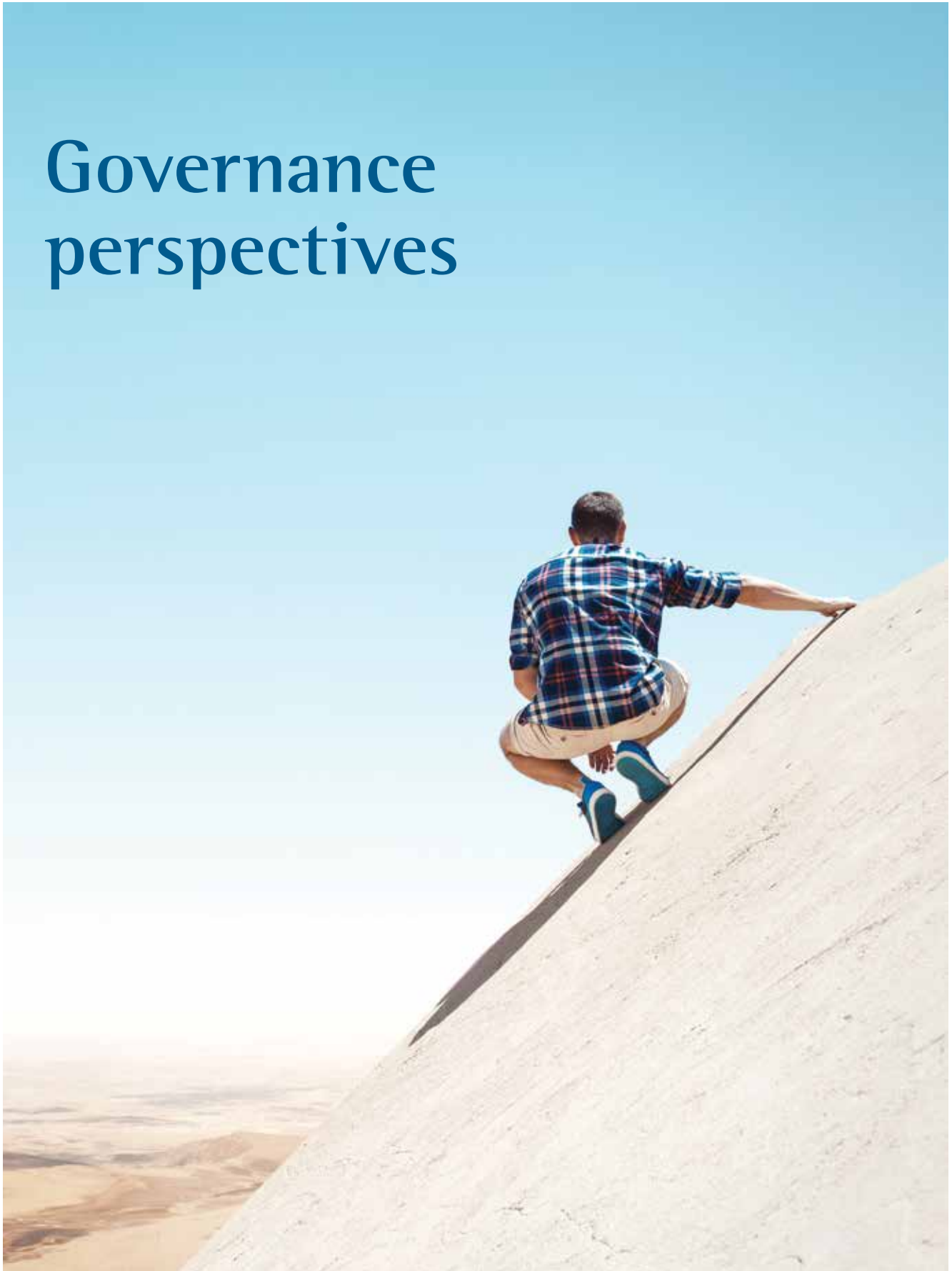


Governance perspectives



Corporate governance practices vary internationally, but is a global consensus emerging on corporate governance best practice? Moreover, how will the changing attitudes to governance affect the company secretary role? Edward Speed, the London-based Chairman; and Alice Au, the Hong Kong-based director; of the global executive search and leadership consulting firm Spencer Stuart, give a global and a local perspective on these questions.

