GOVERNANCE

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Lyndsey Zhang

Content

Feature

Governance across the board

Based on a landmark survey of the health, sports, charities and universities sectors **Gerry Brown** looks at how governance can be improved for the benefit of society as a whole.

Our society depends on its institutions being well-governed. But today, in the UK and around the world, we are facing a crisis of governance. And that was before Covid-19 (sadly) threw these problems into even sharper relief. In nearly every type of institution, private, public or third sector, we see a rising tide of scandals and failures. Indeed, the institutions we depend on are letting us down.

What is to be done? These scandals and mis-steps keep happening – as we argue in our new book *The Independent Director in Society* – because independent directors and Chairs of boards are failing to discharge their duty; or even, in some cases, understand what that duty is. Our analysis of the present situation along with our recommendations and conclusions are based on extensive original research including interviews and surveys conducted by Henley Business School involving thought leaders, key executives and staff across four important but often under-investigated sectors – health care, universities, sport and charities. The often shocking responses to these survey questions and interviews expose high levels of ignorance about the role of the independent director and what governance even entails, amongst the public, policy-makers and even among directors themselves.

This state of affairs has implications for us all. It is not just the institutions themselves, but the wider economy which could suffer. Historically, Britain has enjoyed a reputation for good governance (and abiding by legal agreements), one of the factors that made Britain an attractive place for international firms to invest and international organisations to locate offices. But if the present situation carries on and governance standards continue to slide, that reputation will be lost. That could lead to a loss of competitiveness for the entire nation, especially post-Brexit (however that eventually turns out).

Before we go any further, there is a sharp distinction between governance and management, and the role of the former is not always fully appreciated. The day-to-day running of these institutions is the task of the *executive* team and the managers who report to them. They prepare budgets, execute strategy, deliver products and services to clients and customers, and do all the myriad things any organisation must do in order to carry out its mission.

Governance, on the other hand, is about oversight. Managers and executives come and go, but governance structures are permanent. It is the independent directors – sometimes also known as non-execs, governors or trustees, depending on the type of institution – who are the real custodians of the organisation. Their task is to ensure that the organisation stays focused on its mission, balances the interests of its stakeholders and works to the benefit of all. Theirs is the ultimate responsibility. If the organisation has a failure or breaks down in some way – a human or financial scandal, perhaps, or a case of corruption, or a breach of regulations or procedures that puts people's lives in danger – it is up to the independent directors to put things right. It is also part of their role to ensure that these failures do not happen in the first place.

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If we are to place matters of governance centre stage, we felt we needed to survey, analyse and discuss the opportunities, problems and solutions to the governance crisis right across society rather than just narrowly focus upon the business sector. Bringing a joined-up approach and broad perspective to these important sectors of society showed – despite the very different environments, opportunities and challenges each sector faces – that they also have many issues, behaviours and problems in common. The same problems require, in many cases, the same solutions. Sometimes they don't. Equally, issues and solutions from one sector can cross-pollinate or apply to others and to government or policy-makers.

We believe that there are at least two important answers to the Gordian Knot of good governance problems. The first lies in the realm of policy. We argue against the traditional but worthy panacea of more legislation. Mainly because every sector already has a code of governance and, at heart, these codes are broadly fit for purpose. However, a review needs to be undertaken to give them back their teeth and also make them truly fit for purpose in the 21st century. Among the bold recommendations for policy *The Independent Director in Society* sets out is a recommendation that directors (or trustees, or governors; titles change from sector to sector, but the role remains the same) in the third sector in particular should be paid for their work. This may be surprisingly controversial in many quarters, but we are adamant that this measure – among others – will improve the quality of governance by encouraging a more diverse range of candidates to put themselves forward for directorships.

Our second answer lies with independent directors themselves. Urgent improvement is needed in standards of thought and action as well as the calibre of these directors.

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Above all, directors need to develop an independent mindset that will enable them to make better, more accurate decisions. As the research we conducted shows, that mindset is clearly lacking in many cases. Independent directors who are capable, empowered, engaged and actively supported are required to steer organisations in the right direction, for the benefit of all their stakeholders. There are many elements to creating this culture, including selection, training and education for directors, and support from Chairs and executive teams, but most of all directors themselves must recognise their responsibilities in a complex and volatile world.

But what are the recommendations for policy-makers arising from our landmark survey of the health, sports, charities and universities sectors? Too often, independent directors and boards face an uphill struggle in their quest to be more effective and make real impact. We have seen how in the NHS, in particular, governments have sometimes actively interfered with boards and made their work more difficult, compromising their independence. In many other cases boards of vitally important organisations have been left to sink or swim at times when government intervention might have been timely and helpful. If we are to resolve the crisis of governance and end the damaging stream of collapses and scandals, then boards and directors need more support from government and regulators if they are to fulfil their remit and make the kind of social impact we all need and expect of them.

