This article by Dr Chris Pierce (May 2018) discusses recent important trends in global corporate governance. The author is very aware that making forecasts and predictions based upon extrapolated trends is hazardous. When writing this piece many of his colleagues reminded him that there are only two types of forecasts - the lucky ones and the wrong wrongs - and that most of the time the forecaster will be wrong! Despite the wise insight of Lao Tzu, a 6th Century BC Chinese Poet that “Those who have knowledge, don’t predict. Those who predict, don’t have knowledge.” In this section, the author is bravely (and some might say foolishly!) identifying recent important trends in corporate governance practices from around the World and discussing the implications of these trends and assuming that they are permitted to continue.

Trend 1: Increased usage of corporate governance codes

In jurisdictions, such as Mauritius, the corporate governance framework is based upon not only legislation but also ‘soft law’ (corporate governance codes). All of the jurisdictions with corporate governance codes have Companies Acts which regulate the activities of companies and typically have clear “lines” to distinguish legal from illegal activity. However, they also have corporate governance codes that contain “recommendations” for good and responsible governance where companies are typically required to report to their shareholders on a “comply-or-explain” basis. The Australian Stock Exchange (ASX) refers to this as an “if not why not approach?” A ‘comply-or-explain’ approach provides companies with flexibility to adapt their corporate governance to their specific situation.

In some cases these codes are mature. For example, South Africa has its third Code of Corporate Governance (King III 2009) and the Institute of Directors in Southern Africa is currently working on producing its fourth (which will be published in 2016) and this is in addition to the country having a Code for Responsible Investing in Southern Africa (the CRISA Code, 2011).

The main driver for developing codes is the growing recognition by governance policy makers that legislation can be excessively rigid and does not fit with the “one size does not fit all” approach. Recent governance codes are increasingly providing both generic and specific recommendations to different types of organizations (see box 1).

Box1: Mauritius Code of Corporate Governance (2016)
The Mauritius Code of Corporate Governance (2016) is typical of the new generation of codes that provide both generic and specific recommendations. Generic recommendations are those that have general applicability to all types of organizations. Specific recommendations are provided to specific types of organizations that include: listed companies, banks and other financial service organizations, state owned enterprises, family unlisted companies, global companies and complex organizations with multiple subsidiaries.

Codes of Corporate Governance produce a number of specific challenges that include:

---

1 The principle of “comply-or-explain” means that if a company chooses to depart from a recommendation within the corporate governance code the company must explain in their annual report to shareholders which parts of the code it has departed from and why it has done so.

2 Technically “apply-or-explain” (associated with the King Reports in Southern Africa) is more accurate than “comply-or-explain” since an explanation of a departure from a code’s recommendation should be regarded as compliance but this term is rarely employed in countries other than in the Netherlands and South Africa.
• **Finding the right blend of regulation and “soft” law**
  Policy makers need considerable skill and judgement to decide on an appropriate mix of formal regulation and comply-or-explain provisions which will deliver the most effective outcomes in terms of companies’ ability to generate wealth and employment over the long term.

• **Weak explanations**
  Weak explanations frequently occur when companies deviate from the national code of corporate governance and the explanation for the deviation under the comply-or-explain regime lacks detail. An explanation should be considered sufficient if it allows its users to understand how the company is dealing with a particular issue and why it is doing so. In 2012, the European Commission concluded that “the information provided is, in general, unsatisfactory and the oversight by monitoring bodies is insufficient”. It is anticipated that over the coming years bodies responsible for monitoring explanations will expect better explanations to be employed in Annual Reports.

• **“Boilerplating”**
  Many critics argue that listed companies’ annual reports in countries with codes of corporate governance frequently provide information that does not differ from other companies’ annual reports within the same sector and does not change from year to year. Commentators often argue that companies find it easier to comply through copy-paste or give boiler plate ‘excuses’ and then there is no need to reflect on a tailored approach that would need extra explanations.

• **“Box-ticking”**
  Comply-or-explain can lead to a focus on box-ticking by investors that can lead to a significant reduction in the flexibility that the comply or explain approach can provide.

The increased level of acceptance of this governance approach in recent years has been spectacular. For example, all of the Parliaments in the twenty eight member states of the European Union have either introduced or revised their national corporate governance codes in the last ten years and 98% of directors in listed companies in Europe believe that compliance with national corporate governance codes was important or somewhat important.

**Trend 2: Higher levels of regulation and enforcement**

In recent years, regulators around the world have been given greater powers by government to oversee, monitor and enforce activities within key sectors. This is most apparent in the banking and financial services sector since the Global Financial Crisis of 2008. In particular the size of penalties has been rising (see box 2). Between January 2010 and June 2015, the sixteen largest global lenders had expended over £205 billion in litigation, fines, settlements and provisions.

---

4 Heidrick and Struggles (2014)
5 Financial Times 8th June 2015
The main driver for increased enforcement of regulation has been caused by governance failures of organisations acting against the public interest. Regulators are increasingly being required by the public to hold boards vicariously responsible for fraud, bribery and other forms of illegal behaviour at deep levels within their organization.

Many boards are concerned at the level of fines and the number of regulators that have high enforcement powers (see box 3).

