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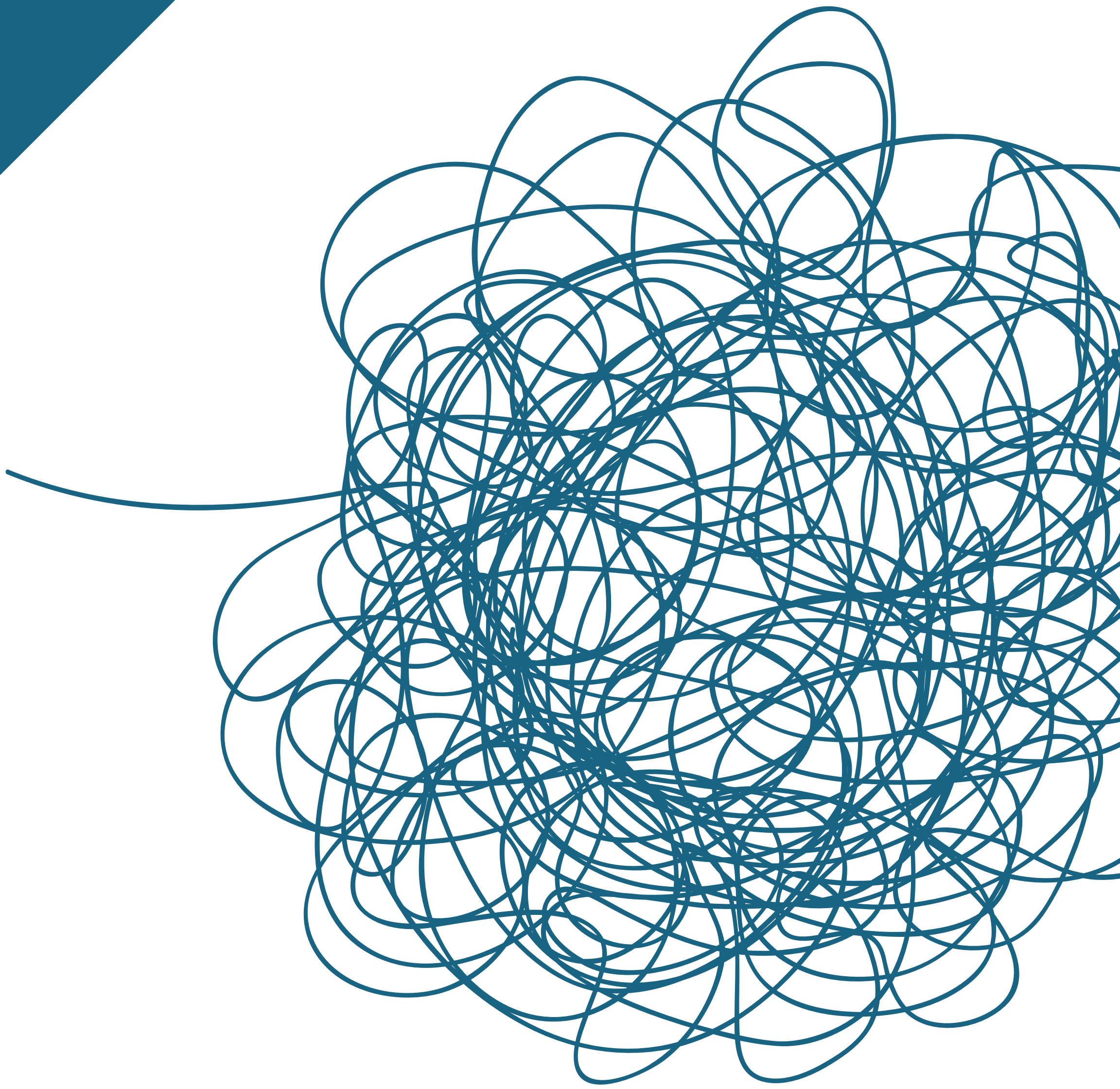

The Future of Governance
Untangling corporate governance

Institute of Chartered Secretaries and Administrators

Introduction to The Future of Governance series

The Future of Governance is a new series of thought leadership papers from ICSA: The Governance Institute, looking at some of the principal issues in the governance environment and seeking to identify solutions to them.

