Inspiring business

General Election 2019

IoD Manifesto

Corporate Governance

Foreword

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Corporate governance is a key driver of business behaviour and economic performance. Improving the standards of governance at UK firms is a crucial endeavour, helping to safeguard against preventable failures. And yet it historically tends to feature very sparingly in the manifestos of most political parties.

To fill this gap, the IoD is proposing 10 policy initiatives which will reinforce the UK's pre-eminent position in the global corporate governance space.

Several of these proposals offer lawmakers a governance mechanism through which business can regain the trust of wider society while at the same time avoiding an extreme lurch to heavy-handed regulation or outright nationalisation.

For example, the introduction of a code of conduct for board members could exert a significant impact on business behaviour. And the establishment of a new legal vehicle through which to organise government outsourcing activities – the Public Service Corporation – represents an innovative way of achieving balance between various stakeholder interests in an increasingly politicised area of the economy.

These proposals are illustrative of an emerging policy trend – the growing role of corporate governance in addressing a wide range of economic and social challenges, not least the overwhelming issue of climate change.

About the IoD

The IoD believes that better directors make for better businesses, which in turn can create a better economy and society. Our Royal Charter sets out a mission to support, develop, and represent our members, while more widely promoting skill and integrity on the part of all directors, and fostering a climate favourable to entrepreneurial activity. Ahead of the 2019 General Election, the IoD will be releasing a set of manifesto papers to outline steps that any party could take forward to further these goals, based on consultation with members and research by the IoD's policy team.

Founded in 1903, the IoD is the UK's leading organisation for individual directors. It is an independent, non-party political organisation, with membership drawn from right across the business spectrum, including the public and third sectors, with around 70% consisting of directors from small and medium-sized enterprises.

Executive summary

The Institute of Directors believes that high standards of corporate governance are essential if public trust in UK business is to be regained. Well governed companies deliver better business performance and safeguard the interests of relevant stakeholders, including shareholders, employees and taxpayers. In order to deliver its agenda, the next Government will have to work constructively with business to create an environment that enables directors to lead sustainable purposeful businesses which are both profitable and internationally competitive.

Over the years, the UK has developed a world-leading reputation for the quality of its corporate governance regime. However, if UK corporate governance is to remain the jewel in the crown of our post-Brexit economy, it cannot be diluted or simply neglected. For the UK's corporate governance to remain a national competitive advantage and to restore public confidence in business, our standards require reform and futureproofing.

Our 10 specific policy proposals are designed to achieve 3 broad objectives:

A **Increase the accountability of the UK corporate governance system to stakeholders and wider society;**

B **Improve the competence and professionalism of UK board members – whose role is central to business decision-making;**

C **Enhance the ability of board members to pursue long-term, sustainable business behaviour – including addressing the challenge of climate change.**

A Proposals to increase the accountability of the UK corporate governance system

1) Support the development of an industry-led Code of Conduct for Directors.

The Government should support the introduction of an industry-led Code of Conduct applying to board members of significant corporate entities, i.e. companies exceeding a certain size threshold or level of importance for stakeholders and the wider UK economy. The new Government should encourage the board members of such entities to become signatories to the new Code and to adhere to its behavioural standards.

Corporate directors do not currently have a formal code of conduct that guides their activities and behaviour as a professional group. Such frameworks of appropriate conduct are common in other professions including accountancy, medicine, and the Law. However, UK directors' behaviour is primarily governed through legal duties defined in company law and other regulation.

The absence of a professional framework of conduct or ethics – which goes beyond mere compliance with the law - is of particular concern at a time when public trust in directors and business more generally remains fragile. In the wake of the recent high-profile corporate collapses, there is an understandable demand for board members to be held more accountable for failures of oversight and direction.

2) Deliver proposed reforms to the regulation of auditors.

The Government should introduce the necessary legislation to enact Sir John Kingman's recommendations concerning external audit regulation.

In the wake of recent high-profile corporate failures, there is a need for more robust regulatory oversight over the external audit process. We agree with the conclusion of the Kingman Review: that the FRC should be abolished and replaced with a new regulatory body (The Audit, Reporting and Governance Authority), with stronger investigative and enforcement powers.

However, the creation of a new regulatory body will require primary legislation. The outgoing Government did not allocate Parliamentary time to this legislation in the Queen's Speech, and this urgently needs to be remedied by the incoming administration.

3) Establish an independent Corporate Governance Commission.

The Government should establish an independent Corporate Governance Commission to oversee the UK's corporate governance and stewardship codes framework, enabling the FRC's successor (ARGA) to focus on its core task of improving company audits.

Despite endorsing Sir John Kingman's recommendations concerning audit regulation, we believe that having corporate governance and investor stewardship regulated within the same body as statutory audit is a far from ideal approach. Governance codes represent an industry-led and 'soft law' approach to regulation – in contrast to the more robust approach that will be required from a statutory audit regulator.

The new Commission would work with industry to create greater accountability and transparency of the UK's corporate governance framework. This would help the process of making changes to the UK Corporate Governance Code become more transparent, with clearer lines of accountability, rather than being subsumed by a large regulator where corporate governance is just one concern amongst many.