**Box 2: Exchange rate fixing: Citibank; HSBC; JPMorgan; RBS and UBS (2015)**

In November 2014, the UK’s Financial Conduct Authority (FCA) imposed fines totalling $1.7 billion on five banks for failing to control business practices in their foreign exchange trading operations. The fines were: Citibank $358 million, HSBC $343 million, JPMorgan $352 million, RBS $344 million and UBS $371 million. The FCA determined that between January 2008 and October 2013 the five banks failed to manage risks around client confidentiality, conflict of interest, and trading conduct. The Commodity Futures Trading Commission (CFTC) in the US also simultaneously imposed collective fines of $1.4 billion against the five banks for attempted manipulation of, and for aiding and abetting other banks’ attempts to manipulate, global foreign exchange benchmark rates to benefit the positions of certain traders. The CFTC specifically fined: $310 million each for Citibank and JPMorgan, $290 million each for RBS and UBS, and $275 million for HSBC.

The main driver for increased enforcement of regulation has been caused by governance failures of organisations acting against the public interest. Regulators are increasingly being required by the public to hold boards vicariously responsible for fraud, bribery and other forms of illegal behaviour at deep levels within their organization.

Many boards are concerned at the level of fines and the number of regulators that have high enforcement powers (see box 3).

**Box 3: JP Morgan Chase (2015)**

In January 2015, Jamie Dimon, the Chief Executive of JP Morgan Chase, whilst reporting quarterly performance figures stated: “Banks are under assault. In the old days, you dealt with one regulator when you had an issue, maybe two. Now it’s five or six. You should all ask how American that is.” Jamie Dimon had good grounds to comment on this topic since the total legal charges for JP Morgan Chase arising from regulation enforcement between 2010 and 2014 was more than $25 billion.

As a result of increased enforcement, boards are instituting many processes to mitigate the impact of enforcement. These activities include:

- A greater focus by the board upon their role of oversight of legal compliance.
- An increased emphasis on developing a tone at the top that reflects corporate citizenship attributes such as in the management of corporate tax affairs or the use of corporate resources in a sustainable manner etc.
- Effective whistle-blowing procedures that encourage the early identification of misconduct. The alleged misconduct may be classified in many ways; for example, a violation of a law, rule, regulation or a direct threat to public interest, such as fraud, health and safety violations, and corruption. Professionals in this area are now increasingly talking of “speak up” rather than “whistle blowing” because the idea of speak up encourages individuals to raise an issue before any harm is actually done, while whistle blowing comes after the event.
- Audits of internal controls related to culture and company reputation.
- Codes of ethics and conduct being rigorously reviewed by committees and boards.
- Improvements in director induction ensuring that directors have an increased knowledge of the law and a heightened awareness of any legal changes.
Trend 3: Greater board diversity

In recent years there has been a focus on increasing board diversity. This debate originally started by focusing upon independence but has now substantially broadened to other areas of diversity. Many commentators (particularly in Anglo-Saxon countries) suggest that for too long boards have been composed of male, frail (elderly), pale (lack of ethnic diversity) and stale (not up to date) members and that increasing diversity should be a major imperative for companies. In addition, some commentators have focused their arguments on improving diversity of thought amongst board members and the avoidance of “group think” where views go unchallenged and there is a lack of innovative thought. Increasing the diversity of backgrounds, skills and experiences of the directors may thus enhance board effectiveness by bringing a wider range of perspectives and knowledge to bear on issues of company performance, strategy and risk.

3.1 Independent directors

The key benefits of including independent non-executive directors on the board include:

- Bringing an outside perspective on strategy and control
- Adding new skills and knowledge that may not be available within the company
- Bringing an independent and objective view from that of the owner
- Making hiring and promotion decisions independent of family ties
- Bringing an independent view whenever there may be conflicts of interest within the board
- Acting as a balancing element between the different shareholders (e.g. members of the family) and, in some cases, serving as objective judges of disagreements amongst family members or managers
- Benefiting from their business connections and other contacts

A European survey identified that the number of independent directors on boards has been increasing. In 2000 the fraction of independent directors was 29 per cent and this rose to 34 per cent in 2010. It identified that both firm size and firm performance are positively related to board independence in European countries.

The long running independent director debate still focuses upon defining independence and recommending a proportion of independent directors that every listed company board should contain. Director independence is not a concept that can be precisely defined. Ultimately, it should be a matter for the board to determine if the director is independent in character and judgement, and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director’s judgement. However, many regulators have attempted to define independence. For example, the New York Stock Exchange Manual states criteria for determining independence. However many countries have now moved on from defining independence and are focusing upon clarifying the role of the independent directors. For example, the Companies Act (2013) in India has defined a code of conduct for independent directors (see box 4) and the mandatory board evaluation in India now employs this framework.

