of the rotten culture at Carillion or complicit in it.

'Non-executives are there to scrutinise executive management. They have a particularly vital role in challenging risk management and strategy and should act as a bulwark against reckless executives. Carillion's NEDs were, however, unable to provide any remotely convincing evidence of their effective impact.

'Carillion's chairman … interpreted his role as to be an unquestioning optimist, an outlook he maintained in a delusional, upbeat assessment of the company's prospects only days before it began its public decline.

'Once the business had completely collapsed, Carillion's directors sought to blame everyone but themselves for the destruction they had caused. Their expressions of regret offer no comfort for employees, former employees and suppliers who have suffered because of their failure of leadership.'

Boards and organisation culture

The board has a vital role to play in shaping and embedding a healthy 'organisation culture'. The values and standards of behaviour set by the board are an important influence on culture and there are strong links between governance and establishing a culture that supports long-term success.

Some important themes in this area that should be considered include:

- delivering sustainable success – the role of an effective board;
- people issues – delivering alignment between culture, values, human resource practices and performance reward systems;
- stakeholder issues – relationships between culture and business models, with shareholders, customers and suppliers, and the impact on the wider community and the environment; and
- embedding and assurance – measuring and monitoring culture, the role of internal audit, risk management and public reporting of cultural indicators.

The UK Code of Corporate Governance stresses the responsibility of the board for culture. Principle B states that 'the board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned'. The board should assess and monitor culture, asking management questions such as what steps they have taken to communicate the company's values and expected behaviours across the company. If the board is not satisfied that the culture is

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properly aligned with the company's purpose, values and strategy, it should seek reassurance from management that measures are being taken to rectify the problem. 'The focus on culture needs to be continuous' (Guidance on Board Effectiveness).

8 CHECKLIST: A FRAMEWORK FOR EFFECTIVE BOARDS AND CORPORATE GOVERNANCE

Issues in corporate governance may be categorised and analysed in different ways, and it is important to understand how the different elements of corporate governance are interlinked. Companies should establish their own framework and apply an integrated and consistent approach. This framework should start with the achievement of business objectives, and should conclude with disclosure in the annual report and accounts. An example of such a framework is set out in Figure 1.2.

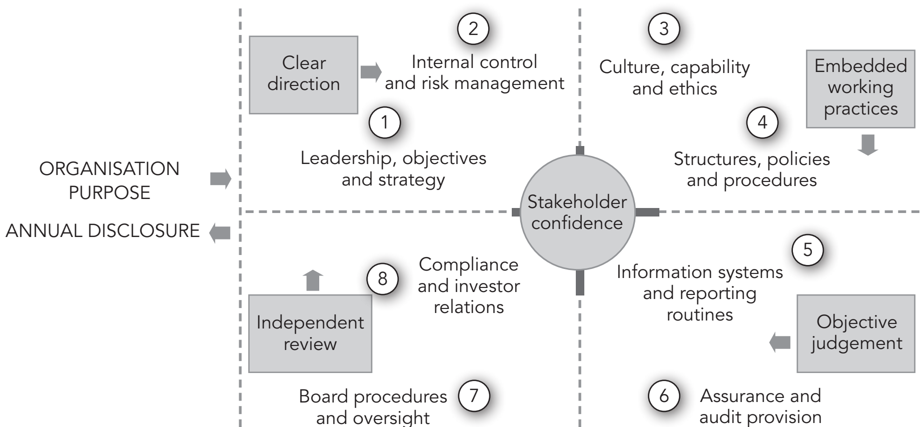

Figure 1.1 A framework for effective corporate governance.

The following checklist sets out a framework of the requirements for an effective system of governance. It can be used by directors and their advisers to make a brief assessment of the effectiveness of governance within their company.

The items under each heading are guiding principles and key practice measures.

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	RATING		
	Good	*Average*	*Below average*
1. Leadership, objectives and strategy			
1.1 Business strategy and objectives are clearly defined and understood.	☐	☐	☐
1.2 Implementation of strategy is monitored regularly.	☐	☐	☐
1.3 Clear direction is provided by the board and senior management, towards meeting the strategic needs of the company and promoting its key behaviours.	☐	☐	☐
1.4 The management team has the appropriate range and balance of experience.	☐	☐	☐
1.5 The right people are in the right roles for implementing business strategy successfully.	☐	☐	☐
1.6 Management demonstrate clear and transparent judgement, giving appropriate consideration to business risks in the decision-making process.	☐	☐	☐
2. Internal control and risk management			
2.1 Risk management policies and procedures are clearly defined, communicated and applied.	☐	☐	☐
2.2 Risk management activities are integrated with business planning activities.	☐	☐	☐
2.3 Risks are identified and assessed in all critical areas.	☐	☐	☐
2.4 Ownership of risk is clearly defined by management.	☐	☐	☐
2.5 Control procedures are well understood by management, and they are documented and consistently applied.	☐	☐	☐
2.6 Risk treatment results in consideration of risk appetite and an appropriate response to risks (i.e. tolerate, treat, transfer, terminate as well as take in certain circumstances).	☐	☐	☐
2.7 Risk monitoring and reporting routines are used to communicate progress.	☐	☐	☐