There used to be an assumption that corporate governance standards would converge around the world on the back of globalisation, but many differences still remain in the way different jurisdictions approach governance issues – do you think a global consensus is emerging on corporate governance best practices?

ES: 'I think we have to recognise that there are different mixes of public companies and private companies in various geographies, and that many listed companies have a controlling shareholder – that is true in Hong Kong for example – and that does impact on governance. However, I do think there are three generally accepted principles of good governance coming through which are relevant wherever companies are based.

One of these principles is that of independence: are all shareholders' interests being protected by a board of directors? We have seen an increasing focus, certainly in the US and here in the UK, on the real independence of board directors. Secondly, I think there has also been a focus on boards taking a longer-term view of the objectives and the strategic direction of the company. This is a reaction against 'short termism' that companies are often accused of. Thirdly, I think people are increasingly seeing the need for a separation of the chairman and the CEO roles. This is a little more contentious, certainly in the US, but we have seen convergence towards this.

Companies are either separating the roles, or, in the case of the US, they are strengthening the position of the lead independent director so that there is a strong counter-balance to the executive power of the combined chairman and CEO role.

In addition to these three themes coming through, I think generally, globally there is also a recognition that some limits to board tenure are required. This links to independence in that independence only lasts so long – directors who have been on the board for 20 years can be perceived as having "gone native".

Looking at the situation here in Hong Kong, would it be fair to say that some of the principles you mention – the separation of the chairman and the CEO roles and the need for independent directors in particular – have met some resistance?

AA: 'We would be the first to say that one

size does not fit all as far as corporate governance is concerned. That has to do with the different regulations, as well as the different shareholding structures in different jurisdictions. But here in Hong Kong and China, I don't think there is resistance to having independent directors. The listing rules in Hong Kong make it very clear that a third of the board needs to be independent and that there needs to be at least three independent directors on the board – and all companies are complying with that.

There is more of a grey area when you come to define independence, of course. The Stock Exchange has a definition of independence but the grey area really comes when you get to issues such as the one Edward was just referring to – the need for term limits. Now, when an individual has been on the board for a long time, we often hear the argument that the individual is very independent-

Highlights

- perceptions of good governance will vary according to the varying requirements of investors and as a result of different regulatory and shareholding structures
- while there is no one size fits all in governance, there is a consensus building around the basic principles of good governance
- these principles include the need for genuinely independent directors, the need for longer-term planning and the preference to separate the chairman and CEO roles

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Alice Au, Director, Spencer Stuart



minded so there shouldn't be a problem. We accept that there will sometimes be exceptions, but as a general rule term limits are a good thing because they revitalise the board.

I would add that where our clients have listed subsidiaries outside of Hong Kong, in London or in the US for example, they are facing shareholders who are increasingly asking about the independence of their directors. I have a case that we are working on where the overseas shareholders are asking whether directors who have been on the board for 10 years can still be considered independent. So shareholders do look at this issue, they will question it at the subsidiary level and then at the group level as well. So I think this plays a part in changing attitudes. If shareholders ask these questions often enough, companies come to realise that, even though it may not be a legal requirement, having term limits is part of good governance. I am seeing this here in Hong Kong and I think it also applies to Greater China companies as well!

ES: 'I think that corporate governance is a journey and Hong Kong has come a long way. I don't think we want to be demonising very successful Hong Kong businessmen and women who hold combined chairman and CEO positions. All we have to make sure is that we have strong independent oversight of the executive. That could be carried out by a highly respected director who would be seen as holding executives, including the chairman and CEO, accountable. In a way we would rather have that than having someone made chairman and the previous chairman/CEO going on as before.'

Could we turn to board evaluation. Are you seeing more acceptance of this as a good governance practice globally?

ES: 'It was Socrates who said "the unexamined life is not worth living". I think all boards should from time to time stop and think about how effective they are and examine the way they work. That is part of good corporate governance. We have a rule in the UK that a review should be undertaken every

year and every third year it should be done with an external independent party.

I think there is a strong role for the corporate secretary to play here; on my board the corporate secretary undertakes the annual survey of my directors. We have a pretty vigorous process which includes peer evaluation. I think that is a good thing to do so that the chairman can give feedback to individual directors on how they are performing in the eyes of their peers. This includes an evaluation of how the chairman is performing in his role, so I have the same thing done to me.