---

6 Ferreira and Kirchmaier (2013)
A survey (2014)\(^7\) identified that 63% of directors of European listed companies believed that a diverse gender mix on the board was important and a further 25% felt that it was somewhat important. A European survey found that: “Boards should comprise people with different perspectives, backgrounds, and experience. Board renewal is important to ensure a flow of new ideas.”\(^8\)

---

**Box 4: Code of Conduct for Independent Directors in India \(^1\)**

Detailed guidelines for professional conduct, roles and responsibilities for independent directors in India include:

- Upholding ethical standards of integrity and probity;
- Acting objectively and constructively while exercising director duties;
- Exercising responsibilities in the interest of the company;
- Devoting sufficient time and attention to professional obligations for informed and balanced decision making;
- Not allowing any considerations to vitiate objectivity and independent judgment;
- Not abusing position to the detriment of the company or its shareholders or for personal advantage;
- Bringing an objective view in the evaluation of the performance of board and management;
- Safeguarding the interests of all stakeholders, particularly the minority shareholders;
- Undertaking induction and regularly updating and refreshing skills, knowledge and familiarity with the company;
- Keeping well informed about the company and the external environment;
- Satisfying themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;
- Seeking appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts;
- Paying sufficient attention and ensure that adequate deliberations are held before approving related party transactions and be assured that they are in the interest of the company; and
- Reporting concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy.

---

3.2 Gender

Progress on improving the gender balance in boardrooms has been slow. Only 15.8% of board members and 16.8% of non-executive board members of the largest companies listed on stock exchanges in the 27 Member States of the European Union are women, while more than 96 out of 100 company presidents are men. Consequently, in November 2012, the European Commission adopted a directive which sets a minimum objective of 40% of women in non-executive board member positions in listed companies in Europe by 2020, and by 2018 for listed public undertakings.\(^9\) The gender quotas or targets in Europe are listed in Table 1.

---

\(^7\) Heidrick and Struggles (2014)
\(^8\) Ecoda (2010)
\(^9\) European Commission (2012)
Table 1: Gender quotas or targets

<table>
<thead>
<tr>
<th>Country</th>
<th>Quota / target</th>
<th>Expected date</th>
<th>Current figures</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>40%</td>
<td>2017</td>
<td>25%</td>
</tr>
<tr>
<td>Norway</td>
<td>40%</td>
<td>2008</td>
<td>39%</td>
</tr>
<tr>
<td>Spain</td>
<td>40%</td>
<td>2015</td>
<td>13%</td>
</tr>
<tr>
<td>Belgium</td>
<td>33%</td>
<td>2017</td>
<td>15%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>30%</td>
<td>2015</td>
<td>19%</td>
</tr>
<tr>
<td>UK</td>
<td>25%</td>
<td>2015</td>
<td>18%</td>
</tr>
<tr>
<td>Italy</td>
<td>20%</td>
<td>2013</td>
<td>11%</td>
</tr>
</tbody>
</table>

A growing body of research is showing that gender diversity is positively associated with:

- **Financial performance and shareholder value**
  A report found that gender-balanced companies have a 56 per cent higher operating profit compared to male-only companies. Catalyst contend that companies that achieve diversity and manage it well attain better financial results, on average, than other companies using three measures to examine financial performance: return on sales, return on invested capital, and return on equity. They found:

  - Companies with the most women board directors outperform those with the least on return on sales criteria by 16 per cent.
  - Companies with the most women board directors outperform those with the least on return on invested capital criteria by 26 per cent.
  - Companies with sustained high representation of women board directors, defined as those with three or more women board directors in at least four of five years, significantly outperformed those with sustained low representation by 84 per cent on return on sales criteria, by 60 per cent on return on invested capital criteria, and by 46 percent on return on equity criteria.

However, research on the effects of the 40 per cent female quota legislation introduced in Norway has indicated that the effect of the female quota caused a drop in the stock market price at the announcement of the law and a decline in asset value over following years. In addition, the research found that the quota led to less experienced boards, and deterioration in operating performance consistent with less capable boards.

- **Improved board performance**
  Research has identified that female directors have better attendance at board meetings and male directors have better attendance when boards are more gender diverse. Other researchers have identified that higher diversity is associated with higher group dynamic complexity in reaching consensus and that there is a heavier duty on the chair to organize an effective discussion.

---

10 Heidrick and Struggles (2014)
12 Catalyst (2011)
13 Ahern and Dittmar (2011)
14 Adams and Ferreira (2008)
Core values and risk attitude
Research (2009)\textsuperscript{15} has identified that female and male directors differ systematically in their core values and risk attitudes. They found that female directors were more “benevolent and universally concerned” but less power orientated than men. Women directors were also found to be less traditional and security oriented than their male counterparts and were slightly more risk loving than male directors. Their research indicated that having women on the board did not necessarily lead to more risk averse decision making.

Public demand
Europeans strongly support better gender balance. In a recent Europe-wide opinion poll, 88% of people said that, given the same qualifications and skills, women should be equally represented in top business jobs and 75% said they were in favour of legislative measures to enforce this.\textsuperscript{16}

Companies are being required in some jurisdictions to increase the professionalism of their search for Non-Executive Directors. This requirement is being addressed in some cases by executive search firms addressing gender diversity in their search processes (e.g. the UK Voluntary Code of Conduct for Executive Search dealing with FTSE 100 board appointments, 2011)

3.3 Ethnic and national origins
A survey (2014)\textsuperscript{17} identified that 63% of directors of European listed companies believed that nationality mix on the board was important and a further 25% felt that it was somewhat important. In addition, a 2010 survey found that: “Boards should comprise people with different perspectives, backgrounds, and experience. Board renewal is important to ensure a flow of new ideas.” \textsuperscript{18} A Heidrick and Struggles survey identified that overall, boards are becoming more international in their mix, with non-national directors now making up 30% of the director pool across Europe.

