Column

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ALIGNING BOARD COMPOSITION WITH SHAREHOLDER VALUE

Investors risk losing out unless these two elements work in tandem.

The scrutiny of boards has seldom been greater, but corporate governance is often seen purely as a regulatory and compliance overlay, and the board or supervisory board as a form of insurance against undesirable outcomes.

Corporate governance codes challenge this view. According to the UK Corporate Governance Code, "a successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society."

Meanwhile, the US's Commonsense Corporate Governance principles suggest, the board agenda should emphasise, "creation of shareholder value, with a focus on the long term. This means encouraging the sort of long-term thinking owners of a private company might bring to their strategic discussions, including investments that may not pay off in the short run."

While risk mitigation is clearly important, boards have a broader role focusing on the upside as well as the downside, and contributing to a sustainable increase in the value of the organisation over time.

Board composition and effectiveness must be aligned to increase value. If this is not the case, shareholders and stakeholders should ask why.

Boards and corporate crises

Corporate governance and board accountability invariably attract attention when things go wrong. All too often, high-profile corporate crises shine a light on board function. In such crises, governance failings are usually identified that claim scalps among the top team: the chair and CEO are mostly likely to bear the consequences.

Averting corporate crises is clearly a vital governance function, and some warning signals are now well understood:

- The overweening CEO who views the board as a hindrance.
- Aggressive sales targets linked to financial rewards without a focus on revenue quality or behavioural implications.
- The lack of a strong health and safety culture driven from the top.
- Unethical behaviour tacitly condoned by senior management.
- Failure to act on reports from whistleblowers.
- Deafness to changes in the public mood representing a business model challenge.

Regulators are increasingly taking boards to task for failing to pick up on these. In financial services, opaque pricing and unclear product benefits too often create a tension between shareholder returns and value for customers, resulting in numerous cases of mis-selling of financial products in various countries, leading to legal or regulatory measures to provide compensation.

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This is behind the UK Financial Conduct Authority's current focus on value for money, a metric that is closely monitored across a number of regulated industries including utilities and social housing. Even the German rental sector, for a long time the home of public landlords and reasonably priced accommodation, is facing calls for rent controls due to rising prices in cities such Berlin. Boards ignore such political and regulatory trends at their peril.

Boards driving value

The board is much more than a goalkeeper keeping the ball out of the net and the executive under scrutiny. It must be proactive and focused on creating long-term benefits in a number of forms:

- Challenging management to fearless, objective examination of the business and its issues.
- Developing and approving a robust and genuinely forward-looking strategy.
- Aligning skills, experience and perspective at both board and executive level with strategy and corporate goals.
- Promoting a culture of innovation.
- Contributing diversity of experience and perspective and being alert to weak signals that may have a profound impact on the business model.

Good governance and value

We talk of high-performing businesses. There are also high-performing boards. The metrics of their success may be more multifaceted and long-term than the media or shareholders expect. Yet a high-performing board can galvanise and drive the organisation. Such a board can provide the essence of governance – a commitment to sustainable value generation for shareholders and stakeholders.

In turn, these shareholders and stakeholders are subjecting boards to increased scrutiny. Boards need to articulate how composition and effectiveness contribute to and align with value generation. If shareholders and stakeholders are unable to make this connection, boards will face a downward spiral of compliance, regulation and risk aversion.