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Corporate governance for the modern world

The world of work is changing fast, influenced by technology as a powerful, disruptive force, but also by social and political change. At the same time a slew of corporate scandals over recent years have significantly eroded trust in big business alongside a wider public scepticism and mistrust of the ‘establishment’. Twenty-five years on from the publication of the Cadbury report, we have a once in a generation opportunity to modernise the rules on corporate governance in the UK to better reflect the modern and more varied business environment and context, and critically to rebuild trust and encourage greater transparency.

Making the intangible tangible

In the last 30 years, through a more services driven economy, intangible assets – such as people and brand - have overtaken physical assets as the key drivers of corporate value. Yet, corporate reporting and stock market expectations are still geared towards traditional financial metrics, quarterly forecasts and short-term earnings, with reporting of intangibles being hugely inconsistent. Money and people really are the vital constituents of any enterprise, and whilst we have long focused on and measured the money, we now need to do much more regarding the people element.

Human capital, intellectual capital and social capital – people, their skills and knowledge, and organisational culture - are key sources of competitive advantage and longer term value, as well as the key sources of risk. But they are not consistently measured or understood and the short term focus on financial returns has long prevailed, reinforced through executive reward and the culture of stock based bonuses. Supporting the share price through dividend payments and share buy-backs has been incentivised in preference to longer term investment in our workforces and workplaces. Over time this has contributed to too many low quality jobs and the growing mismatch in skills, poor labour productivity rates and stagnant average wage growth.

Accountability, good principles and behaviours lead to sustainable change

The pace of change is slow but we are starting to move in the right direction. The review of the UK Corporate Governance Code by the FRC, the BEIS consultations on pay and governance, and industrial strategy, as well as initiatives such as the Taylor Review on modern employment practices and the Mayfield review on productivity, are all positive reactions to the issues – but they will all need to connect. At the same time, enforced additions to corporate reporting requirements in areas such as gender pay gaps and challenges on executive pay signal the growing demand for transparency.

But for positive change to occur we also need accountability, and an alignment to good principles and values, and leadership behaviour that drive positive corporate cultures from the top down. This cannot be accomplished by rules alone. Indeed, too much legislation and rule making deflects attention and accountability and can encourage cultures of compliance versus appliance of good principles – as has been demonstrated through many decades of behavioural science research.

From a policy and regulatory perspective, we need to encourage a better understanding of people and culture, and to seek greater transparency and reporting of evidence in how principles and values are being applied and embedded throughout our organisations. The old adage of what gets measured gets done holds true. And business needs to take the lead, to hold itself to account and not just be forced to change through legislation. Holding ourselves up to greater scrutiny and seeing how we compare is a very good way to motivate change.

An ongoing board dialogue about people, culture and value

Guidance and frameworks on corporate governance are also important in shifting the focus and strengthening the board dialogue and insight.

Ideas such as evolving the Remuneration Committee to consider issues of pay and remuneration across the whole organisation, or establishing human capital sub-committees with the remit to understand key aspects of the organisation from culture, pay and reward strategies, to investment in people and the changing nature of the workforce, could provide a better channel to the Board, and be something that the HR function could work with more closely.

A more consistent language for human capital measures and ways of reporting would help connect external stakeholders, including the influential shareholders to encourage businesses to hold to the principles and values they espouse, and to encourage the ongoing investments in their workforce and workplaces for the longer term. The Pension and Lifetime Savings Association, representing pension fund interests, and the Investor Association have been increasingly vocal on more consistent human capital reporting, but we need to define more consistent standards.

Better business outcomes

In all of this we have to find ways to encourage application of good principles and practices across all forms of organisation, large and small, public and private. This must involve collaboration with other external agents, such as auditors, and bringing together the internal functions of HR, risk, finance, marketing and others to build the comprehensive picture managers, directors and those responsible for corporate governance really need.

Rules and legislation must exist but we also need principles that provide a framework in which people and organisations can innovate and be encouraged to do the right things. The FRC has a significant role in guiding organisations towards better corporate governance which is widely applicable beyond the regulatory requirements for listed companies, and helping to create truly sustainable businesses and fairer futures for all.

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