In preparing these papers, we are asking our authors to think radically about governance, looking at what we are seeking to achieve and how best that may be done; rather than at how the current model can be improved. So many times in recent years, governance ‘enhancements’ have been developed from the existing regime and yet we often find ourselves saying 'if I wanted to do x, I wouldn’t start from here'. Is it time to review the system from scratch? Have we tweaked it enough? Does the governance system which we have in place deliver the outcome that we want? If not, what do we need to do about it?

All these are valid and important questions which, we believe, may often be overlooked in the rush to take action. One of the risks of using existing systems to address new problems is that new challenges can be created. Who would have thought, for example, when the reporting of executive remuneration was first being mooted, that we would reach a position where that transparency was being blamed in some quarters for the explosion in executive pay levels?

The purpose of this series of papers is, therefore, to encourage reflection; to consider the issues dispassionately; and then to look at what really needs to be done to address them. We do not expect to identify all the answers. Indeed in some cases we may simply raise more questions. But it is hoped that the process of reviewing these complex issues may give us the opportunity to make a fresh start in governance.

With that in mind, we have asked Chris Hodge, our Policy Adviser and former Director of Corporate Governance at the Financial Reporting Council, to give us his personal view of the current UK corporate governance model, its strengths and weaknesses, and whether it achieves what it is intended to achieve.

Simon Osborne
Chief Executive
ICSA: The Governance Institute

Overview

The term 'corporate governance', as it is generally used now, encompasses a much broader range of issues and purposes than when the regulatory framework for corporate governance in the listed sector was established 25 years ago.

While that framework – built on 'comply or explain' good practice standards, public reporting by companies and enforcement by shareholders – remains appropriate for its original purpose, it is not well suited for delivering some of the other objectives that we now expect.

In particular, it is not capable of preventing or effectively sanctioning bad behaviour by boards or directors or – on its own – of delivering public policy objectives that are relevant to the UK economy or society as a whole. Encouraging good business practices, punishing bad business behaviour and promoting the public interest are interrelated objectives, but they are not the same and cannot all be achieved through the same mechanisms.

We need to untangle the different components of what we now call corporate governance if we are to address each of them effectively.

Some elements of the Government's proposals for corporate governance reform, such as paying greater attention to the governance of private companies, will contribute to these broader objectives. This paper identifies other actions that should be considered, including:

- rethinking our policy approach to issues such as income inequality, tackling them across the economy as a whole using tools better suited to the purpose;
- promoting good governance standards in all sectors, and in other investment asset classes that receive a significant amount of money from UK investors;
- improving the effectiveness of the various mechanisms by which listed companies are held to account; and
- introducing effective legal sanctions to punish bad business behaviour.

Chris Hodge
Policy Adviser
ICSA: The Governance Institute

Background

It is now 25 years since the first corporate governance code for listed companies was established in the UK, and the regulatory framework on which we still rely for improving standards of governance in that sector was introduced.

During that time our definition of corporate governance has changed, and what we see as its scope and purpose has broadened significantly.

In its introduction to the original code, the Cadbury Committee (or the Committee on the Financial Aspects of Corporate Governance, to give it its official title), defined corporate governance as 'the system by which companies are directed and controlled'[1], and went on to identify the elements of that system in its definition of the role of the board: setting strategy, providing leadership, supervising management and reporting to shareholders on their stewardship.

The Committee also emphasised that the first code was 'focused on the control and reporting functions of boards'; nothing more than that. It acknowledged that the corporate scandals that had prompted the Committee to take action had led to a loss of public confidence in business and expressed the hope that listed companies could contribute to restoring that confidence; but it did not set that as one of its objectives.

That relative modesty of ambition has long since been discarded. An informal definition of how we now think of corporate governance might be 'everything that companies do'.

The formal definition is set out in the latest version of the OECD Principles[2], the global standard for corporate governance. The Principles state that the purpose of corporate governance is:

> 'To help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies.'

The Government has expressed a similar ambition in its recent Green Paper on corporate governance reform[3]. In the Prime Minister's introduction to the Green Paper, she says that 'both the Government and big business must rise to the challenge of restoring faith in what they do, and in the power of the market economy to deliver growth, opportunity and choice for all'.

In the 25 years since the Cadbury Committee reported, our expectation of corporate governance has gone from 'improving control and accountability' to 'restoring faith in capitalism'.

1 'Report of the Committee on the Financial Aspects of Corporate Governance'; 1992
2 'G20/OECD Principles of Corporate Governance'; OECD; 2015
3 'Corporate Governance Reform: Green Paper'; Department of Business, Energy and Industrial Strategy (BEIS); 2016

That is clearly a much bigger job – for boards of companies, but also for the regulatory framework on which we rely.