4) Transform the operation and functioning of Companies House.

The current Government has already developed a range of proposals to improve the functioning of the UK Registrar of Companies at Companies House. These include measures to better scrutinise the accuracy of UK company data and reduce the likelihood of identity theft, a matter of considerable personal concern to company directors.

These reforms should be prioritised through the allocation of the necessary resources and Parliamentary time through which to enact the required primary legislation.

B Proposals to increase the competence and professionalism of UK board members

5) Mandate minimum requirements for director training.

The Government should require that newly-appointed directors of significant entities should fulfil a minimum requirement in terms of director training and professional development.

Within our complex and regulated economy, almost anyone over the age of 16 can become the director of a corporate entity. There are no legally-defined prerequisites in terms of knowledge or professional training. This freedom to establish a company and serve as a director may be the hallmark of a free economy, but the directorship of a significant entity is a major social responsibility. It should not be entered into without a full and clear understanding of the responsibilities that the role demands of the post-holder.

Directors, and particularly non-executive directors, require knowledge and skills to perform the role, beyond commercial experience. Independent non-execs have a vital function in holding the management to account and constructively probing their decisions. Directors at companies of all sizes can benefit from job-specific training and we call on the Government to increase the focus in this area. Revising the Corporate Governance Code to increase the expectation that directors had undertaken some formal training would be a positive step.

6) Encourage the adoption of a Code of Practice for board evaluation.

Externally-led board evaluations are an increasingly important aspect of good corporate governance. Independent board performance reviews allow boards to continuously improve their own performance and the performance of the company, and to demonstrate a clear commitment to doing so. The UK Corporate Governance Code recognises the important role that such reviews play by requiring an independent evaluation to be undertaken at least once every three years.

However, there is little consistency in the way in which such evaluations are undertaken, which reduces their value to stakeholders. We therefore, believe that the Government should push forward with the introduction of a voluntary Code of Practice for the providers of board evaluation services and formal arrangements for implementing and monitoring such a code.

C Proposals which encourage a longer-term, sustainable approach to business behaviour

7) Create a framework through which companies can project their Business Purpose.

Prior to the Companies Act 2006, companies were required to include an Objects Clause in their Memorandum of Association. Historically, such clauses set out the purpose of the company and legally defined the scope of the activities that the company was planning to undertake.

The requirement for an objects clause was scrapped as part of company law reforms. However, we believe that a clearly defined objects or 'business purpose' statement is still a valuable feature of a company's constitutional framework, which allows companies to communicate their expected social impact beyond merely maximising profits.

The Government should seek to encourage companies to adopt clearly defined 'business purpose' clauses, either in their constitutional framework or elsewhere in their annual report.

8) Encourage a consistent approach to Climate-Related Corporate Disclosures.

The Government – working together with other relevant bodies - should mandate a consistent framework of corporate reporting on climate change to be implemented by UK companies.

In July 2019, the Government published its Green Finance Strategy which sets the direction for climate change regulation and action. Asset owners and listed companies are expected to report in accordance with the requirements of the Task Force on Climate-Related Financial Disclosures by 2022.

However, an appropriate reporting framework should be implemented for UK listed companies as soon as possible. The FCA has indicated that it would like to see such a reporting framework implemented in 2020, and the Government should get behind this ambition.

9) Explore opportunities to establish an ESG-oriented Sovereign Wealth Fund

The Government should explore opportunities to establish a UK Sovereign Wealth Fund to invest in the green and sustainable companies of the future and in doing so embed the highest standards of corporate governance across the economy.

Such an entity could be funded through the sale of Government backed bonds to institutional investors looking for secure ESG (Environment, Social, Governance)-oriented investments. Such an entity should be overseen by an arms-length body and insulated from political control in order to ensure that the right decisions are made for the long term.

10) Establish a newly-defined corporate form – the Public Service Corporation.

The debate about how public money is spent on private-sector contracts continues to be politically charged and fraught. The Government should establish a newly-defined corporate form – the Public Service Corporation – through which the outsourcing of public services and related activities could be delivered.

Such a legal entity would be constructed in order to ensure that the board maintains a balance between the interests of shareholders and other stakeholders – such as creditors, employees, suppliers and the pension fund.

Like a private company, such a vehicle would have shareholders and operate on a commercial basis. However, its underlying legal framework would require a balance to be maintained between the interests and obligations relating to its various stakeholders, including its shareholders, employees, pensioners, creditors and public sector clients. This duty would be defined in the general legal duties of its board of directors. The composition of the board would also reflect a more pluralistic approach. In particular, the appointment or dismissal of directors would not only be a matter for shareholders — as is currently the case according to UK company law — but for other key stakeholder groups too.

Such a corporate form should not be imposed on outsourcing companies on a mandatory basis. However, it could be encouraged through government procurement decisions on the basis that such entities would embody a good balance between commercial know-how, prudent governance and social legitimacy.

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The Institute of Directors

The IoD has been supporting businesses and the people who run them since 1903. As the UK's longest running and leading business organisation, the IoD is dedicated to supporting its members, encouraging entrepreneurial activity and promoting responsible business practice for the benefit of the business community and society as a whole.

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