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White Paper

The Governance Inquiry

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Foreword

by **Sir Michael Lyons**

The Lunar Society exists not only to stimulate debate and encourage new ideas but also to promote action for the public good. It is against that background that we enthusiastically supported the efforts of the Governance Forum and ICSA; the Chartered Institute of Governance to develop a set of principles that could be used to both guide and evaluate governance arrangements across all three sectors: private, public and “third sector “ covering voluntary and not for profit endeavour. We then went one step further in supporting a focused discussion amongst active West Midlands practitioners to test those principles to ensure that they are fit for purpose. The results of that exercise are presented here and made freely accessible to anyone interested in better governance.

I believe the contribution is timely. Building on the work of one of our own former colleagues, Sir Adrian Cadbury, the UK Corporate Governance Code is ever more demanding of companies that they comply with best practice or explain clearly why not. Increasingly investors, led by some of our largest institutions, require that companies should focus on Environmental, Social and Governance (ESG) issues and clearly publish both policies and achievements. The Charity Commission and The National Audit Office apply the same arguments in their oversight of charitable and public bodies. Yet, still there are egregious failings in all sectors and these are inevitably accompanied by calls for tighter regulation.

Regulation has its place and there can be no doubt as to its importance in a complex, modern society. There are many areas where, arguably, regulation needs to be tightened and extended (think building safety; environmental impact and social media for just 3). But regulation is a blunt tool. It can be slow to recognise systemic failings and changes in technology. It can inhibit innovation. Regulators are distant from the day to day decisions made by the women and men who populate our board rooms, councils and trusts. In short it is not a replacement for good governance. Instead they should respect and complement each other.

The quality of discussion and decision making within Boards and other governing bodies remains crucial and needs to reflect the highest standards of openness, challenge, evidence and integrity. We hope these reports will support those involved in that work.

Sir Michael Lyons

The Lunar Society

Birmingham, September 2020

Introduction

Companies around the world are facing a significant challenge to improve their governance now and for the future.

It is proposed by The Governance Forum (TGF) that this challenge can be met through the adoption of The 12 Principles of Good Governance which would improve organisational outcomes through a comprehensive and flexible approach to governance. However, organisations may operate with a 'tick box' approach to compliance, which presents challenges to achieving this. An added challenge is the impact of the 4th Industrial Revolution and how to practically apply good governance principles within this context.

This Inquiry, therefore, investigated the nature of organisational cultures that boards set and operate within, the aims of The 12 Principles and the attitudes of governance practitioners to the solutions offered by The 12 Principles. The focus of the Inquiry was on obtaining practitioners' views on the key opportunities in The 12 Principles and the key challenges involved. The Inquiry was carried out via online group discussions held as part of a series of seminars with governance practitioners from the PWC Middle East Region, ICSA: the Chartered Governance Institute West Midlands Steering Group, ICSA: the Chartered Governance Institute West Midlands Members, and The Lunar Society.

Deirdre LaBassiere LL.B (Hons) FLS

**Chair
The Lunar Society**

Background

It is almost 20 years since UK companies were called on to improve corporate governance through adopting the Cadbury Code. The Code provided a set of principles for good governance that have over time become incorporated within what we now know as the UK Corporate Governance Code 2018. This and numerous other reports, codes and standards, including the Sarbanes Oxley Act 2002 in the USA, have sought to address the previously piecemeal approach to corporate governance and regulation. The areas that have been worked on over those two decades include corporate structures and processes, board leadership and membership, board culture and behaviours, internal and financial controls, risk assessment, accountability and audit.

But guidance becomes outdated as the environment in which organisations work in becomes more complex and the expectations on boards grow. In this context Karl George of The Governance Forum (TGF) is proposing as a solution, a set of governance principles that are fit for future boards and applicable across all jurisdictions. The principles are seen to be a potential solution to improve governance through clear, practical approaches and activities that organisations can adopt and apply.

The search for new ways to govern organisations in a fast-changing world in which companies need to continually adapt the way they run is of great importance to organisations across all sectors, sizes and jurisdictions. This motivated The Lunar Society to collaborate with TGF and Central Consultancy in an inquiry to find out governance practitioners' views on The 12 Principles of Good Governance

The 12 Principles of Good Governance was published in November 2019 by The Governance Forum (TGF) in association with ICSA: The Chartered Governance Institute. As the fundamental governance issues are remarkably similar across sectors and jurisdictions TGF reviewed Codes from different countries and different sectors and used their commonality to inform their principles. Where unique elements in different codes were seen to have potential to help to improve practice everywhere, they were also used to inform the principles.

