7

The chairman of the board

The chairman's role in governance

In governance terms, the importance of the role of the chairman of the board (and similarly the chairman of a board committee) cannot be overstated. In the words of the FRC Guidance on Board Effectiveness, 'good boards are created by good chairmen'. For this reason the role merits examination in its own right, separate from the other non-executive directors. Setting the chairman apart in this manner reflects the heightened emphasis now placed upon his position as the leader of the board. While the doctrine of the unitary board requires that he or she is subject to equal duties and liabilities with the other directors, in practice the developing profile and stature of the role has elevated the chairman to the key position of responsibility on the board.

Company law places full responsibility for directing the company and promoting its affairs on the board. It follows, therefore, that the chairman, as leader of the board, is pivotal to creating the conditions necessary for the board to be effective in providing entrepreneurial leadership for the organisation. By the same token, where the company underperforms, particularly where this derives from a failure in governance, it is the chairman's effectiveness that will come under close scrutiny. Although this judgement may appear harsh, the logic of current thinking on these matters compels the conclusion that an ineffective chairman will result in an ineffective board, with the associated risk of corporate underperformance.

It has been observed that a board is not a natural decision-making organism (assuming it is not dominated by an imperious executive personality). Yet it is the board's responsibility to reach a consensus and then to make a decision. The chairman is the person who needs to lead the board through that process, extracting from a variety of views a single decision and a clear strategy. A good chief executive is not bound to have a consensual approach, but a good chairman must govern the board in a manner that ensures that consensus is achieved without impairing the board's effectiveness as a decision-making body. In the same context, Sir Adrian Cadbury, who has likened the chairman's role to that of a good conductor of an orchestra, directing and

controlling without imposing their own views or stifling individual contribution, commented that:

> 'Taking the chair at board meetings is the aspect of the job of chairmen which is furthest from the public eye, but the one where their personal contribution is decisive.'

The 2009 Walker Review observed that 'good corporate governance overall depends critically on the abilities and experience of individuals and the effectiveness of their collaboration in the enterprise' and that deficiencies in the boards of banks and other financial institutions 'related much more to patterns of behaviour than to organisation'. The ability of the chairman to enhance the effectiveness of the board by influencing the board members' collective behaviour means the role of chairman is uniquely powerful. Whilst the earlier focus of corporate governance developments on chairmen tended to relate to their responsibilities, more recent work, such as the FRC Guidance on Board Effectiveness, has highlighted some of the personal and behavioural attributes required to carry out the role effectively.

What makes a good chairman?

The evidence is that the role of chairman is not one for which many incumbents have a natural ability. Equally, the traditional route to chairmanship – the climb up to senior executive management with the addition of some non-executive experience – does not appear to provide an adequate training ground. The role requires, in summary, a unique set of skills, but there is little by way of formal preparation. The report *What Makes an Outstanding Chairman* by Directorbank Group attempted to establish some of the characteristics which could lead to a chairman underperforming. The list included lack of impartiality, poor leadership, lack of involvement in or knowledge and understanding of the business, arrogance, poor control of the board, inability to make difficult decisions and poor communication skills. Research annexed to the Walker Review final recommendations identified the behaviours required of an effective chairman. These are reproduced in Table 7.1 overleaf.

It is worth noting again here that those appointed to chair a committee will need to demonstrate similar behaviours to those described above in order to create the right conditions for the committee to be effective in its work.

Selecting and appointing the chairman

Uniquely amongst the non-executives, it is the personal qualities of the chairman that matter. Other non-executives may be selected on account of the specialist skills they bring to the board, their business sector knowledge or their capability to enhance the diversity of perspectives of the board. The chairman needs, above all, to have qualities of personal leadership, with clear

Table 7.1 Behaviour of an effective chairman – the Walker Review

1. Integrating the board's collective thinking
This is possible when a chairman excels at seeking and sharing information; building ideas into concepts; analysing and considering multiple perspectives and different alternatives; and can subvert his or her individual needs for commitment to a common goal.

2. Empathy and promoting openness in board members
The ability to listen at multiple levels is critical to successful chairmanship and team dynamics. Listening to what is not being said is as critical as listening to the words that are spoken. Only with this ability can a chairman engender deep trust and respect.

3. Facilitating interaction
This requires that a chairman's behaviour moves seamlessly depending upon who needs to be in the conversation, rather than 'managing' the process. It requires that skills and expertise (authority) are valued and respected regardless of hierarchy or power dynamics.

4. Developing others
Undertaking active coaching, mentoring and development of talent within the board, in particular with new board members.

5. Communicating complex messages succinctly
Effective communication, through written and spoken means, reduces the cognitive load on the board, freeing more time for analysis, exploration and learning.

6. Collaborating across boundaries
The ability to identify boundaries and successfully navigate across and within them is critical to creating a culture of collaboration and efficiency.