That framework consists of minimum standards set out in law and regulation (including listing rules), good practices contained in a 'comply or explain' code, public reporting by companies, and enforcement by shareholders. It operates within a broader legal framework of director's duties and shareholder rights, and of shareholder primacy.

The framework has been enhanced over the past 25 years – for example, some issues such as executive remuneration are now dealt with primarily in law rather than through the UK Corporate Governance Code (the Code), and the Stewardship Code has been introduced to strengthen the enforcement mechanism. It has not, however, fundamentally changed.

We need to ask whether this framework is adequate for the broader purposes that we now attribute to corporate governance.

But before doing so, we first need to ask whether it remains capable of delivering its original, more modest, purpose.

Is the framework still fit for its original purpose?

To answer that question, it is necessary to understand why the existing framework was introduced in the first place, and the context in which it was developed.

There were three assumptions underlying the Cadbury Committee's approach:

- that the Committee's purpose was to encourage listed companies to aspire to and adopt good practice, not to set out minimum acceptable practices – hence the use of a voluntary code rather than law;
- that some companies would need to be prodded into doing so – hence the 'comply or explain' reporting requirement; and
- that as the role of the board was to act in the best interests of the members of the company, it was for those members (the shareholders) to judge whether it was doing so – hence the 'enforcement' function being given to shareholders rather than regulators.

In addition there were a number of features of the UK market at the time without which, I believe, it might have been concluded that a more traditional 'hard law' approach was needed. These features included:

- relatively strong shareholder rights, which gave shareholders the ability to hold the board to account if they felt it necessary;
- the majority of companies had dispersed ownership, with few controlling shareholders. 'Comply or explain' would not have been seen as an effective mechanism were the controlling shareholders essentially explaining to themselves (as the current example of Sports Direct arguably demonstrates); and
- a critical mass of shareholders who would be willing to carry out the enforcement role. Specifically, the majority of shares were owned by UK based investors such as pension funds and insurance companies who needed to get a return on their investments over a long period. It was believed that they would therefore see it as being in the interest of their clients and beneficiaries to invest in well-governed companies, and to put resource into monitoring and engagement.

In assessing whether the regulatory framework is still the right one, we need to consider whether the original assumptions about its purpose remain valid, and whether the market structure still enables the enforcement mechanism to work effectively.

Codes are more effective than regulation as a way of raising general standards. They can set those standards higher than is usually possible in law, which tends to be used to set the lowest acceptable rather than highest desirable expectations. However, some form of requirement to report on the extent to which those standards have been adopted is useful, so that companies cannot choose simply to ignore them.

As directors are primarily responsible to the members of the company, it is reasonable to assert that the judgement on how well the board has carried out its control and oversight functions should rest with the shareholders, as long as they have the ability to take action if they are not satisfied.

There is a legitimate debate to be had as to whether shareholder primacy is the right model, and some have argued that the directors' duties described in Section 172 of the Companies Act 2006 – which temper but do not challenge it – need to be revisited. However, for as long as directors' primary duty is to their shareholders, it is appropriate that those shareholders should carry out the enforcement role.

For these reasons I believe that the governance framework remains, in principle, the right approach for those aspects of what we now call corporate governance that it was originally designed to address.

Turning to the question of whether the framework works effectively in the current market, many of the features that reassured the Cadbury Committee 25 years ago are still in place. Shareholders have even more extensive rights than they did in 1992 and, while there are high profile examples of large listed companies with controlling shareholders, they remain very much in the minority.

There have, however, been significant changes in the ownership base of UK listed companies.

In 1992, over 50% of shares were owned by UK pension funds and insurance companies (the investors who were implicitly expected to make 'comply or explain' work). By 2014 that figure had fallen to less than 10%. The percentage of UK shares held by individuals has also declined since 1992. The majority of shares in UK listed companies are now held by institutions based outside the UK, which were not a significant presence in the market in 1992[4].

In addition, the UK equity market is much less important to UK investors than it used to be. Between 2005 and 2012, the percentage of assets that defined benefit pension schemes allocated to UK equities fell from 32% to 10%[5]. More recent data from the Investment Association on assets managed by its members shows that only 13% of those assets were invested in UK equities last year, down from over 25% in 2007[6].