The 12 Principles are orientated around three areas: resources, competency and execution. Each of these three areas has four principles. TGF summarises the principles as "organisations should have complete and up to date resources, individually and collectively competent boards and the boards should execute their strategic role appropriately".

Karl George has uniquely illustrated The 12 Principles of corporate governance over three generations. TGF sees governance as a journey through three levels of maturity. From Governance 1.0 in which successful operation of governance is held back by dominance hierarchy (for example Maxwell); through Governance 2.0 in which successful operation of governance is held back by blind spots (for example Enron); to Governance 3.0 in which governance takes advantage of new technology, new ways of working together, makes room for generations Y and Z and has the potential to help organisations successfully navigate fast-changing, uncertain, ambiguous and disruptive environments.

Findings

Governance Practitioners' views

The relative simplicity and certainty of The 12 Principles needs to be able to deal with a huge variety of individual issues and regulatory requirements if it is to be applicable to organisations of different sizes, sectors and countries. It was therefore important to test the principles as a practical tool.

The views of governance practitioners were therefore collected by Central Consultancy through online discussion groups. In one discussion group an anonymised online poll was conducted. The poll covered the adequacy of the principles, organisational readiness for adopting the principles, barriers from structures and delegations, and organisational readiness in terms of technology.

Invitations went out for a series of seminars and discussion groups with governance practitioners from PWC Middle East, ICSA: the Chartered Governance Institute West Midlands Steering Group, ICSA: the Chartered Governance Institute West Midlands Members, and The Lunar Society. A total of 90 governance practitioners took part across the four online seminar and discussion events. In one event involving ICSA: Chartered Institute of Governance members, 57 participants took part in an online poll. Many different sectors were represented across the three sessions. Public, private, not-for profit and charitable organisations were all represented across health, education, social housing, local government, creative and technology sectors. The practitioners who took part brought both Executive and Non-Executive experience.

Adequacy of the principles

The discussions first asked participants whether or not they thought that one set of governance principles could be applied across organisations in different sectors, sizes, maturity and geographical jurisdictions?

Participants discussed this in small groups. All groups agreed that the principles could be used across all the sectors. Figure 1 shows there was near unanimous support for the principles in the poll: 98% said that they thought that The 12 Principles covered by TGF framework provide a robust methodology that can be used across all sectors.

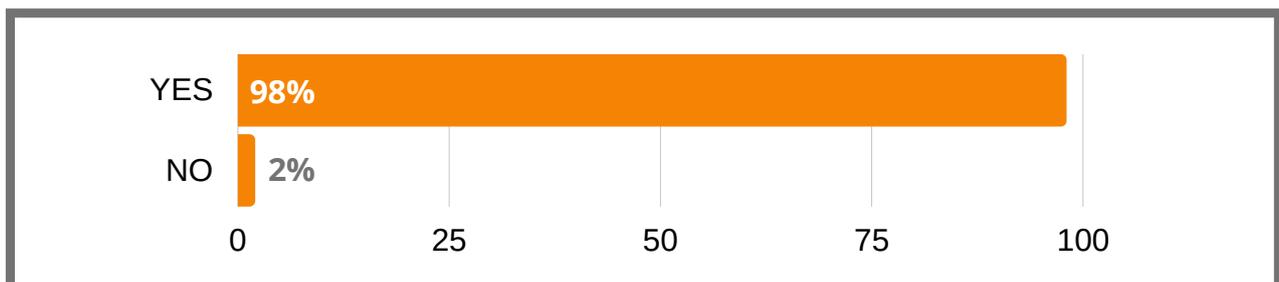


Figure 1: Do you think the 12 Principles covered by the TGF framework provide a robust methodology that can be used across all sectors?

The presence of Karl George and colleagues from TGF at the events clearly posed a potential problem of stakeholder influence on the research data and for this question in particular. However, both TGF and participants were motivated by a common purpose; to establish a practical tool. Whilst it is unlikely that there was no stakeholder influence, the anonymity of the poll allowed for different views to emerge.

Explanations were put forward in discussion. One participant from a charity in the health sector identified an increasing need for good governance between organisations in partnerships. It was acknowledged that the principles are limited to the extent that they are designed to be applicable to single organisations, and do not extend to governance of partnerships. Another participant called for exemplars to be provided to illustrate each principle. Ultimately only examples that strongly correlate adoption of The 12 Principles with positive organisational outcomes will adequately answer the question asked. Intended organisational outcomes were highlighted by a participant who said “In the UK we tend to have a top-down governance model in which running a business is often seen as financial governance rather than overall governance”. This highlights the importance of the contribution that The 12 Principles can make to cross sector discussions on what Environmental, Social and Governance (ESG) reporting should mean in terms of governance criteria.

