GOVERNANCE

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AGMs during the pandemic

'Clearly one-size AGMs don't fit all, and individual companies will have to weigh up the pros and cons of how to best hold their meeting in 2021 just as they did last year. However, based on the events of 2020, companies will need to prepare to move away from the traditional shareholder meeting and be ready for change.'

John Britton

Towards EES+G and the bright pyramid

'But even ESG is not enough. It lacks the entrepreneurial element which is an essential element of good governance. So "EES+G" is a wiser and more integrated concept as it challenges boards of all sorts – private, public and not for profit – to refine their purpose by learning to balance and rebalance in real-time the Economic, Environmental and Social impact consequences of their decisions …'

Professor Bob Garratt

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Towards EES+G and the bright pyramid

In an extract taken from his key note address to the Caribbean Corporate Governance Institute's International Forum in November 2020, **Professor Bob Garratt** suggests developing a necessary new mindset for future corporate governance.

How can we escape the Dark Triangle?

At a time of the great turbulence in world health, economic, environmental and social relationships caused by the Covid-19 virus, I am optimistic that new governance opportunities can be grasped to better understand the wider context to develop and control our future organisations. Covid-19 is proving the intellectual turning point by which to reset public and directors' expectations for future organisational performance. This is despite the deeply engrained perception of gloom and hopelessness held by so many people about the current poor effectiveness and efficiency of our organisations.

The present situation is indeed dire both in terms of our ability to organise and especially on the quality of much of our present leadership. This latter reflects often the psychological phenomenon known as 'The Dark Triangle' where paranoia, narcissism, and psychosis combine toxically in our leaders to then create organisational psychic prisons. Many working folk report feelings of powerlessness brought on by these Dark Triangle behaviours, but few know what questions to ask or actions to take to break the triangle.

Yet all is not lost. This global lack of public trust in effective governance is now encouraging much critical questioning of the present, easily accepted, basis of national, and corporate, governance. Much social media criticism is focusing these diverse demands on to how best to govern all types of our future organisations. This unique CCGI multi-continental conference on Reframing Corporate Governance Post Covid-19 will explore many of these ideas and pressures and, most importantly, we intend to distil and share constructive actions and learning internationally on a bi-monthly schedule long after November 2020. All are welcome to join.

As we progress, I shall have in mind the words of the evolutionary biologist E O Wilson 'we shall stumble into the twenty-first century having created a Star Wars-style civilisation, with Stone Age emotions, Medieval institutions, and God-like technology'. For our own salvation we have to learn how to transcend (do better than) this. I argue that effective corporate governance is a key to this.

Current issues

Current corporate governance is a ragbag of untested long-held myths, some good practice and much comforting legal ignorance.

There is so much international evidence of public dissatisfaction with the economic, social and environmental performance of our organisations – private, public and not-for-profit – that it is demanding our politicians make radical changes to future corporate governance. The public now demands that 'something must be done'. But the public is woefully ignorant of what 'effective corporate governance' means. Sadly, and alarmingly, so are many directors, owners, legislators and regulators. So we see untested single, 'silver bullet' solutions offered every day. Most such proposals are random, unsystematic and biased in favour of the proposer. Many are likely to worsen the existing situation by unbalancing it even further. Blame only on the directors is prevalent.

What can be done to rebalance effective corporate governance for the future? Lots. But only if we understand the history of how we got here. I argue that at least in Common Law countries we have evolved since the late 1890s a patchwork of partial solutions to immediate issues without using a broader and long-term societal context.

These patches have not created a rational, integrated system of effective corporate governance that combines the needs and performance assessment of directors, owners, legislators and regulators, under an agreed process of public oversight. Nor has it set the business in the context of their environmental, social and economic impacts on society. This has been caused by the unquestioning acceptance of a number of self-perpetuating myths and open secrets of which the public are unaware and which few of those involved are willing to declare publicly. I have listed below some of the antidotes to the major current myths:

- Nobody owns a company under Common Law. They are separate legal entities and personalities (legal fictions) created originally to help reduce the personal liability of increasingly vulnerable and rich shareholders. But the ownership and control issue were never properly resolved by the 1896 Salomon judgment, and it has proved expedient for the current players to leave wide open the issue of who now controls a limited liability company. Hence the many failed court cases due to the inability to determine who is 'the controlling mind' that has the ultimate liability for a company and a board's actions.
- Shareholders do not own a company but do own a right to have dividends when appropriate, to have a share in the residual assets (should there be any) if things go wrong and to have rights to vote in AGMs and EGMs on who becomes directors, dividends, remuneration etc.
- Shareholders have become convenient and increasingly powerless kick-arounds for the public to blame. Yet from the

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1920s, building on the widely-accepted Berle and Means thinking from the US, they have been treated increasingly as irrelevant when compared to the growing power of the executives, especially the CEO. Shareholders' only real power is seen increasingly in their ability just to buy and sell shares.