4 UK pension funds owned 32% of shares in 1992 but only 3% in 2014. For UK insurance companies the figures were 19% and 6%, and for individuals 20% and 12%. Investors based outside the UK owned 54% of shares in 2014, compared to 13% in 1992. All data from 'Ownership of UK Quoted Shares: 2014'; Office for National Statistics (ONS); 2015

5 'Trends in Defined Benefit Asset Allocation'; Pensions and Lifetime Savings Association; 2013

6 'Asset Management Survey 2015-16'; Investment Association; 2016

Untangling corporate governance

If UK investors are reducing the proportion of their assets that they invest in UK equities, it is entirely rational for them to limit the time and resources they devote to monitoring them as opposed to their other assets. There are also limits to what can be expected of overseas investors. For many of them the UK market represents only a small percentage of their overall equity portfolio, and they face practical barriers to direct engagement with UK companies.

New challenges have arisen as a result of changes over the last 25 years in the way that the investment market operates, including what John Kay called the 'explosion of intermediation in the investment chain… [which has led to] an increased potential for misaligned incentives'[7].

Whether the means that investors have to hold companies to account are functioning effectively is also open to debate. The annual report and accounts is bursting at the seams. AGMs are sparsely attended, and the fact that they are bunched together reduces the amount of attention investors can pay to each of the resolutions on which they are being asked to vote.

Having said all that, while the ability of 'comply or explain' to provide an effective enforcement mechanism has been tested, it is not broken.

Notwithstanding these changes and challenges, there is still a considerable appetite on the part of many investors to monitor and engage with the companies in which they invest.

Voting levels in the UK are consistently high in comparison with other markets[8]. There has been strong support for the Stewardship Code since it was introduced in 2010 – even though not all signatories have taken their commitments as seriously as they might, as the FRC's tiering exercise shows – with both companies and investors reporting increased levels of direct engagement in recent years. Industry initiatives such as the Investor Forum also appear to be having a positive impact.

In turn, reported compliance rates with the UK Corporate Governance Code remain high, even though its scope and expectations have increased substantially since it was first introduced. Last year over 90% of companies complied with all but one or two of its 54 provisions[9], and the evidence suggests that most companies respond rapidly to changes to the Code. This indicates that it has, over time, acquired a momentum that enables it to overcome any shortcomings in the enforcement mechanism.

In summary, while the effectiveness of the current governance framework can be improved, and the standards set out in the Code and in law need to be kept under regular review, its track record shows that it remains fit for its original purpose.

7 'The Kay Review of UK Equity Markets and Long-Term Decision Making'; BEIS; 2012
8 Average voting turnout in the UK in 2015 was 73%, compared to a European average of 67% ('European Voting Results Report'; ISS; 2015)
9 'Developments in Corporate Governance and Stewardship 2016'; Financial Reporting Council (FRC); 2017

Achieving the broader purpose

The broader purpose that we now attribute to corporate governance is encapsulated neatly in the Prime Minister's introduction to the recent Green Paper. In it, she talks about the need to strengthen decision making and accountability, restore faith in big business, and deliver opportunity and choice for all.

The first of these objectives is the reason our current framework was established; the other two express the expectation that corporate governance can prevent, or at least reduce, the sort of behaviour that led to the loss of faith in business, and can contribute to public policy objectives.

The short answer to the question: 'is the current governance framework capable of achieving these additional objectives?' is 'No'.

It can make a contribution, but it is not designed to be the sole, or even the primary, means of achieving those objectives.

The current framework can reduce the incidence of bad behaviour or harmful actions, but it cannot prevent them entirely and does not always deal with them adequately when they occur. Listed companies must be expected to contribute to public policy objectives, and the actions of investors can spur them to do so. But they cannot deliver these objectives on their own, and a reporting and shareholder enforcement model may not be the most effective way of ensuring they play their part.

Each of these objectives is important, but we do them a disservice if we bracket them together under one heading and assume that the same regulatory approach is right for them all.

A combination of different approaches is needed. It would be a mistake simply to keep adding more of the same to the framework that we already have in the belief that this will provide the solution.

When developing any policy approach, it is necessary to ask a series of questions, starting with: 'what is the problem that we are trying to solve, and what would be a desirable (and proportionate) outcome?' Once that has been decided, the questions concern how the objective is to be achieved, for example:

- Who do we need to target?
- Do we encourage, threaten or both?
- What is the right mix of tools (which might include, for example, voluntary action, rules, inspection, sanctions and incentives)?
- Who do we get to manage the system for us?

