Letters to a new chair

tomorrow's company

In association with KPMG

June 2019

Culture, values, long term sustainability and purpose have become key cornerstones of good governance.

The 'Letters to a new Chairman' (as they were then titled) were first developed by Hugh Parker and the IoD in 1990 and revisited by Tomorrow's Company in 2014. We argued then, as we still do – that good governance is a cornerstone of good business, and that the chair's role is pivotal in both.

Our first involvement with these letters was through our work leading the Good Governance Forum, which was established to develop practical tools and innovation, to help boards tackle behavioural and cultural challenges and open up new opportunities. Here, we have re-launched and refreshed them, in partnership with the KPMG Board Leadership Centre.

These letters look at how concepts such as culture, values, long-term sustainability and purpose have become key cornerstones of good governance. Similarly, board diversity in all its forms has become a necessity, not just the preserve of those forward thinking chairs. But how does the chair set the organisations purpose and character? What are the key relationships to work on? How do you exercise the right tone from the top? These are just some of the questions these letters seek to address.

The letters are not just for chairs. They celebrate and explore what makes for good governance; recognising that while the chair brings all of these people together, governance is a collaborative effort. This collaboration between executives and non-executives, supported by all members of the board, with all utilising the vital role of the company secretary, and through strong and effective engagement with and regard to the perspectives of investors and stakeholders. These themes come up time and time again in our conversations with directors about what makes good governance work for the organisation.

Governance is frequently held up as a solution to bad or unethical business. With every new scandal, we look to the boards of our largest companies and ask – how they could have let it happen? Barely a month goes by without outrage over an executive's pay or bonus, and the requirements and responsibilities of boards continue to increase. This is only right, and boards must see these changes as an opportunity to demonstrate fully how seriously they take their responsibility, and strive for better, moral behaviour that reflects their role as a vital part of the ecosystem. The companies that will do best are those that can see codes, regulations and reporting requirements as an opportunity, and think creatively about what governance is there to achieve and unlock, not that which it prevents.

The letters are also intended to spark debate. There has never been a one-size-fits-all model of governance and these aren't either. Instead, they are a starting point for putting good governance into practice.

Melanie Richards
Deputy Chair, KPMG UK

Dr. Scarlett Brown
Director of Research and Policy, Tomorrow's Company

Letter from an

Institutional Investor

Environmental, social and governance issues matter

The chair embodies the culture, tone and performance of the business

Look to demonstrate resilience, long-term thinking and how the company contributes to society

Investors want to see a strong chair who has a constructive and balanced relationship with the CEO

Long-term investors seek a longer term view of the company's condition and prospects

Interactions with the board provide a glimpse into the mind of the organisation

Dear Alex

Congratulations on your new appointment. As you'll be aware, the role of chair is a key for investors. Increasingly, we are scrutinising such appointments closely because the individual occupying that position has such a significant impact on the culture, tone and indeed performance of the business. In recent times, the responsibilities of shareholders have also been under the spotlight, and as a result pressure put on investors as the primary stakeholders to exercise influence over the companies in which they invest. The key is to monitor the skills and competence of chairs, CEOs and directors, and support them in their value-creating efforts, vote them out in good time when things go awry, rather than standing by and watching them destroy value. Areas of concern include short-termism, excessive or misaligned remuneration, and general lack of confidence in the effectiveness of corporate leadership. There is increasing pressure on the institutional investors, demonstrated in the Stewardship Code, to be more active in making their perspectives known, engaging with companies in their portfolios and using their votes responsibly.

Institutional investors have different perspectives themselves. Many of them are corporates in the financial services sector, and not immune from the same shortcomings that they observe in their investment portfolios. All are concerned with the value of their investments, but their ways of harvesting gains in this value range from active strategies such as spotting restructuring opportunities or being long-term equity supporters, or more passive strategies such as investing in funds that track an index. Each of these deserves a different approach to the relationship, and each is acting for its own client base. Each is concerned with delivering gains to their clients' income or capital. Some have separate governance departments whose teams may not even interact with the fund managers. Others are more integrated and ensure that they take a joined up approach to the companies in which their clients invest. From your perspective, the second model is easier to deal with. The majority of time investors spend assessing any company is focused on analysing the numbers and examining its performance. The reality is that most of your company's conversations with investors and analysts will be with your CEO and CFO whenever quarterly or annual results are published. This tends to reinforce the short-term nature of financial analysis and media exposure.