3.4 Age
In most countries there has been little change in the average age of board directors. Some companies have identified age as an important diversity attribute particularly if a company is producing products or services that may attract adverse social media comment (see box 5).

Box 5:Tunisia
The Tunisian Code of Corporate Governance recommends that over 30% of the board seats on listed companies should be below 40 years of age.

3.5 Professional and up to date
Chairmen of boards are increasingly considering whether non-executive or independent appointees have enough time available to devote to the job. Letters of appointment are now setting out the expected time commitment, and non-executive and independent directors are undertaking that they have sufficient time to meet what is expected of them. Their other significant commitments are being

\textsuperscript{15} Adams and Funk (2009)
\textsuperscript{16} European Commission (2012) (b)
\textsuperscript{17} Heidrick and Struggles (2014)
\textsuperscript{18} Ecoda (2010)
disclosed to the board before appointment and the board is being informed of subsequent changes. The chairman is facilitating the effective contribution of non-executive and independent directors and ensuring constructive relations between all directors. Non-executive and independent directors are expected to constructively challenge and help develop proposals on strategy, scrutinise the performance of management in meeting agreed goals and objectives, and monitor the reporting of performance.

A recent survey (2014) identified the characteristics of high impact boards. Directors on high impact boards were identified as spending over twice the number of days (40 days per year in total) than directors on medium or low impact boards (19 days per year in total).

Regulators are increasingly focusing upon the competencies of board members through: prescribed competency matrices; requiring the production of curriculum vitae, and interviews with directors. Activists are searching director backgrounds and track records to determine that there is an appropriate alignment between competencies, the business model and the strategy of the company. In general, the nomination process is requiring potential candidates to be more professional. In some cases the induction manual given to new directors is in excess of 1,000 pages!

**Trend 4: More focus on strategy, value creation and corporate responsibility**

**4.1 Strategy**

A key board role is to ensure that the company is pursuing an appropriate, effective strategy. Effective boards make the time to focus on strategy and mutually agree upon the role of the board versus management in the strategy process.

A recent survey (2014) identified the characteristics of high impact boards. Directors on high impact boards were identified as spending 3 times more days (12 days per year in total) working on strategy than directors on medium or low impact boards. The benefits identified with spending extra time spent on strategy included allowing the board to:

- Evaluate that resources are allocated to strategic priorities
- Debate strategic alternatives
- Adjust strategy based on changing conditions
- Assess management’s understanding of the drivers of value creation
- Engage with management opportunities for innovation (e.g. new products or business models)
- Assess the company diversification, capabilities and cross-business synergies
- Avoid groupthink

Typically boards are now separating their strategic discussions from the rest of the board discussions. Strategy retreats and strategy away days which are totally dedicated to strategy topics are now becoming much more common. These meetings often include members of the senior executive team who are not directors as they can provide important perceptions and input particularly concerning strategy execution and implementation. A study of companies in Europe identified that 56% of companies have a strategy away day.

---

19 McKinsey (2014)
20 Ibid (2014)
4.2 Value Creation

Organizations create and maximize value by serving the interests of and working with all major stakeholders, including employees, customers, suppliers, creditors, communities and the environment. Value created in this way manifests itself in financial returns to providers of financial capital and also in positive or negative effects on the economy, the environment and society. Companies are publishing in their Annual Reports ever greater details about their business model so that shareholders and other stakeholders can understand where the value is being created within the organisation.

4.3 Corporate Responsibility

Companies and their boards of directors worldwide have been giving increasing attention to corporate responsibility and even formalizing, through policies and reports, corporate responsibility related activities, reporting, and communications. A 2014 study identified companies’ involvement in corporate responsibility activities (Table 2).

Table 2: Companies’ involvement in corporate responsibility activities

<table>
<thead>
<tr>
<th>Activity</th>
<th>% of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1  Donating money to community causes / charities</td>
<td>68</td>
</tr>
<tr>
<td>2  Participating in community / charity activities</td>
<td>65</td>
</tr>
<tr>
<td>3  Improving energy efficiency / waste management</td>
<td>65</td>
</tr>
<tr>
<td>4  Donating products / services to a charitable organisation</td>
<td>53</td>
</tr>
<tr>
<td>5  Changed products / services to reduce their environmental impact</td>
<td>39</td>
</tr>
<tr>
<td>6  Calculated carbon footprint</td>
<td>31</td>
</tr>
<tr>
<td>7  Partnered with a charitable organisation</td>
<td>30</td>
</tr>
<tr>
<td>8  Intentionally sourced local, ethical trade or organic products</td>
<td>26</td>
</tr>
<tr>
<td>9  Changed products / services to reduce their social impact</td>
<td>25</td>
</tr>
<tr>
<td>10 Participated in Corporate Social Responsibility platforms / initiatives</td>
<td>25</td>
</tr>
<tr>
<td>11 Conducted due diligence on impact of business on human rights</td>
<td>24</td>
</tr>
<tr>
<td>12 Partnered with a charitable organization to address business issues</td>
<td>20</td>
</tr>
</tbody>
</table>

The private sector is being encouraged in their corporate responsibility approaches by investors, consumers, the public sector, and governments. In some cases, governments have formalized some corporate responsibility requirements in legislation and regulations. In other cases, corporate responsibility activities and approaches are being encouraged through voluntary measures, and corporate responsibility remains a non-mandatory corporate activity, without compulsion or persuasion. In all cases, corporate responsibility involves wider contact with company stakeholders.

