Dinner with Sarah Wilson - CEO, Minerva Analytics

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KPMG Board Leadership Centre

Sarah Wilson, CEO of Minerva Analytics - the home of Manifest, the independent stewardship support service - joined our FTSE350 Board Leadership Centre dinner to share her thoughts on corporate governance, board effectiveness and the role of proxy voting agencies. Here we look at ten of the key themes arising:

1. Proxy advisors – chroniclers of company data

Proxy advisors are not the cause of all the distress often attributed to them by the press and others. Information is the life blood of the capital markets. If shareholders are to vote responsibly they should do so on the basis of fair and accurate information, but despite the efforts of regulators, the quality of annual reporting is still inconsistent. This is why proxy advisors play a role as 'chroniclers' – providing their clients with a dispassionate analysis of the relevant corporate data.

That said, the corporate governance world is too reliant on box ticking and the structural aspects of governance rather than on culture, behaviour and values – and this is exacerbated by US rules that mandate shareholder voting; which in turn leads to many investors blindly following a proxy agency's voting recommendations. (Note: Minerva provide only analysis, not voting recommendations.)

2. A new paradigm

We are at an inflection point in corporate governance. Maximising shareholder return is not the only game in town. Society is demanding that companies serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies should benefit all of their stakeholders, including shareholders, employees, and the communities in which they operate.

The January letter from BlackRock chairman and CEO Laurence Fink to CEOs captured the attention of the business community. Entitled "A Sense of Purpose", the letter urged companies to focus on their social purpose and long-term strategies. As head of the world's largest asset manager, Fink made clear BlackRock's expectation for a new model of shareholder engagement, "that strengthens and deepens communication between shareholders and the companies that they own".

Fink's words were applauded by those focused on driving greater corporate social responsibility; others called his views "misguided". But whether or not directors agree with his views, many think Fink has captured the zeitgeist of our times and boards would be well advised to consider how to respond.

3. Joined-up reporting aides decision making

Annual reports are often not as joined-up as they might be. The financial statements, strategic and operational analysis, governance and sustainability sections are often drafted as discrete sections rather than integrated into a single narrative. Even executive remuneration is often based on one or two simple share price based metrics rather than strategic, operational and people related KPIs.

It would be a positive development if more companies published their full annual report at the same time as the preliminary announcement of the company results. This would allow investors to make better decisions – notwithstanding the above, decisions based on a more complete information set including not just the financial information, but also relevant strategic, operational, governance and sustainability information; and the auditors report.

4. The 'voice' of the workforce

The recent changes to the UK Corporate Governance Code might not be radical, but they do present boards with a number of key questions – not least, how best to get the 'voice' of the workforce heard around the boardroom table. For many, worker directors sit uncomfortably with the traditional UK Corporate Governance framework. Nevertheless, they can provide tangible benefits to companies and perhaps ought to be seen as an opportunity rather than a threat. A Board Leadership Centre paper on the benefits and challenges of worker directors can be found here.

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While the success of the German corporate sector might be less about board structures and more about executives and the workforce working in partnership, workers have been represented on the boards of German public companies since the end of World War 2 (if not before). It is natural to fear change, but if people are your greatest asset how can you not reflect them in your governance structure? Why not give it a chance? It's a bit of an experiment, but it was once thought 'experimental' to have women on boards!

5. The board chair and the nine year cap

While some people lose their independence on day one, others remain robustly independent for twenty years or more. That said, the new provision is very likely designed to encourage board churn and diversity at the head of the board - as some board chairs can be blockers when it comes to diversity and inclusion in the boardroom.

Any issues around the loss of corporate memory might be addressed through others within an organisation – corporate memory doesn't have to be the preserve of the board itself. Chairs could also step aside but still sit on the board as a non-independent non-executive director though this might create a difficult environment for the incoming chair.

6. Board members - the next generation

Succession planning should be a key issue for boards – especially with a pervasive governance model in which non-executives outnumber executive directors by five to one. Finding the next generation – getting them trained up and exposed to boardroom issues - requires a great deal of thought. Think about young people, think about people with technology expertise, and think about women. Don't try to shape your future board in the image of the current board - as the issues facing companies are hugely different as their strategies transform. Ten questions boards might ask about board composition can be found here.

7. Risk aversion and asymmetric information flows

The increased board focus on risk management since the financial crisis is a good thing, but perhaps one of the greatest risk businesses face today is the risk of taking no risk. Excessive risk aversion leads to a lack of innovation and ultimately stagnation and failure.

This supposition is supported by a recent Audit Committee Institute survey which suggests that the majority of non-executive directors would describe themselves as 'risk cautious' (81 percent) rather than 'risk adventurous' (19 percent).

Risk, derived from the Italian *risicare* or *to dare*, is an ever-present aspect of the business world.

If entrepreneurship is to flourish, risk should be managed, not avoided. The key is to knowingly take risk rather than be unwittingly exposed to it.

With this in mind, non-executive directors should be alert to asymmetric information flows with all (or the vast majority) of their information coming from the executive. Perhaps non-executive directors could be bolder in bringing issues to the board and driving the agenda.

8. Executive remuneration

Most would agree that the 'headline' remuneration figures we read about in the media are unsustainable, but the data actually shows that executive pay has been reasonably flat over the last few years and there are far fewer egregious pay policies that one would imagine. However, if charismatic CEOs are intimidating the board over pay, then that is probably symptomatic of a bigger problem around the boardroom table.

It is also important that individuals are not asked to chair the remuneration committee immediately on joining the board (as a lot of women have been asked to do). As the new Code suggests, all remuneration committee chairs should have at least twelve months prior experience on a remuneration committee before being asked to take on the chair role.

9. Dialogue with shareholders

Generally if you don't hear from your shareholders that's good news – but don't be complacent. It is important that boards understand their principal investors. Do they do they own research, do they blindly follow a proxy advisors recommendation? Do they 'prioritise' Environmental, Social and Governance issues? There are fund managers (primarily in the US) that are sceptical about climate change while others - primarily in Asia and Europe – see it as a core issue.

10. The Annual General Meeting (AGM)

In theory, all shareholders have the same rights, but that's not always the case in practice. AGMs could be more like analyst briefings, but they seem to be stuck in a rut. Also, if we are to have a shareholder economy (let alone a stakeholder economy), we need more 'business' education in schools. A review of the 2018 AGM season can be found here.

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