Of course, we have the role of the senior independent director on British boards and that person, together with the corporate secretary, plays an important role in effecting board evaluations. I think that is good corporate practice and it is very prevalent now in continental Europe, as well as here in the UK. Increasingly we are seeing externally facilitated board evaluations in the US as well.'

Why do you think board evaluation, at least in terms of a formal process, is still relatively rare in Hong Kong?

AA: 'We highly recommend that boards take this up and there have been more board evaluations in Hong Kong since the Stock Exchange made it a Recommended Best Practice in the Corporate Governance Code. Our 2015 Board Index found that 21% of Hang Seng Composite LargeCap Index (HSLI) companies are now doing board evaluations. Of those companies only 8% engaged an external facilitator, but, as Edward was saying, Hong Kong boards are on a journey. Doing an internal evaluation is a first step and still gives a health check for your board.'

The number one reason many companies are not engaging external facilitators is that they are still thinking about the cost. We would argue that this cost is relatively low and it is an investment in your board – if you do an assessment of your executive level why don't you also do an assessment of your board?

I think another factor is the reluctance to open up the company to an outside party. This is a common concern where the chairman is the owner/founder of the business. The companies that are getting external facilitators are usually the companies with a more diversified ownership and it is often the independent non-executive directors (INEDs) in these companies who are advocating it because they have seen the benefits on the other boards they sit on. So I think that this will be an evolution and it will also be an area where the company secretary, together with the INEDs, can be an advocate. For a small cost you obtain rich data on the health or otherwise of the board.'

We have discussed the signs of convergence towards key governance principles – where do you think this is going to take us? If we have this conversation again in 20 years time will the best practices of today have been universally adopted?

AA: 'I don't think there is something we could call perfect corporate governance, though there will be common themes – such as the need for transparency and independence – which investors, no matter where they are from, will want.'

ES: 'I think we should look at this from the other end of the telescope. We should look at the sources of capital and what are the owners of that capital require in terms of governance. The big institutional shareholders, such as the pension funds, want companies to behave in a certain way and have their own reporting requirements. The sovereign

wealth funds and private equity owners will have different requirements. The state-owned enterprises in China have a different source of capital and will be subject to different expectations. So I think there will be parallel regimes dependent on the requirements of the sources of capital. You will have US pension funds wanting, wherever they invest in the world, to have an "all the bells and whistles" form of governance, while others might be happy with a more streamlined version. Now, it is a bit like a country, you get the constitution and the political environment that you deserve in a way. I really don't think there is a one size fits all and that will be the case in 20 years' time.'

Could we turn to the role of the company secretary? Company secretaries are increasingly relied on as advisers to the board and as a

Insights into the company secretarial role

The interviewees work closely with company secretaries both here in Hong Kong and globally. Their insights into the nature of the company secretarial role include:

- it is a role that is critical to the smooth functioning of the board
- the responsibility to keep directors informed is critical because good decision making is impossible without a good debate based on facts
- practitioners need to have active engagement with all of the directors, in particular providing the vital connectivity between the executives and the non-executives
- the company secretary is often the repository of institutional knowledge and continuity in an organisation as directors come and go
- the role calls for high standards of integrity in order to build trust
- to get to the top of the profession, practitioners need to have good soft skills as well as the requisite technical knowledge
- these skills include: discretion, judgement, a high EQ and good interpersonal skills to assist the chairman in navigating ever-changing board dynamics.

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corporate secretary
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Edward Speed, Chairman, Spencer Stuart



governance gatekeeper – what's your view on how the role has changed, and how it will change in the years ahead?

ES: 'I think that journey will continue, moving from a purely administrative and back office role to playing a much more active role as part of the triumvirate of the chairman, the CEO and the corporate secretary facilitating best decision making in boards. And that calls for much more active engagement with all of the directors. In particular, it calls for more active liaison and vital connectivity between the executives and the non-executives. It's a role that is critical to the smooth functioning of the board and it calls for very special skills. It's all about discretion, touch, judgement and having very high standards of integrity because if you don't have that you can't build trust.'

Corporate secretaries can be in an invidious position because while they are on the company payroll, they are primarily aligned with the chairman.

The role calls for very high levels of moral fibre and backbone. The corporate secretary is also a real repository of institutional knowledge and continuity. Directors come and go, chairmen come and go, but the corporate secretary can be a constant.'