The key incentives for business are that a company:

- Manages risks to earn/maintain a license to operate. A company’s long-term viability depends on the continued support for its activities from the wider community and stakeholders, including customers, employees, shareowners, and/or government. Companies must identify and analyze their stakeholders to determine which ones may threaten or prevent their license to operate.
- Enhances corporate reputation and brand image. Business success is highly dependent on the company’s reputation within the community.
- Through the use of corporate responsibility initiatives, a company may be able to reduce or eliminate avoidable risks and losses (such as those related to damage to reputation or operations, or changing community attitudes).

---

21 Grant Thornton (2014)
• Improves access to markets and customers because the company is learning from, innovating with, and responding to changes within society. Corporate responsibility supports a climate that encourages a company to identify and take advantage of business opportunities, to develop new business practices and to maintain or enhance competitiveness.

• Increases employee motivation, retention, and productivity. A company’s reputation affects its desirability as a potential workplace. It is in a company’s strategic interests to attract and retain the most highly skilled and expert employees, and this can be encouraged by maintaining an ethical and attractive reputation. Generally, quality corporate responsibility approaches reduce employee absenteeism and turnover.

• Enhances relations with communities and regulators. The long-run viability of a business depends on its strategic positioning, which includes developing the economy and community in which it operates, working with government to facilitate better regulatory regimes, or integrating environmental breakthroughs into assets to reduce lifecycle costs and improve efficiency.

• Improves relations with shareholders and other stakeholders. Investment capital is important for a company’s ongoing activities and ability to expand or enter into new ventures. Technology advancements have ensured that investors have greater access to information about a company’s operations, including its social and environmental performance. There is evidence that investors are increasingly taking these into account when making investment decisions. Eurosif survey (2012) identified that European responsible investment strategies outgrew the market and that in four out of six cases have grown by more than 35% per annum since 2009.

A study of some 2500 companies undertaken in 2014 by Grant Thornton, identified the key corporate responsibility drivers (Table 3).

Table 3: The key corporate responsibility drivers 23

<table>
<thead>
<tr>
<th>Activity</th>
<th>% of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1  Cost management</td>
<td>67</td>
</tr>
<tr>
<td>2  Customer demand</td>
<td>64</td>
</tr>
<tr>
<td>3  The “right thing to do”</td>
<td>62</td>
</tr>
<tr>
<td>4  Brand building</td>
<td>59</td>
</tr>
<tr>
<td>5  Staff recruitment / retention</td>
<td>58</td>
</tr>
<tr>
<td>6  Tax relief</td>
<td>42</td>
</tr>
<tr>
<td>7  Government pressure</td>
<td>39</td>
</tr>
<tr>
<td>8  Saving the planet</td>
<td>38</td>
</tr>
<tr>
<td>9  Investor relations</td>
<td>38</td>
</tr>
<tr>
<td>10 Public pressure</td>
<td>30</td>
</tr>
</tbody>
</table>

22 www.eurosif.org

23 Grant Thornton (2014)
Trend 5: Greater emphasis on the governance of risk

Risk management should be a feature of all businesses. Companies take risks to generate returns. The board is responsible for ensuring that all business risks are identified, evaluated, and suitably managed. In a world of increasing complexity and uncertainty, directors should oversee management who manage organisation risk more assiduously than ever before. The execution of risk management should be entrusted to management, which is in charge of daily risk management. Effective boards ensure that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

All organisations should be clear about their willingness to accept risk in pursuit of their strategies. Armed with this clarity, both boards of directors and executive management should make informed decisions about what actions to take and what they must do to deal with the associated risks. They can also articulate their approach to risk to owners and stakeholders. Good risk management and internal control are both necessary for the long-term success of all organisations and internal audit is the last line of defence. Deficiencies in risk management point directly to deficient board oversight.

Effective boards now have directors possessing risk expertise, as regulators are increasingly requiring this. Every board should approve a risk management framework, including internal control reporting.

Box 10: Case study – UK

The Institute of Business Ethics (2003) identified that:

- UK companies with an ethics code outperformed those without one (in terms of Economic Value Added, Market Value Added and P/E ratio).
- UK companies with an ethics code experienced far less P/E volatility than those without one.

A later study by the Institute found that the provision of training in business ethics and financial performance compared to those who only disclosed ethical values.

In 2013, the top 15 ethical issues associated with company behaviour in the UK were identified by the Institute of Business Ethics as:

1. Corporate tax avoidance
2. Executive pay
3. Employees being able to speak out about company wrongdoing
4. Bribery and corruption
5. Discrimination
6. Environmental responsibility
7. Harassment and bullying in the workplace
8. Sweatshop labour
9. Fair and open pricing of products and services
10. Human rights
11. Advertising and marketing practices
12. Openness with information
13. Safety and security in the workplace
14. Work home balance for employees
15. Treatment of suppliers
and independent, coordinated, assurance over controls mitigating each major source of risk and their interactions.