- CEOs run the company. Since the 1920s, the supremacy of power in a business has leached away from the board of directors and towards the CEO. This is not the law.
- Shareholder value is the key purpose of any business. Paradoxically, since the 1970s and Milton Friedman's much accepted focus on free markets and the consequent emergence of the hazy concept of 'shareholder value', the role of the CEO was reinforced even further. The perverse thinking was that through the focus on CEOs being rewarded ridiculously well, usually based on their rising the annual share price, (which often they alone could manipulate), the long-term interests of the shareholders would be protected. This is not proven.
- Boards of directors are irrelevant appendages. Again, this reduced the supremacy of the board who often felt as powerless as the shareholders. The power of others including stakeholders, regulators and legislators were then excluded as far as possible from the shareholder value game. Yet it became convenient for all parties to blame the board for all consequent business problems whilst denying them the legal clarity to understand their roles and the long-term purpose of their company. Everyone else could then hold firm views on this, even if they knew little, especially if they knew little, about the legal basis of governance.
- Cadbury is the eternal benchmark. The Cadbury Report of 1992 was a breath of fresh air by introducing the term 'corporate governance' to the wider public, and, indeed to the majority of directors and politicians. But as he acknowledged before his death in 2015 it was a pity that it focused only on 'The Financial Aspects of Corporate Governance'. It was sponsored by the London International Stock Exchange and the Institute of Chartered Accountants of England and Wales so its research was basically on Listed Companies, thereby excluding private companies, state owned enterprises, partnerships, mutuals and not-for-profits.
- Cadbury fits all. This then widely accepted narrow focus on finance and listed companies created two problems that have dogged the development of universally effective 'corporate governance' ever since. First, it has created an erroneous view that corporate governance is only for listed companies. It assumed that the wider environmental and social impact consequences of board decisions were always subservient to the economic benefit of the company. Non-listed organisations were left to retro-fit the existing Corporate Governance Codes as best they could. This has led to much distortion of what is called 'good practice'.
- Secondly, the creation of the UK Corporate Governance Code from the 1992 Cadbury Report was copied so many times around the world, and so easily, that it came to be treated like Holy Writ. It was not and is not. It was a first attempt to codify both the law and good practice. Sadly, it also became a regulator and bureaucrat's dream. Copying it and imposing it on nationally registered organisations was the silver bullet that let legislators off the hook. They could then announce to the public that they had 'solved' corporate governance by applying the Code indiscriminately to all registered organisations in their country (regardless of appropriateness) and had then appointed regulators to enforce it.
- Then if there were subsequent issues the regulators could just add more clauses. Sadly, often without checking the legal basics and which they then over-rode increasingly. This was an attempt to create law without due legislation. This created confusing and sometimes contradictory secondary rules which wrecked the original legislation. Yet no-one seemed to care as governance was mainly hidden from an indifferent or ignorant public. It was seen as a minor sport for geeks who should be left to their own devices. But as Sir Adrian Cadbury pointed out in 2015 the entrepreneurial basis of effective corporate governance was being destroyed by a fixation with Codes and this, taken to extremes over time, would destroy all forms of wealth.

'But CSR was a weak concept; easy to say, difficult to measure, and treated by most boards as a wimpish feel-good factor unrelated to the fast-changing world reality.'

Covid-19, ESG and the turning point towards the Bright Triangle

Covid-19 has given time for societies to refocus on their governance and corporate inadequacies. It is now becoming clearer to the public that companies are not autonomous economic entities only but exist only within a wider ecology where not just economic impact must combine with environmental impact and social impact to deliver their long-term purpose.

The signs have been there for decades but especially since the western financial breakdown of 2008. A dramatic and key *mea culpa* was made by Alan Greenspan, ex-Chairman of the US Federal Bank in his book *The Map and the Territory* (2013) where he admits that their deep belief in the self-correcting nature of financial markets was shattered by the crisis. 'The models did not work, despite some 250 PhDs working for

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me'. The driving factors not considered important by them during the meltdown were 'the nature and speed of market dynamics' in globally integrated financial systems, and, of great importance for the future, 'people and their unpredictable emotions'. The concept of Rational, Economic Man was dead. This has shattered macro-economics. In retirement he took a course in anthropology to better understand human nature.

In August 2019, 181 CEOs of most of the largest US corporations wrote under the heading of the US Business Roundtable that they now committed 'to lead their companies for the benefit of all their stakeholders – employees, customers, suppliers, communities and their shareholders'. The Age of 'ESG' had arrived. The issues of ESG impacts rose to the fore and boards have now to face this. Most avoid them. They had been growing in public consciousness for some decades but had been ignored at corporate and legislative levels. They had assumed that for corporations at best Corporate Social Responsibility (CSR) was good enough. But CSR was a weak concept; easy to say, difficult to measure, and treated by most boards as a wimpish feel-good factor unrelated to the fast-changing world reality.