Untangling corporate governance

With the Government's welcome interest in reform, now is the right time to take a step back and ask these questions in relation to 'restoring faith' and 'delivering opportunity and choice for all'.

Restoring faith

There has been much talk in the years since the financial crisis of the need to rebuild trust in business, and rightly so.

For policymakers it is, however, a very difficult objective to deliver. Your ability to exert any direct influence on the outcome is severely limited – trust cannot be regulated for, it has to be earned.

The most you can hope to do is take actions that will encourage companies and their directors to adopt and display the sort of behaviours that may, in time, earn back that trust.

The existing governance framework can, and should, contribute to improving general standards of business behaviour, and making companies more alert to the impact of their activities on their stakeholders.

However, while it can help to reduce the risk of bad behaviour or poor decision making, it cannot eliminate the factors that really cause them. As the FRC noted in its report on corporate culture, 'while legislation, regulation and codes influence individual and corporate behaviour, they do not ultimately control it'[10].

The way in which we react to cases of corporate scandal has, I believe, been a factor in the way policymakers have sought to respond to them.

There is a tendency to argue that every time a company behaves in a way that impacts adversely on one or other interest, it represents a failure of public policy or a failure of governance.

Blaming each example on systemic weaknesses encourages the assumption that the system can be adjusted to prevent them from being repeated. And branding them as governance failures encourages the assumption that adjusting the apparatus that has been put in place to regulate governance is the way to prevent them.

One of the consequences of those implicit assumptions is that insufficient attention has been paid to what happens when they are proved to be wrong.

Revising the Code, or adding more reporting requirements or voting rights, will often be the right response. But sometimes it won't be.

10 'Corporate Culture and the Role of Boards'; FRC; 2016

While there are exceptions, most corporate scandals are not examples of systemic failure. Most are simply examples of bad judgement, bad behaviour, or negligence. Their root cause is human nature – individual and collective foolishness, laziness or greed – which is not something that can be remedied by regulation.

In other areas of public policy, the human factor is explicitly recognised. Nobody assumes that the rules will always be obeyed. Sanctions for disobeying them are an integral part of the policy approach and serve as both a deterrent and a punishment.

The governance framework as it is currently designed does not include sanctions that are adequate for the purposes of punishing bad behaviour by directors.

The sanctions shareholders are able to impose – voting against a resolution or selling their shares – can have a disciplining effect. But in cases of seriously damaging behaviour they will often be too little, too late; and they do nothing to reassure those who have suffered as a result of that behaviour that justice will be done. Furthermore, as the FRC has noted in its evidence to the House of Commons BEIS Select Committee Inquiry on corporate governance, legal sanctions are at best incomplete.

Delivering opportunity and choice for all

The regulatory framework for corporate governance is never, on its own, going to be sufficient to deliver 'opportunity and choice for all' or other public policy objectives.

The first, and most obvious, shortcoming is that – at present – it applies only to listed companies. Listed companies represent an important but relatively small part of the economy[11]. While they must, of course, play their part in delivering the desired public policy outcomes, they cannot do so on their own.

Taking action only in relation to the listed sector will have minimal impact on most parts of the UK economy and society.

The second shortcoming is that the enforcement role rests with shareholders. This is entirely appropriate for the original purpose of corporate governance – improving decision making and control in the interests of the members of the company – but not for these broader purposes.

Unlike companies, who rightly have legal duties to their stakeholders, the environment and so on as well as to their owners, shareholders are only responsible to their clients and beneficiaries. The two sets of duties are not aligned.

11 SMEs account for over 60% of private sector employment ('Business Population Estimates for the UK and Regions'; BEIS/ ONS; 2016), while there are more than six times as many private companies employing over 100 people than there are listed companies ('Corporate Governance Reform: Green Paper'; BEIS; 2016)

This is not to say that shareholders cannot contribute to the public interest. They can and they do. Responsible business behaviour is now seen as an investment issue as well as a social one. Levels of investment in ESG funds are at an all-time high;[12] and so-called mainstream investors are increasingly paying attention to social, ethical and other factors that have the potential to affect adversely either the reputation or the performance of the companies in which they invest.

By putting pressure on companies to tackle these issues, investors can help to deliver public benefits. But, importantly, it is not the reason they do so. It is a beneficial side-effect of their desire to achieve a good return for their clients, not an attempt to fulfil some sort of implicit public duty.