7. Continuous improvement
Good behavioural objectives include continuous evaluation against internal and external benchmarks. The continual focus on improvement is as much a mindset as a behaviour.

objectives for the board and sufficient personal authority to ensure that they are realised in both clement and inclement circumstances. Account will need to be taken of these qualities in the selection and recruitment process for a chairman.

There are no special rules in the UK Corporate Governance Code governing the process for selecting and appointing the chairman. However, having observed that, not only is the pool of talent for people to fill the role of chairman small, but able candidates are difficult to identify. The Higgs Report set out three guiding principles (not rules) about the process. These are as follows:

- The senior independent director or the deputy chairman, if independent, should normally lead the appointment process, not the incumbent chairman.
- A systematic approach should be taken to identify the skills and expertise for the role and a job specification prepared.
- A shortlist of good candidates should be considered, rather than possible individual candidates being considered in turn.

As with other board appointments, the recruitment process will be led by the nomination committee. The first of the Higgs guiding principles described above is now enshrined within Code Provision B.2.1 which requires that 'the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship'.

Higgs also noted that the process of selecting candidates would almost certainly benefit from external advice, provided by a specialist executive search agency. The UK Corporate Governance Code requires that an explanation should be provided where neither external advice nor open advertising has been used in the recruitment of a chairman (Code Provision B.2.4). For appointments to the chairman's position it will be difficult for the nomination committee to provide such an explanation given the last of the three principles from the Higgs Report set out above and the increasing focus on the need for transparent recruitment criteria for board appointments generally.

Subject to the provisions of the company's articles of association, the appointment of the chairman will be formalised by a resolution of the full board, taking into account the recommendations of the nomination committee. Once approved, it should be confirmed by written terms in an appointment letter, setting out the specific job requirements as well as the normal non-executive director terms – as discussed in Chapter 9. If the chairman is new to the board he or she will be required to retire and offer him or herself for re-appointment by an ordinary resolution of the shareholders at the first available AGM of the company. Under Code Provision B.7.1 the chairman, in common with all directors of FTSE 350 companies, is required to stand for annual re-election. Reflecting the chairman's status as 'board representative', the NAPF has identified a number of general governance issues, the occurrence of which might warrant an investor deciding to vote against the re-election of the chairman.

The level of remuneration paid to the chairman will vary considerably according to the time commitment and the size of the company. As with non-executive remuneration generally, the trend is upwards on account of the greater demands and concerns over the risk/reward ratio. Guidelines from the ABI state that shareholders consider it inappropriate for chairmen to receive performance-linked incentives as this could impair their impartial oversight.

14

Corporate social responsibility

Definitions, aims and perspectives

Corporate social responsibility (CSR) is now embedded in the mainstream of corporate governance thinking. This chapter begins by setting out the background and attempting a definition of what this type of corporate activity and reporting is all about.

Political and corporate background

Over the past decade or so, the momentum behind CSR has escalated significantly. At the UN Millennium Summit in 2000, participating governments adopted a series of Millennium Development Goals which were in part aimed at setting a framework for private sector businesses to act in partnership with governments on matters ranging from tackling poverty to protecting the environment. In particular, Goal 8 on the development of a global partnership for development invites the private sector to cooperate on providing new technologies to assist developing countries (for example, by pharmaceutical companies donating essential drugs at affordable prices). The World Summit on Sustainable Development in Johannesburg in 2002 gave further impetus to the principle that corporate entities should take responsibility for addressing social and economic development needs and environmental protection matters. The resulting measures built upon the pre-existing *OECD Guidelines for Multinationals*, with a view to enhancing their impact and relevance. More recently, the UN Human Rights Commission has published a number of reports on the human rights responsibilities of corporate enterprises and in particular *United Nations Guiding Principles on Business and Human Rights* provides helpful clarification of the universal human rights responsibilities of businesses. In 2004 the World Economic Forum published a report calling on investors to take account of CSR issues.

Within the EU, the political momentum behind CSR and the principle of sustainable development has also been significant. The European Commission has a history of giving greater political visibility to CSR and CSR goals are reflected in both the Europe 2020 Strategy, which includes targets on relevant issues such as the environment, poverty and social exclusion, as well as in the EU CSR Strategy 2011–14. The 2011 communication on that

strategy promotes a strategic approach to CSR by businesses as 'increasingly important to the competitiveness of enterprises' citing potential risk management benefits, cost savings, enhanced access to capital, better customer relationships, improved human resource management and increased innovation capacity. The communication observes that CSR 'concerns actions by companies over and above their legal obligations towards society and the environment' but that, whilst CSR is therefore essentially voluntary, regulatory measures can 'create an environment more conducive to enterprises voluntarily meeting their social responsibility'. EU regulation on CSR reporting in the form of proposed changes to the Accounting Directives were announced in April 2013 with a view to requiring larger companies (those with 500+ employees) to report relevant and material information on policies, results and risks concerning environmental aspects, social and employee-related matters, respect for human rights, anti-corruption and bribery issues and diversity on the boards of directors.