Drawing upon the differences and similarities revealed, my co-authors Professor Andrew Kakabadse and Dr Filipe Morais (both of Henley Business School) and myself tried to define what independent directors and Chairs of boards *should* do – generally and in each specific sector – as well as where the gaps are between present practice and what is needed. Across all sectors – health, university, sports and charity – our key general findings include:

- The challenges facing boards and independent directors are formidable and have never been greater.
- Boards are failing to be effective.
- Training for directors is sparse to the point of non-existence.
- There is a serious lack of diversity.
- The consequences of board and independent director ineffectiveness are dreadful for society.
- Understanding of digital economy issues and grasp of data are poor.
- Directors themselves are failing to perform their duties.
- Regulatory exhaustion is increasingly common.

Of course, boards do not exist simply to perpetuate the organisation, or themselves. Impact is their *raison d'etre*. Boards exist to ensure the organisation is well run and delivers the goods and services that stakeholders need. If the board does not do so, then it is failing in its purpose. To deliver impact, directors need to carry out those twin duties of compliance and stewardship, control and engagement. Once again, these are the two faces of the same coin.

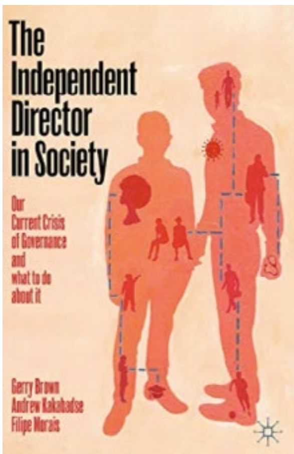
'Independent directors who are capable, empowered, engaged and actively supported are required to steer organisations in the right direction, for the benefit of all their stakeholders.'

Control ensures that organisations are run responsibly; engagement ensures that they are run well. Together, they drive the organisation forward so that it meets the needs of the people.

It should go without saying – but, sadly, actually often needs re-iterating – that independent directors are society's unsung heroes. They have no public image or face, and there is widespread ignorance about what they actually do. They rarely receive credit when things go well, although society is all too happy to blame them – often with good reason – when they do not. Many are underpaid, or receive no pay at all for the service they give. Yet without them, the vitally important institutions that serve society and bring benefit to us all would collapse. We need to recognise the role that they play, and we need to give them the support and assistance they deserve so they can carry out their role more fully. Investing in support for independent directors will be repaid many times over, in the forms of more efficient and effective institutions, contributions to tax income, a prospering economy and a healthy, happy society.

The time to begin reforms and end the crisis of governance is now.

Gerry Brown is Chairman of private equity firm Novaquest Capital Management and is also the co-author (with Andrew Kakabadse and Filipe Morais) of 'The Independent Director in Society: Our Current Crisis of Governance & What To Do About It' which is published in the UK this month by Palgrave Macmillan.



The Independent Director in Society

Gerry Brown
Andrew Kakabadse
Filipe Morais

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China's 2019 FIL still needs work, but it establishes the principles necessary to create a more equal environment for foreign investors, to simplify the approval process for foreign investments entering and exiting China's market, and to better protect foreign investors' interests. Most reforms of current FIL still need detailed provisions for practical implementation and these reforms are foundational to fixing VIEs. Therefore, leaving the VIE structure as a grey area could be a practical decision which indicates that the Chinese Government is still working to improve these foundations and is unlikely to prohibit or restrict VIE structure in the near future.

Conclusion

The VIE structure has provided a workaround structure or shortcut for Chinese companies to access foreign capital over the past 30 years. However, Chinese companies need to understand the risks of the VIE structure and disclose the risk properly for the awareness of investors. Those companies not on the negative list need to re-evaluate the risk and benefits before choosing VIE structures. The VIE structure will not remain a regulation grey area forever. When Chinese regulators are ready to close the VIE loophole, companies on sound legal footing will be more resilient regardless of the regulatory change.

Lyndsey Zhang is the founder of BoardEpoch Inc. and podcast host of Boardroom&Beyond. Her company specialises in comprehensive culture transformation, governance optimisation and strategic engagement for companies with cross-culture connections. Lyndsey is also an accomplished speaker and writer on international corporate governance issues. www.boardroomandbeyond.com www.linkedin.com/in/lyndsey-zhang

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