It may be tempting to believe that shareholder interest can be a proxy for public interest. In 1992 – when 70% of shares were owned by UK pension funds, insurance companies and individuals – that might even have seemed plausible. Yet looking at the ownership base today, with over 50% of shares owned by overseas investors, it would be illogical to do so. Why should we expect the citizens of Norway or the retired teachers of California, for example, to feel they have a responsibility to look after the best interests of UK society?

While shareholder interest and public interest – or the interest of one or another group of stakeholders – may often coincide, that will not always be the case. Indeed, one of the charges laid in the current debate about directors' duties under Section 172 of the Companies Act 2006 is that some boards have given too much weight to the interests of their shareholders at the expense of the interests of other stakeholders. If those stakeholders do not have the ability to represent meaningfully their own interests, the answer is not to ask shareholders to do so on their behalf.

As I have said, by acting in the interests of their clients and beneficiaries and putting pressure on companies to tackle issues that affect their long-term viability, investors can also contribute to the public interest. They should be encouraged to do so. But this is not, on its own, an adequate solution. Primary responsibility for looking after the public interest has to rest with the public authorities.

The other, related, reason for my reservations about the adequacy of the current governance framework as a means of achieving broader policy objectives is that it relies heavily on reporting for its effectiveness.

Reporting can be a very effective way of bringing about change, but only when there are consequences. If companies believe that regulators or shareholders might take action against them – whether that be imposing sanctions, voting against a resolution or selling their shares – they will act in order to protect themselves from such consequences.

12 'Asset Management Survey 2015-16'; Investment Association; 2016

However, if there are no consequences, reporting in itself achieves nothing. If investors in listed companies do not see it as their duty to look after the public interest, or do not use the disclosures to inform their investment decisions, then making companies report to them on a particular issue is unlikely to achieve much.

In addition, reporting alone has little value as a means of identifying and dealing with breaches of law or truly egregious behaviour, as companies have no incentive to disclose such events.

In my view, policymakers in the UK and internationally have too often been guilty of assuming that a requirement to report on something would be sufficient to bring about change. As a result, I think reporting has been overused as a policy solution. As well as sometimes being an ineffective way of dealing with the perceived problem, this tendency has contributed to the increased length of the typical annual report and accounts that many feel does not contribute to genuine accountability.

To my mind, there is no better example of this misdiagnosis than reporting on directors' remuneration. It is over 20 years since the Greenbury report first recommended that companies report to their shareholders on this issue, and since that time the reporting and voting regimes have been regularly strengthened and, it seems, may be about to be strengthened further.

This regulatory approach has arguably benefitted shareholders by enabling them to put pressure on companies to align pay with performance, and may therefore be worth preserving for those reasons.

But in over twenty years it has done nothing to slow the increase of executive pay – some would argue it has contributed to it – or to reduce income inequality. There is no evidence to support the view that those objectives can now be achieved by adding more reporting requirements and voting rights.

The suggested disclosure of the CEO: workforce pay ratio, for example, may potentially be useful to shareholders as an indicator of governance concerns when a company is an outlier in its sector, or where the ratio increases from one year to the next. However, it is not obvious what direct benefit it will have for low-paid members of the workforce; and it will have no impact at all on the majority of the UK labour force that is employed in other sectors.

The World Economic Forum has identified income and wealth disparity as the trend most likely to determine global developments in the next ten years[13]. It is an extremely important policy issue. To tackle it a different approach is going to be needed, and one that is not directed only at listed companies.

13 'Global Risks Report 2017'; World Economic Forum; 2017

Strengthening decision making and accountability

There is, however, one public policy objective for which the governance framework in the listed sector is well suited, and that is the one for which it was originally designed – what the Green Paper calls 'strengthening decision-making and accountability'.

Which begs the question: if it is considered an important enough objective to justify government action in relation to listed companies, should that not also be true for other sectors or large organisations whose activities have a significant public impact?

Conclusions

What actions should be taken to achieve the three interrelated, but separate, objectives with which we now associate corporate governance?

To achieve 'opportunity and choice for all', we need to recognise that – while listed companies can and must contribute to this and other public policy objectives – they cannot achieve them on their own. Programmes addressing issues such as income inequality and equal opportunities need to be extended to all sectors of the economy, where this is not already the case, if they are to make a major difference. Addressing these issues only in the listed sector limits both the ambition and the impact.