Build mutual

As long-term investors we believe we have a responsibility, not just to our clients, but to society as a whole. We would like a much longer-term view of the company's condition and prospects, an idea of what it stands for, and the scope of its ambitions. Environmental, social and governance (ESG) issues matter as they impact the long-term value of our clients. Conversations and interactions with the board on such topics would be highly desirable. They provide the context and the colour for the short-term data and provide a glimpse into the controlling mind of the organisation. This is where I would venture to give you advice as chair: to welcome and organise engagement of this sort, to establish and lead direct relationships with your key investors, and to put current performance into its long-term context. We are (very) actively-interested observers, often with a wealth of experience and expertise in our given sector, and you can use engagement as a way of understanding how the market sees your company. It is an encouraging sign to see the chair being receptive to outside ideas about the company's performance, and not just focussing on internal perception and information.

There is scope for you to take the initiative. I tend to seek direct contact with the chair of an investee company when I have concerns about an aspect of a company's performance. This may be related to strategy, capital structure, governance or risk management. However, there are always many interesting topics to discuss with a chair and so more regular contact would be welcomed, not least because this would help us to understand the company in a broader and better balanced sense. When and if an issue did arise, a communicating relationship would already exist which can only be an advantage on both sides.

Understanding the future direction of the company and the scope for added value is one thing, and believing it is in good hands is another. Both are important. I think the role of the chair is more important now than it has ever been. As an investor, I want to see a strong chair who has a constructive and balanced relationship with the CEO. But these distinct roles should never be confused. The chair must be able to run an effective board that strongly supports the executive management team but stands up to them and challenges them appropriately, and projects externally the high level strategy and culture of the company. Without direct access to the boardroom it is extremely difficult for me as an outsider to know about the quality of the conversations you are having – how well decisions are being shaped and challenged, choices and proposals interrogated and stress-tested – and I am therefore reliant on a few symptoms to try and help me diagnose the leadership and be confident of the health of the company.

c

Far better, in my view, would be direct discussions with you as chair that included such topics. On my wish list would be all the things that make a board effective: the state of your relationship with the CEO, outcomes of board evaluations, any symptoms of imbalance or dysfunction in the board – the emergence of overbearing personalities is always a red flag, I want to feel confident that you have a highly competent board, and for that board to be able to deal with the turbulent business environment. I will leave it to you to judge the characters you have around the boardroom table, but if you do not think you have the right skills and balance of voices around the table then I would urge you to be decisive and take corrective action. With that confidence in place, we would always back your judgement in voting for directors at your AGM. I would advise you to remember that the CEO, or any board member for that matter, is never irreplaceable. You will need to have a viable succession plan in place for all, no matter how uncomfortable discussions around this can make people, or you will always be on the back foot if a member of your team no longer fits the role and will have a weaker negotiating position when it comes to remuneration.

I can't tell you exactly what your investors will expect from you, but I do know that their demands and expectations will be shaped by their view of the business. If you have inherited a company in a steady state we would look for a chair with motivating and team building skills, if there are crises to solve we would expect action. Finally, I would also advise you to be wary of the common misperception that fund managers are only interested in short-term results. Most will actually look at the long-term because what they really want is a company that will grow in value and survive the difficult times. I urge you to initiate regular conversations with your key investors as this will help build mutual confidence. Anyway, I am quite sure that you are being overwhelmed with well-meaning advice, and my voice may be adding to the confusion! Good luck in the new role, I am quite sure from all Ronnie has told me about you that you will do a fine job and your inquisitive nature will serve you well.

Kind regards
Sidney

onfidence