Organisational readiness for adopting 3rd Generation Governance

Participants considered whether or not the companies that they work for are ready for The 12 Principles at the top level, 3rd Generation Governance. Figure 2 shows a 60% majority of participants said that they thought their company was ready for governing in 3rd Generation.

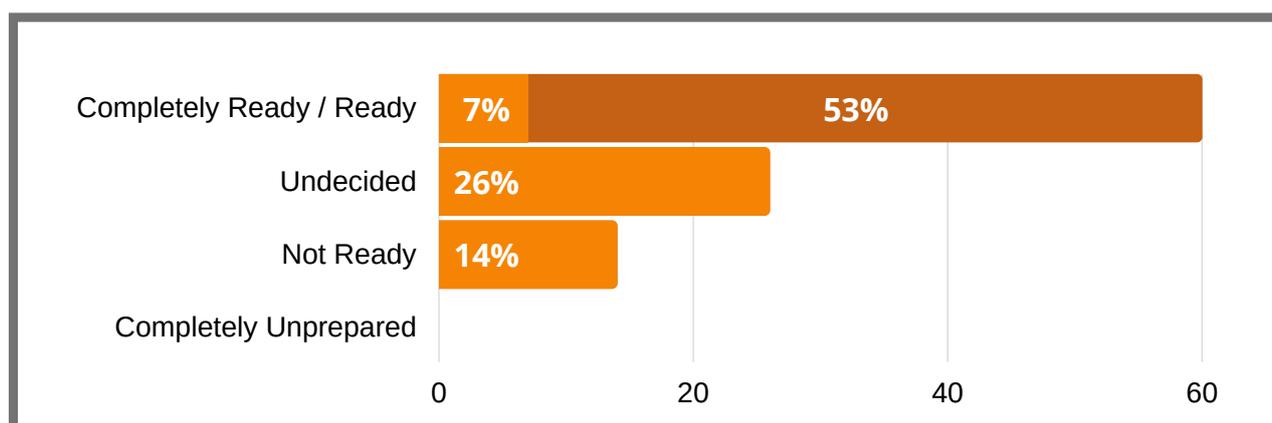


Figure 2: Do you think the companies that you work for are ready for governing in 3rd Generation?

Company size influenced readiness to a greater degree than company type. Participants working in smaller organisations were less confident that their company was ready than those in larger organisations. Reliance on volunteers as trustees was seen as a barrier to readiness in the Charity sector. One participant working in a multi-national company said that their UK arm was more ready than their US arm.

But between sectors participants thought it was “not good enough to say the principles are not applicable because we operate in a different way”. These findings suggest there are particular implications for the adoption of The 12 Principles in small organisations in the Charity sector.

What are the barriers from structures and delegations?

Whilst the participants had a shared desire for driving governance improvement through The 12 Principles, different views emerged about whether companies' structures and delegation of authorities are clear but flexible enough to be adapted quickly in changing circumstances. Figure 3 indicates mixed views: 56% of participants were either undecided or negative about the suitability of structures and delegations.

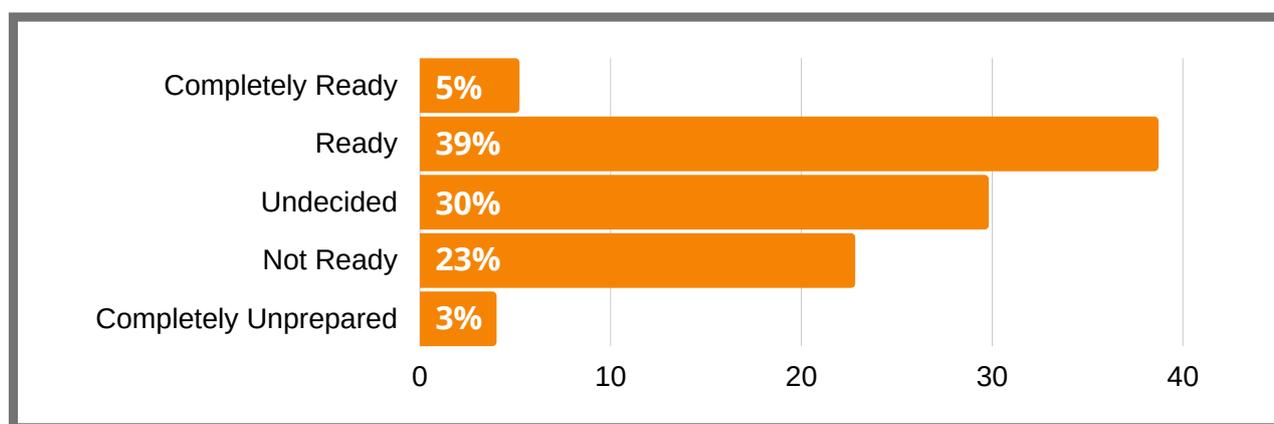


Figure 3: Are companies' structure and delegation of authorities clear but flexible enough for different circumstances where governance structures can adapt quickly as described in governance 3.0?