Many of these themes are already covered in the strategic report requirements relevant to financial periods ending on or after October 2013. Indeed much of the current focus both at home and further afield is on the need for effective narrative reporting in relation to CSR issues and in particular on the need to make clear connections between financial and non-financial disclosures. Of particular relevance here is the work of the International Integrated Reporting Committee (IIRC) which aims to develop proposals for a new international approach to reporting. The objective is to create an integrated reporting framework which provides an insight into an organisation's strategy and how that relates to its ability to create value in the short, medium and long term and its use of – and effects on – the financial, manufactured, intellectual, human, social and relationship and natural capitals. The IIRC believes that by reinforcing such connections through integrated reporting, business will be helped to take more sustainable decisions and investors and other stakeholders will be better able to understand how an organisation is really performing.

In the UK, there have also been a number of other significant initiatives of relevance to CSR issues, including the introduction of various measures in the Companies Act 2006, regulations on socially responsible investment matters for pension scheme trustees, the adoption of environmental targets such as those on reductions in greenhouse gas emissions and the introduction of wide-reaching anti-corruption measures through the Bribery Act 2010. There have been several other developments in the corporate world that have pushed the CSR agenda forward. Accounting standard setters are giving more attention to the valuation of intangible non-financial assets of companies. NGOs' agendas increasingly focus on the role of companies as servants of wider social and public interest objectives. Investors, including pension scheme trustees and other fiduciaries, are paying more regard to the link between shareholder value and sustainable and responsible investment (SRI) strategies. And consumers, employees and society at large are being encouraged to view themselves as key stakeholders alongside shareholders.

Definitions and perspectives

'CSR' is commonly used as a shorthand term to describe responsible corporate behaviour in the broadest sense. However, an appreciation that there are wider issues to corporate responsibility than the purely social has caused some users to drop CSR as a descriptive term. They generally prefer 'corporate responsibility', with a view to highlighting that what is involved is the full range of responsible internal and external behaviour, including, but not limited to, behaviour that has a social impact. For convenience and adopting the majority view, CSR is the preferred term throughout this chapter. Whatever descriptive term is used, there is no universally recognised definition of what it means. Those who approach the subject can have in mind a wide range of different corporate aims: for some it has a moral appeal to the extent that it is about sustainability and ethical investment, for others it is about managing Turnbull risks and safeguarding corporate reputation and brands, whereas for others it is about marketing strategy and building profits.

A widely quoted definition was set out in the introduction to the European Commission's 2006 communication on CSR policy:

> 'CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.'

The emphasis on the voluntary nature of CSR is significant; it characterises CSR not as a substitute for regulation or legislation concerning social rights or environmental standards, but rather as an addition to the underlying legal framework, a kind of 'super compliance'. There is a fairly fine distinction to be drawn here between regulatory and voluntary compliance. The latter relies upon companies recognising the business case for CSR. It is difficult to arrive at a crisp and settled definition mainly because the CSR community contains such a diverse group of constituents. Each of these has their own perspectives and priorities and tends therefore to view CSR issues accordingly. Table 14.1 summarises their typical perspectives and aims.

Table 14.1 Perspectives and aims of the CSR community

Group	CSR perspectives and aims
Government	Views CSR as integral to a larger strategy for sustainable development; emphasises business case for CSR and supports wider stakeholder involvement; light touch on regulation; aims to build supportive regulatory and market framework.
Corporate enterprises	Affirm that CSR is voluntary in nature and should not stifle business creativity; fundamentally, about managing business risk and winning competitive advantage; CSR imperatives must fit with the overall business objectives.
NGOs	Vocal representatives of special interest groups; architects of numerous best practice codes; work closely with regulators and professional bodies; provide an informal monitoring role and a level of informal independent verification.
Trade unions	Advocate a regulatory framework establishing minimum standards; companies to work in partnership with stakeholders; particular focus on labour and human rights abuses; want mechanisms ensuring accountability by companies.
Institutional investors	Seek improved disclosure and transparency; need more consistent verification of performance and objective 'triple bottom line' reporting; looking for sustainable performance and well-managed business risk.
Private investors	Have an appetite for ethical pooled investment funds; expectation that companies will exhibit ethical behaviour beyond mere legal compliance; increased pressure on trustees of pension funds and other fiduciaries.
Consumer groups	Underline the importance of trustworthy information, including labelling; 'fair trade' concerns about conditions in which goods are produced and traded; seek responsible advertising; linkage of brand with corporate reputation.

With so many different perspectives, it is useful to focus on some of the common areas of agreement about CSR. In particular, there is now a consensus about the business case for CSR.

The business case for CSR

In its 2009 *Corporate Responsibility Report*, the then government stressed the business case for CSR, identifying its value as having the potential to increase a company's performance and shareholder value. The role of the state in this regard is mainly one of leadership, supporting and promoting good CSR practices generally and providing the frameworks through which businesses can undertake their activities responsibly. Such support and leadership will include working with businesses to reduce poverty and promote human rights