We should also review whether the approaches that have been used within the listed sector are the most effective ways of promoting broad policy objectives. Some are not capable of being delivered through reporting and shareholder monitoring.

In particular, there needs to be a new approach to dealing with income inequality in the sector. The current reporting and voting requirements on directors' remuneration have done little or nothing to address the issue, whatever their merits in terms of increasing accountability to shareholders, and adding more of the same is unlikely to do so.

In a similar vein, encouraging good standards of governance to improve decision making and accountability should itself be seen as a public policy objective across the economy as a whole.

Greater attention should be paid to the standards of governance in other sectors, where practices are generally less developed than in the listed sector. This would help to reduce the risk of organisations failing or taking actions that impact adversely on the public and, in the public sector, will help to ensure that taxpayer's money is well managed.

The Government's focus on the governance of large private companies in its Green Paper is very welcome. There are, however, many other sectors and activities where paying more attention to raising general standards would be in the public interest – the education sector, NHS trusts and large infrastructure projects to name just a few.

Part of the rationale for promoting good governance practice in the listed sector is to protect the value of the shareholder's investments. Yet only 13% of the assets of all clients of asset managers operating in the UK are invested in UK equities.

It seems illogical to devote a great deal of resource and attention to governance in respect of a small percentage of these investments, but little or none to the remainder. Greater attention should be paid to other asset classes such as commercial and government bonds, and to the governance of asset managers and pension schemes themselves as the guardians of those assets.

Of course, much work has already been done to improve standards in these sectors and across other asset classes. However, in contrast to listed equities, it has not always been given sufficient priority.

Paying greater attention to other sectors of the economy does not mean letting listed companies off the hook. Their boards must continue to be challenged to demonstrate good governance and be held accountable for their effectiveness.

The standards set out in the Code for the formal aspects of governance are among the most robust in the world and, with the FRC's latest data showing high rates of compliance, in most cases further tweaking of those standards is likely to bring about only marginal improvements.

There are some exceptions. The FRC has highlighted the board's role in setting and monitoring corporate culture as an issue that requires more attention. Furthermore, trends such as globalisation and technological development may require us to revisit whether some of the processes and systems on which companies rely, for example in relation to risk management and internal control, are still adequate.

The priority, however, should be to improve the effectiveness of the mechanisms by which companies are held accountable. This requires action to:

- encourage investors to carry out the enforcement role that has been assigned to them. The steps taken by the FRC to make the Stewardship Code more effective are welcome, but more may need to be done, for example to enable asset owners to hold managers more effectively to account for how they exercise stewardship on their behalf;

- consider whether the routes through which companies report to, and are held to account by, shareholders need to be overhauled. There is a widely held view that the annual report and accounts no longer serves its purpose for either companies or investors, and the value of the AGM is questionable in its current form, when few shareholders participate and the votes have already been decided in advance; and

- provide greater accountability to other stakeholders. The Government has rightly identified this as a priority. The duties of directors to these stakeholders are clearly set out in Section 172 of the Companies Act 2006, but more needs to be done by boards and policymakers to ensure they are followed. ICSA, jointly with the Investment Association, will make its own contribution by producing guidance to companies on how to enhance the board's understanding of the interests of employees and other stakeholders.

Finally, we need to address the issue of sanctions. Legal duties, good governance standards and scrutiny by shareholders and other stakeholders can all reduce the risk of bad behaviour or poor decisions, but they cannot eliminate the human failings that cause them.

At present, there is no means of effectively and appropriately punishing actions by directors that have a significant adverse impact on their shareholders, stakeholders or on society in general. Reporting to and monitoring by shareholders is not adequate for these purposes, and was never designed to be. Any sanctions must, of course, be proportionate and justified, and must distinguish between bad behaviour and poor decisions made in good faith. But that does not reduce the need for them.

Chris Hodge is a policy adviser to ICSA: The Governance Institute in the UK. For ten years until 2014, Chris was Director of Corporate Governance at the UK's Financial Reporting Council. He was responsible for developing and promoting the UK Corporate Governance Code, and for introducing the first national stewardship code for investors in 2010. Between 2014 and 2016, Chris was the FRC's Strategy Director. Chris established, and chaired until 2015, the European Corporate Governance Codes Network, which brings together the bodies responsible for codes in 28 European countries. In addition to ICSA, Chris also advises Nestor Advisors, a specialist governance consultancy.

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The Governance Institute

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