Regulators are imposing onerous risk coverage requirements on directors that require oversight of internal controls, risk-takers and limitations. Particularly in the US, investors and proxy advisory firms are targeting directors for risk oversight failure.

As a result of the global financial crisis since 2008 the focus of corporate governance amongst many of the corporate governance initiatives has sought to prevent excessive risk taking involving the long-term viability of a company being put at risk for short-term rewards. Effective governance requires that the board’s and the executive team’s role in risk management needs to be clearly defined and established with well understood boundaries. Since 2013, European Listed Companies are required to disclose in the management report of the company’s Annual Report relevant and material information on policies, outcomes and risks.24

**Trend 6: Greater emphasis on information governance**

Most of the recent focus on information governance has been upon Information technology governance. There is profound technological ignorance by many or most boards that is creating an inability to direct and oversee management. Cyber security and social media are risks that, reviews indicate, have deficient or non-existent internal controls, which in turn cause privacy breaches, reputational damage, and significant investor losses.

Control Objectives for Information and Related Technology (COBIT) 5 is a framework created by ISACA for information technology (IT) management and IT governance. It has a toolset that allows the board and executive management to bridge the gap between control requirements, technical issues and business risks.

Boards are becoming more IT literate. Executive management are increasingly improving their internal scenario testing and mock attacks are becoming more common and expert guidance and assurance is being requested by boards.

**Trend 7: Greater emphasis on compensation governance**

The remuneration of senior management increasingly requires shareholder approval at a general meeting on the policy and various components of compensation of executives. Compensation policies are being designed by compensation committees which aim to stimulate longer-term value creation and link executive pay to performance. Poor remuneration policies and/or incentive structures can lead to unjustified transfers of value from companies, and their shareholders and other stakeholders, to executives. Principles that policy makers are focusing upon concerning compensation governance include:

- Setting a limit of a fixed component of director remuneration on severance pay;

---

24 **Directive 2013/34/EU**
• Banning severance pay in case of failure;
• Requiring a balance between fixed and variable remuneration and linking variable remuneration to predetermined and measurable performance criteria to strengthen the link between performance and pay;
• Promoting the long-term sustainability of companies through a balance between long- and short-term performance criteria for directors' remuneration, deferment of variable remuneration, a minimum vesting period for stock options and shares, and retention of part of the shares until the end of the employment contract;
• Allowing companies to reclaim ("clawback") variable remuneration awarded on the basis of data which proved to be manifestly misstated;
• Extending disclosure requirements that improve shareholder oversight of remuneration policies;
• Providing that non-executives should not receive share options as part of their remuneration to avoid conflict of interests;
• Strengthening the role and operation of the remuneration committee such as the obligation for the members of the remuneration committee to be present at the general meeting where the remuneration policy is discussed in order to provide explanations to shareholders and avoiding conflicts of remuneration consultants; and
• Ensuring that shareholders, in particular institutional investors, attend general meetings where appropriate and make considerate use of their votes regarding directors’ remuneration.

The perceived benefits associated with strengthening compensation governance are:

• giving the shareholders control of overall principles for executive remuneration (thus tilting the balance of power more in favour of the shareholders); and
• giving shareholders incentives to get more involved in the governance of companies.

However, possible drawbacks associated with strengthening compensation governance are:

• depriving the board of one of its most powerful instruments for carrying out its fiduciary duties to the shareholders (hire, fire and remunerate management). The European Confederation of Directors Associations has argued that "It is not realistic to turn inactive shareholders into micro-managers. …If the board is not performing its duties the shareholders should dismiss the board, not take over the management of the company"25;
• a lack of clarity as to who can be held accountable for bad remuneration decisions; and
• "Upward delegation" from the board to the AGM does not necessarily imply better corporate governance.

Strengthening compensation governance may well be suitable for empowering shareholders and incentivizing them to engage in the governance of companies in jurisdictions where shareholder power and engagement is weak. However, in jurisdictions with strong shareholder power the drawbacks may well override the advantages, leading to worse rather than improved corporate governance standards.

25 www.ecoDa.org
Trend 8: Greater emphasis on accountability and responsibility to shareholders and other stakeholders

Enlightened companies are increasingly employing better mechanisms for the identification of shareholders by companies and enhancing the engagement of shareholders. Shareholder engagement is more than just voting at the general meeting. Shareholder engagement is a purposeful dialogue with companies on matters such as strategy, performance, risk, capital structure, corporate governance, including remuneration. Shareholder engagement aims to promote long term success of companies. A proactive and constructive relationship between shareholders and the board increases mutual understanding and commitment, both at times of crisis and during normal business conditions. It is generally believed that effective engagement benefits companies, shareholders and the economy as a whole.

“If long term relationships are to be developed, it is important that companies should communicate their strategies to major shareholders and that shareholders should understand them. It is equally important that shareholders should play their part in the communication process by informing companies if there are aspects of the business which give them cause for concern. Both shareholders and directors have to contribute to the building of a sound working relationship between them.”

Around the world the transparency rules for institutional investors are being strengthened to include disclosure of institutional investors’ voting and better shareholder control over related party transactions (e.g. CRISA, South Africa).