ESG has risen as a harder-edged concept. It incorporates the demands of the environmentalists, including, for example, corporate impacts on global warming, zero carbon and deforestation; with social impacts on the communities within which a corporation operates in terms of employment, supply chains, community cohesion, and customer satisfaction; with governance including clarity of the long-term purpose of the company; duties of the directors, induction and development to competence of the board, and the assessment of the performance of directors and executives. I note that many new scorecards and ratios are being developed for the environmental and social impacts of a corporation. But so far we have few for assessing governance performance, especially by the investment community.

Towards the Bright Pyramid and Integrated EES+G

But even ESG is not enough. It lacks the entrepreneurial element which is an essential element of good governance. So 'EES+G' is a wiser and more integrated concept as it challenges boards of all sorts – private, public and not-for-profit – to refine their purpose by learning to balance and rebalance in real-time the Economic, Environmental and Social impact consequences of their decisions on their community eco-systems. This is a major mindset change for the majority of boards. It is not new, but little known. Indeed, section 172 of the UK's Companies Act 2006 (persuasive of company law across the 54 Commonwealth countries) and section 171 on the Seven Duties of a Director mentions all three elements of EES+G. The trouble is that it is so rarely read, let alone used as the basic induction tool for all new directors. Economic, Environmental, and Social Impacts (EES+G) are the new stable, triangular base on which boards can design their future decisions to deliver their purpose. (Such a mindset change is a major challenge for all of us as we move from the Dark Triangle.)

Towards the Bright Pyramid

Such a mindset change by boards is a major challenge for all of us as we move away from the Dark Triangle. This is where future directoral thinking needs to shift from 'two-dimensional' to 'three-dimensional' thinking. Apart from engineers and architects most professionals are not trained to think in three, or four, dimensions. Boards now need to integrate increasing public oversight above the levels of future EES+G decision-taking. Remember that 'governance' from the ancient Greek means both seeing the way ahead (direction) and ensuring prudent control of an organisation. Accepting 'EES+G' as defining new effective corporate governance creates a more effective mindset for future boards. It creates a Bright Pyramid using 'EES' as the stable triangular, two-dimensional base; with 'G' as corporate governance rising up a level to form the integrative middle balancing process to create the organisation's future whilst still ensuring control in the present – a true Learning Board. And, crucially, with public oversight at the top of the pyramid.

This cannot be claimed as a new concept, merely the integration of centuries old concerns. We have struggled since 1776 with the issues of how we deliver Economic Wealth whilst balancing it with Moral Sentiment, Social Justice, Environmental Respect, and effective Governance. That year saw the publication of three books that still shape the modern world. Adam Smith's *The Wealth of Nations* (including Moral Sentiment), Jean Jacques Rousseau's *The Social Contract*, and the US *Declaration of Independence* leading to the US Constitution, dealing with the necessary balance in governing between the legislature, judiciary and the executive. They continue to challenge what we mean by effective governance, national or corporate.

I propose that this conference commits to make a significant and continuing contribution to the development of EES+G and so helps restore public confidence in our organisations for the benefit of all; for corporate governance to play a significant role in creating the common wealth.

This article is based on the Key Note address given by Professor Bob Garratt at the Caribbean Corporate Governance Institute International Forum 26–27 November 2020.

Professor Garratt works with his wife Sally reviewing and developing boards of directors on five of the six continents. He is a practitioner and researcher whose book 'The Fish Rots From The Head: Developing Effective Directors' became a best seller internationally. He is a Visiting Honorary Professor at City Business School, London; and Professor Extraordinaire at the Business School of Stellenbosch University, South Africa. He is External Examiner of the Gulf Co-operation Council's Board Development Institute for their new Director Development accredited awards. He is currently writing 'A Shining Light in a Naughtie World' to be published in Autumn 2021.

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around 13% said they would very likely supplement the meeting with a webcast or equivalent technology.

Most strikingly, 37% of companies indicated they were 'likely' or 'very likely' to consider a fully virtual meeting if restrictions going into the 2021 AGM season remained broadly the same as present, while more than 40% said they were 'likely' or 'very likely' to consider a hybrid meeting if it were to take place in the present conditions.

It seems clear that while traditional AGMs remain the popular default choice, the global pandemic is helping to demonstrate the benefits of increased use of technology to aid shareholder engagement, which may lead to greater use of virtual or hybrid AGMs once companies are free of the restrictions that have made physical meetings so difficult over the last year.

John Britton is Governance and Industry Officer at Computershare. John's role inside Computershare includes providing insight on industry issues as well as on internal and external stakeholder management. John holds qualifications from the Chartered Institute for Securities & Investment as well as from ICSA: The Chartered Governance Institute.

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