AA: 'I think if you look at the really good corporate secretaries among the Hang Seng Index companies in Hong Kong, they have a trusting relationship with the chairman, they have that touch and discretion, that understanding of the business and that EQ that Edward was talking about. I think this is where The Hong Kong Institute of Chartered Secretaries (HKICS) has an important role – the HKICS can help to build the soft skills of the next generation coming through and help them recognise the full potential of the role.'

Could we go deeper into the company secretarial role in board support, in particular facilitating effective decision making? That can be a tricky area because, as you both mention,

it takes a great degree of tact and people skills.

ES: 'Directors are feeling more and more, as they should do, their fiduciary responsibilities and they feel they need to engage much more than they used to in the past with the company's business. Now some very big companies, Shell for example, have a corporate board office that arranges inductions for newly appointed directors, provides information to directors and helps them with additional data if they want to go deeper into a particular issue.'

I think that trend is going to grow as well, and corporate secretaries, with the agreement of their chairman, need to be ensuring that individual directors are as effective as they can be. Obviously without "leading the witness" in a particular way but to offer information. It is really critical because you can't get good decision making unless you have good debate based on facts and rigorous data. My corporate secretary will go to a board director and say "it doesn't sound like you really understood all the issues"

in a non-negative way, "should I give you a bit more reading on this?"

When the chairman is driving an agenda he or she has to be thinking three moves ahead, so it is quite difficult to spot everything that is going on with the board. So it is useful to have an independent observer watching the dynamics in the boardroom. The corporate secretary can whisper in the chairman's ear when someone is not happy with where things are going, or when someone is harbouring a misunderstanding about something, so that the chairman can have a chat with that director in the break. These are all very sensitive matters which is why corporate secretaries need to have the EQ and the interpersonal skills we discussed earlier. Plus the humanity and the low ego needed for the job because the last thing you want in your corporate secretary is a "wannabe chairman".

Should the corporate secretary answer to the chairman or the CEO?

Keeping track of board governance: Spencer Stuart's Board Index reports

Spencer Stuart's Board Index reports can help corporate secretaries keep track of best practice in board governance. These reports are published in over 20 jurisdictions globally, including many Asian jurisdictions such as Hong Kong, Singapore, India and Japan. The Board Indexes provide governance professionals with hard data on the key issues in board governance, including the major trends in board composition, structure and compensation. They also include international comparison tables, comparing governance practices across the countries where Spencer Stuart has collected data. Beyond the data analysis, the Indexes also include articles on frontier topics of interest – the *2015 Hong Kong Board Index*, for example, includes articles on corporate culture and board diversity.

The Spencer Stuart '2015 Hong Kong Board Index' is available on the Spencer Stuart website: www.spencerstuart.com.

ES: 'Definitely to the chairman. Pay and rations comes from the executive, but in terms of where they get their orders from, it is from the chairman of the board!'

One final question. Integrated reporting gets businesses to think in terms of their six capitals – including natural and social capitals. Do you think that how businesses address their environmental and social impacts and performance is going to be a major part of what state the world will be in in the medium and long term?

ES: 'One would hope that all boards are thinking in an integrated way. We need to be thinking about the role of our businesses in particular communities. Are we engaging around climate change and the responsible harvesting of resources? Are we contributing to society on a wider level? So it is not just pure return to financial shareholders, it is a broader contribution to the wider stakeholder community in which the company operates.'

The King IV Report on Corporate Governance has just come out in South Africa, and it puts a lot of emphasis on integrated reporting and sustainability. They led the way. In the UK right now we have a political imperative around this kind of contract with broader society, looking at things like societal representation on boards in terms of gender and ethnicity, pay and having broader stakeholder representation on the board!'

Do you think that getting it right in these areas will be a licence to operate issue for businesses?

ES: 'Yes. I think these are two sides to the same coin. A societal contract becomes a licence to operate but it also makes very good business sense. If you look at what companies like Unilever have done around sustainability, that has been incredibly effective in helping them attract high-calibre talent; it has added lustre to the company and made it easier for the company to engage with governments, business partners, and the wider communities in which they operate.'

AA: 'I think that this is another area where corporate secretaries can add value to the board and also the chairman. A lot of time the chairman has to be so focused on the business that they might miss some of the governance trends we are discussing here. A good corporate secretary can keep track of these trends and help enhance the functioning of the board by bringing them to the attention of the chairman.'

Edward Speed and Alice Au were interviewed by Kieran Colvert, Editor, CSj