Shareholders are increasingly fulfilling their role as owners of the company’s shares by taking a regular interest in the company and its strategy. Improving shareholder engagement normally leads to:

- **Improved minority shareholder protection**
  Given that many companies outside the US and the UK have a controlling interest, the protection of minority shareholders rights becomes very important.

- **Better oversight of related party transactions**
  Related party transactions involve situations where companies contract directly with their directors, controlling shareholders or other related parties. Such transactions may cause prejudice to the company and its minority shareholders, as they give the related party the opportunity to receive large amounts of money at the expense of the company. For this reason, adequate safeguards for the protection of shareholders’ interests are of great importance. Material related party transactions should be approved by shareholders. Most jurisdictions require companies to include in their annual accounts a note on transactions entered into with related parties, stating the amount and the nature of the transaction and other necessary information.

- **Better oversight of remuneration policy**
  This involves improving transparency on the annual disclosure of remuneration (see trend 7).

- **Regulating proxy advisors**
  There is considerable concern about the level of influence and lack of transparency associated with proxy advisors. In 2012 the European Commission 27 identified that there was a lack of

---

26 Cadbury (1992)
27 European Commission (2012)
transparency of proxy advisors in preparing their advice and that there were perceived conflicts of interest.

- **Alignment of incentives of institutional investors**
  The disclosure of voting and engagement policies of institutional investors is showing some signs of improvement. This includes: the development of institutional investors and asset managers voting and engagement policies, the publication of some elements of asset managers management mandates (portfolio turnover, actual and estimated cost of portfolio turnover), and increased disclosure of the methodology applied and transparency rules by proxy advisors.

**Case study: Europe**

The EU Accounts Modernisation Directive (2005) requires listed companies to publish an ‘enhanced directors’ report’ in their Annual Report. Under this Directive, the company must provide a balanced and comprehensive analysis of:

- the development and performance of the business of the company during the financial year, and
- the position of the company at the end of that year consistent with the size and complexity of the business.

The regulations state that the review must include:

- analysis using financial key performance indicators, and
- where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters.

Medium-sized companies, while not required to include analysis using non-financial KPIs, were encouraged to report on these issues voluntarily in recognition of the benefits such disclosure brings to the operation of the business.

Key performance indicators are “factors by reference to which the development, performance or position of the business of the company can be measured effectively”. The selection and number of key performance indicators included in the review is for directors to decide. The Regulations do not say how many key performance indicators should be included, nor mandate any particular key performance indicators for companies to report on.

In 2013, the coverage of the key performance indicators has been extended. European Listed Companies are additionally required to disclose in the management report of the company’s Annual Report relevant and material information on policies, outcomes and risks, and relevant non-financial key performance indicators concerning environmental aspects, social and employee-related matters, respect for human rights, anti-corruption and bribery issues, and diversity on the boards of directors.\(^\text{28}\)

A new integrated reporting model is currently being adopted by many leading organisations across Europe. This approach involves a new reporting model (figure 5.2) (For further details visit www.theiirc.org).

\(^{28}\) Directive 2013/34/EU
Integrated reporting provides many challenges for the accounting and auditing professions. The establishment of credible standards for measuring and reporting non-financial information is still in a prototype and development phase. The methodologies for providing positive assurance on nonfinancial information is being developed and integrating standards and assurance methodologies for financial and nonfinancial information in a way that provides a “true and fair view of an organization’s sustainability” have not yet been finalized. The accounting and auditing professions are likely to require considerable education and training in order to provide professional services in this area.

**Trend 9: Increased usage of board evaluations and board performance development**

There is no global approach or model for Board evaluation. In some countries, such as the UK, the USA and India, Board evaluations are now mandatory for specified listed and public companies. In most countries, Board evaluation is a recommended practice. Within those countries conducting Board evaluations, priorities are influenced by regulatory requirements and leadership preferences. Much of the focus in US companies is upon how the Board deals with oversight of internal controls with particular reference to Sarbanes-Oxley (2002) requirements. Many of the UK companies are focusing upon Board behaviors.

Board evaluations are inevitably challenging for board members. The evaluation process can be made easier, however, by using facilitators, and by treating it as a forward-looking process whose goal is the improvement of the board’s workings, rather than an implicit critique.
One technique for reducing directors’ opposition to the evaluation process is to recast them as “performance improvement plans” (PIPs). These plans emphasize that the exercise’s objective is to improve performance rather than criticizing performance or behavior. Treating reviews as a forward-looking planning process, rather than a backward-looking critique, may make the process appear more goal-oriented and positive.

