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Starting Corporate Governance from the Board Room

In an era when trust in business is at a premium, and scrutiny from stakeholders is ever wider and more intense, it has never been more important for organizations to behave in accordance with their core purpose and principles in order to protect reputation and trust. Corporate governance is a vital mechanism through which boards can ensure that the behaviors of their workforce are aligned to the organization's purpose and principles – and that corporate goals and values are translated into their people's decisions and actions.

Our latest thinking is that good corporate governance can be summarized under three main themes.

First, effective corporate governance is grounded in a clear view of what matters most to the business, the full range of risks facing the organization, and how these risks relate to the business and its strategic priorities. Only with an understanding of these areas is it possible to say what is or isn't a risk. Second, it begins and ends with the board, which is responsible for crystallizing a clear corporate purpose, exhibiting the right values, and ensuring these are being acted upon. Third, behavior and decisions in the 'moments that matter' represent the ultimate test of good corporate governance – not least when a crisis hits.

When boards succeed in creating and sustaining effective corporate governance, it generates a range of business benefits that combine to create higher trust, stronger resilience and enhanced competitive edge. So this is not just an ethical responsibility for the board, but a strongly commercial one as well.

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At root, the best corporate governance creates a clear and visible line of cause-and-effect from the board's mandate, purpose and values all the way to the cultural norms and everyday behaviours exhibited at all levels. A business that can demonstrate this linkage will be well placed to outperform its competitors and provide a step further to achieving their goals.

The five pillars of corporate governance

Our view is that effective governance is founded on five pillars, all of which are interrelated, and each of which must be in place and functioning well for governance to do its job (see Figure 1). The pillars are:

Figure 1: The five pillars of effective corporate governance

Key framework elements	Leadership strategy and culture	Structure and performance oversight	Risk	Management information and controls	Transparency and reporting
Code 'Principles'	Leadership	Effectiveness	Accountability	Remuneration	Relations with shareholders
Framework sub-components	• Tone at the top • Conduct • Chairman & CEO • Decision making • Strategy setting • Reserved matters and delegations • Board meetings • Relationships with management	• Board composition and commitment • Appointment succession and re-election • Board committees • Board evaluation • Induction and training • Management information and advice • Entity governance • Auditor relationships	• Risk appetite • Risk and control culture • Principal risks and going concern • Risk management framework • Risk and control monitoring • Policy framework • Assessment of effectiveness	• Execute compensation and benefits • Performance related remuneration • Incentive schemes (Share schemes/ pension) • Remuneration balance • Risk adjusted reward • Balanced scorecard • Non-financial performance	• Stakeholder engagement • Stewardship Code • Annual General Meeting (AGM) • Financial and non-financial reporting • Regulator(s)

Leadership strategy and culture

The way a business's leaders conduct themselves and communicate on a daily basis – and the ethics and values they exhibit in doing so – are instrumental in setting the 'tone from the top'. This tone shapes every action, decision and relationship across the organisation. As a result, the right leadership tone is the starting-point and bedrock not just for corporate governance, but also for the effective overall management of any business.

Structure and performance oversight

The tone from the top must be infused and embedded at all levels of the organisation, through structures that ensure it is translated into everyday behaviours. Mechanisms for achieving this include monitoring by the board and its various sub-committees, assurance through functions such as Internal Audit and Compliance, and contingency plans for crisis management.

Risk

Risk is the pillar which lies at the heart of corporate governance, underpinning and interconnecting the other four. All components of an organisation's governance framework need to be designed and managed in the context of its overall risk appetite, reflecting the fact that managing risk – and being accountable for doing this effectively – are central to the board's role. The right focus on identifying and owning risk equips the board to understand, analyse, prioritise and manage risks of all types, supported by the Risk & Compliance Officer.

Management information and controls

Clear and open reporting requires a solid underpinning of timely and accurate management information, so both financial and non-financial impacts and performance across the business can be monitored, measured and benchmarked against relevant key performance indicators (KPIs) using a balanced scorecard approach. This pillar encompasses the information systems for collecting, analysing and reporting the information, and reward and recognition processes that encourage the behaviours that the board wants to see across the business.

Transparency and reporting

One of the benefits of a well-developed structure and effectiveness is that they enable the business to communicate in an open, accurate and timely way with all its stakeholders. This means interested parties ranging from shareholders to regulators, from employees to regulators, and from suppliers to environmental NGOs can gain a clear understanding of the business's unifying purpose or 'board mandate', how its chosen strategy aligns with this purpose, and how it's pursuing this strategy.