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	RATING		
	Good	*Average*	*Below average*
3. Culture, capability and ethics			
3.1 The company has an approved code of business behaviour and ethical conduct. This code of conduct has been communicated across the business.	☐	☐	☐
3.2 Effective and comprehensive training programmes are in place, and ethics and code of conduct training programmes are up to date.	☐	☐	☐
3.3 Governance, risk and control, business skills and competencies are assessed as part of the personal business development programme.	☐	☐	☐
4. Structures, policies and procedures			
4.1 The organisation structure is appropriate and is based on the key business activities of the organisation.	☐	☐	☐
4.2 Policies, procedures and processes are clear, up to date and well-documented. The scale and scope of policies and procedures reflect the culture of the organisation.	☐	☐	☐
4.3 Roles, responsibilities and levels of authorisation are defined and agreed.	☐	☐	☐
4.4 Systems and procedures are flexible, capable of responding to changes within the business and within the business environment.	☐	☐	☐
5. Information systems and reporting routines			
5.1 Information systems (IS) are well-defined and support the strategic direction of the business.	☐	☐	☐
5.2 IS investment, change programmes, security routines and system performance are well-managed, with appropriate reporting routines.	☐	☐	☐
5.3 IS are as secure as possible against cyber attack/hacking, and comply with data privacy laws	☐	☐	☐
5.4 Business continuity plans (BCP) and disaster recovery plans (DRP) are defined, documented and tested.	☐	☐	☐
5.5 Information provided to the business is timely, reliable and meets the needs of its users.	☐	☐	☐

	RATING		
	Good	*Average*	*Below average*
6. Assurance and audit provision			
6.1 The role of all assurance providers, and the range of work that they do, is reviewed, approved and communicated. (This may cover external audit, internal audit, health and safety, security, environmental, insurance and compliance.)	☐	☐	☐
6.2 Assurance activities are planned, integrated and co-ordinated. They are focused on the critical risks faced by the business. (For example, decisions about the need for internal audit are based on risks rather than the size of business operations.)	☐	☐	☐
6.3 Reporting to the board by assurance providers is 'fit for purpose', comprehensive and covers a full range of internal control areas.	☐	☐	☐
6.4 Any material weaknesses identified by independent reviews result in action plans that are followed through to completion.	☐	☐	☐
7. Board procedures and oversight			
7.1 The board of directors has a clear definition of its mandate, and there is a clear definition and understanding of the role and responsibilities of individual board members.	☐	☐	☐
7.2 The chair provides effective leadership for the board, so that all directors contribute to board decision making and board meetings are constructive. Directors receive informative papers for board meetings, in good time to study them before the meeting. The board is not dominated by one or two individuals.	☐	☐	☐
7.3 Members of the board have appropriate skills and expertise, and there is a formal and rigorous annual performance evaluation of the board, its committees and individual directors.	☐	☐	☐
7.4 There is an appropriate balance of executive and non-executive directors on the board. (The definition of 'appropriate' depends on the size of the business.)	☐	☐	☐

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		RATING		
		Good	*Average*	*Below average*
7.5	The NEDs make sufficient time available to fulfil their responsibilities and have a good understanding of the company and its business. Induction and professional development are provided for directors.	☐	☐	☐
7.6	There is an effective decision making process at board level. Items of board business are resolved, without undue delay, disagreement, or uncertainty and lack of clarity.	☐	☐	☐
7.7	The board committees have clear mandates. These committees provide appropriate levels of both insight and oversight.	☐	☐	☐
8.	**Compliance and investor relations**			
8.1	All areas of external 'disclosure' required relating to financial, commercial, operational or other matters (such as disclosure requirements in the UK Corporate Governance Code) are well-documented and approved by the board.	☐	☐	☐
8.2	All compliance matters for the business are defined and given appropriate attention. Compliance issues are dealt with on a timely basis.	☐	☐	☐
8.3	The business has a robust and transparent investor relations programme.	☐	☐	☐
8.4	The business satisfies the demands for information (and develops appropriate relationships) with investors, analysts and key stakeholders.	☐	☐	☐

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