Common reasons why evaluations do not take place include:

- Some directors may feel uncomfortable about being evaluated
- Pressures of day-to-day activities cause the board to delay the evaluation
- Evaluation might be perceived as a sign that the board lacks trust or confidence in the CEO’s performance
- The board feels it lacks the skills and expertise to undertake effective evaluations
- The board has not been emphasizing planning or evaluation. There are no performance targets for the board, committees, or executive managers
- Dysfunctional board
- The CEO, chairman, and/or founder may be dominating the board and be concerned about the issues that an evaluation may raise
- Previous board evaluations were ineffective

South Africa (2009)

The King 3 Report states that the evaluation of the Board, its committees and the individual directors should be performed every year. The Institute of Directors in Southern Africa has undertaken over 80 board evaluations since the publication of the King 3 Report in 2009 and has identified that board evaluations are associated with

- Assisting boards in assessing how well they have performed through benchmarking their performance against established best practice
- Allowing for reflection on the role of the board, what its objectives are and how it has fulfilled those objectives
- Creating the opportunity for enhancing board effectiveness
- Informing the recruitment and appointment of directors
- Providing a basis for identifying future development needs of the board

Characteristics of successful evaluations include:

- The purpose, objectives, process, and outcomes have been fully explained and discussed with all concerned parties
- Strict confidentiality is maintained at all times
- The chairman and the CEO should play a key role in developing and approving the process
- Regular, annual process
- Benchmarks of board, committee, executive, and company effectiveness should be used as performance indicators
- A written format that is discussed by all concerned parties
- The chairman should provide the full board with a report
- The process itself should be evaluated for improvements to be undertaken in the following year
A recent survey (2014)\textsuperscript{29} identified that board evaluations in European listed companies are becoming increasingly common:

- 70% of European listed companies undergo a performance evaluation every year;
- 8% undergo a performance evaluation once every two years;
- 6% undergo a performance evaluation once every 3 years or less often; and
- 16% never undertake a performance evaluation.

Research has not yet clearly identified the main drivers for the increase in these board evaluations over time. It is clear that many listed companies such as those in the UK have undertaken board evaluations due to regulatory mandates whilst others such as those in Scandinavian countries have undertaken evaluations because the chairman and non executive directors have convictions of the perceived benefits.

The survey also identified that 41% of board members and 30% of CEOs believe that it is the chairman’s job to lead board evaluations among listed companies in Europe, but only 4% of chairmen perceive it as their responsibility. Further, the survey identified that the use of external advisors and evaluators is not insignificant.

- 21% of European listed companies use external consultants / facilitators every year;
- 10% use them once every two years;
- 36% use them once every 3 years or less often; and
- 33% never use one.

External evaluators typically use a combination of questionnaires and interviews to obtain responses from board members. There are no standard contents of the questionnaires and many of them are proprietary and regarded as the intellectual property of the firm that is carrying out the evaluation. Typically an evaluation will contain the following generic categories:

- The structure of the board and its committees. This evaluates board and committee organisation and dynamics including the mix of skills, knowledge, diversity, how the board works as a unit and the tone set by the chairperson and CEO.
- Board efficiency and effectiveness parameters including individual performance, clarity of purpose, direction of the organisation, quality of leadership and key board relationships.
- Risk management and governance.
- An evaluation of the strategic review and resource allocation.
- People issues, ethics and succession planning.
- Business performance including the level and quality of reporting measures.
- Board committees’ performance and their relationship with the board.

When external evaluators are employed, considerable professional expertise is required for the board to draw up a “watertight” contract with an evaluator concerning confidentiality of data and non-disclosure. This is so for the following reason. Many evaluators may wish to employ evaluation data to generate sectoral performance indicators to benchmark other clients against. While this can be perceived as adding value to their services, there is a considerable risk of competitors being able to identify the “anonymous” governance characteristics of other companies listed within their sector.

Most commentators would now argue that publication of this information will signal to key stakeholder groups as to how well the company is being governed. A robust board evaluation process will lead to the building of trust between the board and shareholders. This is important given the existing perception

\textsuperscript{29} Heidrick and Struggles (2014)
amongst some shareholders that boards are not accountable at all. Bridging the trust deficit is likely to allow the board and management increased flexibility in executing their plans for the company.

**Director and Board development**

European member states have been witnessing a growing demand for director and board development activities. Most of the European countries have expanding Director Institutes that aim to improve the professionalism of directors. Some of the Institutes have developed certification (e.g. the UK Institute of Directors, the Australian Institute of Company Directors, the Directors College in Canada, the Caribbean Corporate Governance Institute, the Mauritian Institute of Directors and Hawkamah and Mudara in Dubai) or are currently developing certification as a good way to enhance directorship as a profession and further promote sound corporate governance. In some markets the director training institute maintains a database of certified directors, and companies can subscribe to it. For example, the Slovenian Directors Association invites members who hold positions on supervisory boards of listed companies to become a “chartered supervisory board member” by passing an examination. All candidates who successfully complete the examination are listed in a national register of supervisory board members.

**Conclusion**

Over the last decade significant improvements have been made to corporate governance practices around the World. The aim of these changes has been to focus upon improving director professionalism that lead to improvements in board effectiveness. Some of these changes are being introduced as a result of individual directors wishing to improve their professional effectiveness and in some cases the changes are being introduced through increased levels of competition in the market place and through more rigorous legislation. Many of these changes in corporate governance practices are taking place in countries outside of the US and the UK and these countries are likely to continue their pioneering work in this area. Researchers and commentators increasingly need to be aware of these changing practices in these countries. It is unlikely that the level of change experienced over the last decade is likely to diminish in the near future.

**Dr Chris Pierce is CEO of Global Governance Services. He is the Principal Author of the Mauritian Code of Corporate Governance that came into operation in July 2017. His email is chispierce@ggs.uk.com and his company website is www.ggs.uk.com.**