The role of the board

From setting the right 'tone from the top' to maintaining and monitoring business controls – and from rewarding the right behaviors to communicating openly and transparently with all stakeholders – the board plays a pivotal role in all aspects of corporate governance. These activities can sometimes be disconnected, so it's the board's role to apply the right risk lens to every decision and action. For this to be a success, organizations need to have the right people on the board – challenging, experienced, inquisitive and with the time to understand both the risk landscape and their legal and ethical responsibilities.

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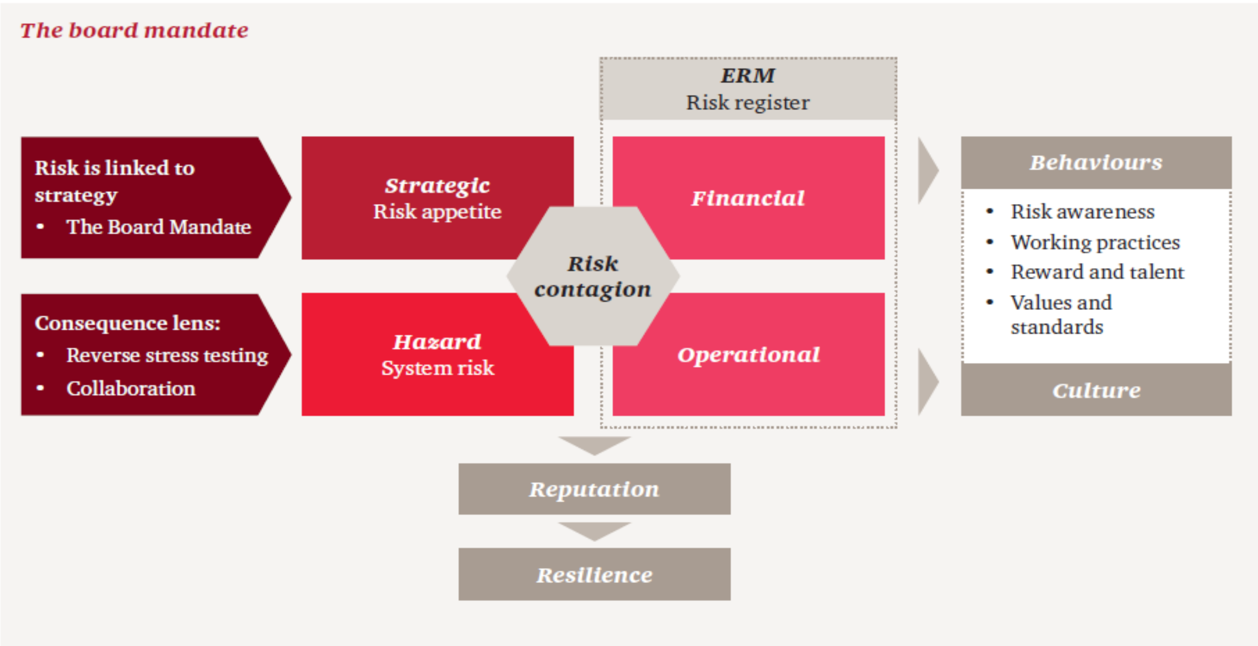
Adapting to the four types of risk in today's risk landscape

The board is best placed to enable and ensure effective corporate governance. As Figure 3 shows, today's risk landscape includes four broad categories of risk that the board must monitor, manage and mitigate: financial, operational, hazard, and strategic risks.

Figure 3: The role of the Board – from mandate, via risk lens, to culture & behaviours



1. Financial risks are usually a regular focus of board risk discussions, with strong impetus coming from today's increased regulatory, accounting and financial audit focus. Financial information is clearly a key element of stakeholder communications, performance measurement and strategic delivery.

2. Operational risks are typically managed from within the business, and often focus on market, quality, compliance and health and safety issues where industry regulations and standards require. These risks may affect an organization's ability to deliver on its strategic objectives.

3. Hazard risks tend to stem from major factors that affect the environment in which the organization operates. While contingency planning is often used to help address them, there is a danger that the difficulty of controlling these risks means boards may not take them into account when formulating strategy.

4. Strategic risks arise when the strategy gets out of line with what the business needs to do to create value sustainably, typically because of external change. In cases where a board get too 'bought in' to a particular strategy, these risks may be missed out from its risk register.

Source:
Corporate Governance in the Boardroom: A practical perspective. A PwC Point-of-View Paper, June 2015
www.pwc.co.uk/riskresilience