Participants gave examples of simplifying structures and said that their organisations had rapidly adapted the frequency and timing of board meetings and level of delegations to meet the need for fast decisions at the start of the pandemic. But more fundamental change such as the size of boards, length of agendas, Company Secretary skills and Board member skills were seen as less flexible.

Many participants said that a culture of ‘taking a tick-box approach to governance’ presented the biggest barrier to change in their organisation. This phenomenon, the fear of breaking rules at the expense of good outcomes for stakeholders, was not only cited by participants in regulated sectors, it happens everywhere. For example, a participant from the private sector said that governance is “top-down and driven by financial metrics”. A participant from the health sector said governance is “driven by metrics set by government to improve transparency, but the metrics can be misleading”

These structural and cultural barriers would prevent The 12 Principles from being implemented in their most ambitious sense, Governance 3.0.

Is diversity in board rooms changing at a rate it needs to in order to address future risks?

The research explored participants' views on diversity in their boardrooms. Figure 4 shows that 70% of participants were either undecided or saw a definite need to improve diversity and everyone strongly supported increasing diversity as a key element of putting The 12 Principles into practice in its most ambitious sense, Governance 3.0.

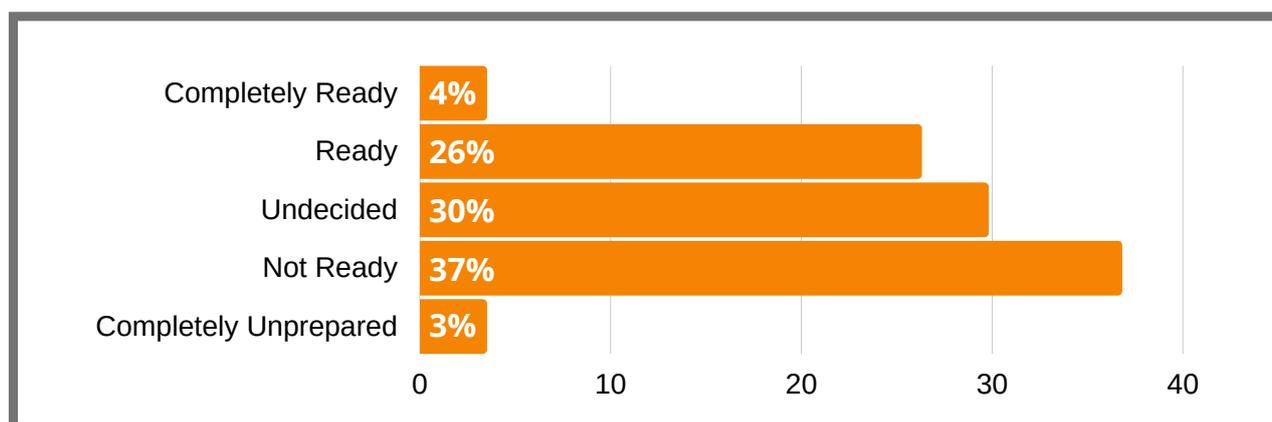


Figure 4: Ideally boards should be diverse, balanced and suited to the needs of the organisation. Are boards functionally diverse and cognitively diverse as described in Governance 3.0?

Participants said that Generation Y and Z should be more involved in shaping governance and that boards should be more functionally and racially diverse. There was strong support for the concept of the cognitively diverse board. One participant as an example identified that people who balance the moral values that we associate with well-being, such as benevolence, with purely commercial objectives are particularly important for modern boards. Another participant identified the people with public sector experience of managing stakeholder relationships should sit alongside commercial expertise. Participants felt that boards should not wait for regulation to require this. Boards should already be re-thinking board culture, leadership, and recruitment in order to change at the rate it needs to address future risk.

Are boards ready with sophisticated technology-based decision-making protocols?

Many participants said that the rapid and wide scale adoption of video conferencing in response to the pandemic has changed their view of how technology can support change in the boardroom. In the poll, only 44% were positive that their boards were ready with sophisticated technology. Whilst digital solutions were seen to be part of the future, participants took a more cautious view of the potential role of Artificial Intelligence in the board room. This was based on experience of technical change alone, enabled by IT solutions, overpromising and underdelivering on meaningful change, without concurrent cultural change.

Conclusions

It is promising that even though many sectors often cite exceptionalism as a reason to be excluded from cross-sector initiatives, participants' views on the adequacy of the principles show a very strong consensus across sectors. However, the 'tick box' approach to compliance presents challenges to achieving this. The findings show that the issue of organisational commitment to good governance is central to practitioners' views on organisational readiness for adopting Governance 3.0. There is a desire for governance that puts outcomes for stakeholders ahead of fear of breaking rules. Participants thought that this has potentially become more realistic in the wake of the pandemic.

The research has shown that practitioners see the development of Governance 3.0 as an imperative. Nevertheless, an imperative that must be put in context. Governance 3.0 is new and rapidly developing and has the potential to deliver great benefits but doing so requires examples of excellence to emerge and be widely shared. As TGF develops Governance 3.0, and as this is overtaken by Governance 4.0, exemplars need to emerge. If the principles of good governance are taken up by organisations in a way that provides the right rhetoric but is carried out with a tick box approach, the principles will struggle to deliver their intended benefits to organisations.

This inquiry has found that The 12 Principles provides a framework that all organisations can use to determine good governance around three areas: resources, competency and execution. In other words, organisations should have complete and up to date resources, individually and collectively competent boards and boards should execute their strategic role appropriately. Participants viewed the concept of Governance 3.0 as a practical tool to guide action and the emergence of modern exemplars of excellence in governance.

About the author

Dr Abigail Robson is a social housing service improvement and governance specialist with a wealth of experience gained in local authority and housing association sectors. She is a retained consultant with Central Consultancy and Training where she works with boards and senior executives in the housing association sector. She has over 30 years combined experience as a practitioner in the public and not-for profit sectors and as an academic, with research experience and interest in the realities of how organisations work in the construction industry. Abigail is a member of the Chartered Governance Institute.

About Karl George

author of the tgf Governance Code – principles of governance

Dr Karl George is a thought leader, author and internationally established consultant in governance. He is Managing Director of the governance forum (tgf), creator of The Governance Framework and the Effective Board Member Programmes. He works with boards and senior executives in the private, public and voluntary sectors and has over 25 years' combined experience in accountancy, business and strategic development. Karl is a Fellow both of the global accounting body ACCA and of international body for governance practitioners The Chartered Governance Institute. He is one of the founders of the Association of Corporate Governance Practitioners (ACGP) and has developed a unique governance framework and kitemark that was endorsed by the late Sir Adrian Cadbury. Karl is the author of the Governance Code - principles of governance for organisations of all sizes, sectors and geographical jurisdictions.

Acknowledgements

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About The Lunar Society

The present-day Lunar Society provides a dynamic forum for its membership to influence change through focusing and informing debate, linking social, economic, scientific and cultural thinking, and catalysing action on issues critical to the common good. In the 200-plus years since the original Society, Birmingham and the region have changed beyond recognition. It is now a lively, multicultural city, open to the world. Its industrial base has high technology, medicine and legal services as well as modern manufacturing. It is also notably a young city, with a high proportion of under-35s. Yet what is still the same is the need to adapt continuously, to connect across different agendas and perspectives, and the need to engage local energy and effort in making change succeed. We are at the forefront of this, contributing to an innovative agenda throughout this region and beyond. Today's Lunar Society has several hundred members and includes leading practitioners from all walks of life in Birmingham and the wider region, people who are prepared to help shape the scientific, political and social agenda not just here in Birmingham and the West Midlands, but nationally and internationally.

About Central Consultancy and Training

Central Consultancy and Training are learning and organisational development specialists with a reputation built over 40 years and an extensive portfolio of clients nationwide in housing, health and social care, local government and the private sector. Our mission is to build a sound understanding of needs and deliver results by combining an informed and respectful external view with a customer's internal depth of understanding.

About The Governance Forum (TGF)

tgf consists of several specialist organisations working together to raise standards in governance practice. We encourage organisations in the private, public and voluntary sectors to think more strategically about the benefits of effective governance and how to achieve it. **tgf** delivers board effectiveness reviews, away days and consultancy and is the creator of the intellectual property associated with The Governance Framework. The **tgf** Governance Methodology is taught on the Effective Board Member Programmes in 11 countries around the world.