PRACTICES

Greater Good

Directors are in a key position to wisely influence the motivations of their colleagues

Bernadette Young

In contrast to the statutory qualification requirements for the Company Secretary, in theory more or less anyone aged 16 or over can be a director of a public listed company. That is quite a statement when you think about it.

Of course, in reality, shareholders require the companies they invest in to be run by suitably experienced individuals and, certainly for listed companies, whilst not required by law, the UK Corporate Governance Code and its associated guidance on board effectiveness expect boards to be comprised of individuals with appropriate skills, knowledge and experience. There is an emphasis, not only on having those attributes on appointment, but on a continual process of learning, development and keeping up-to-date.

The role is far from easy even for experienced and highly-informed board members. Directors need to have a deep understanding of their company's sector, external environment and internal objectives, to apply their knowledge and experience to numerous situations, to offer challenge, insight and support on diverse topics, to look to the future at the same time as reviewing the past, and to reach consensus as part of a team whilst also taking personal responsibility. It is something of a wonder that anyone can live up to these dizzying expectations!

It is therefore not surprising that things can sometimes go wrong. Despite their hard work and dedication, even a competent board can take their organisation in the wrong direction or, despite taking a relatively prudent position, find the business is impacted by a circumstance which could not reasonably have been expected – the pandemic springs to mind!

There is a clear difference, however, between scenarios in which a board has to report that, for whatever reason, performance is disappointing, and one in which the board fails to properly disclose an unfolding crisis, whether because they are deliberately concealing information or else do not have proper processes in place to ensure they are kept well informed. Examples of such failures in recent years include the VW emissions scandal, the overstatement of Patisserie Valerie accounts, and the apparent fraud at Wirecard.

These cases have deliberate wrong-doing (whether suspected or proved) in common, not necessarily at board level, but at some senior level within the organisation. What they also have in common is that these companies' boards were not well-informed and failed, through lack of effective enquiry or otherwise, to get to the bottom of issues which arguably should have raised red flags.

For those corporate failures where there have been inaccuracies in financial reporting, the role of the auditor and the degree of assurance provided by external audit processes have been called into question and there are undoubtedly important issues to consider. However, whatever the failings of audit may be in these instances, they do not absolve the directors of their duty to present fair, balanced and understandable reports and financial statements. Some of the Carillion directors are currently discovering this to their cost as they face Financial Conduct Authority investigations into the roles they had personally in publishing 'misleadingly positive statements about Carillion's financial performance'.

This may seem somewhat unfair, especially on the non-executive directors who are particularly exposed to the information gap which exists between them, with the relatively few hours they spend per month on company business, and their full-time executive colleagues. After all, if a well-resourced audit team with its unrestricted access to the company's files cannot uncover the truth, what hope is there for those who have no direct involvement with the financial records?

Of course, it is terribly easy to be wise after the event. There are always more insightful questions that could have been asked, challenges that could have been more robust, explanations that could have been forensically probed or behaviours which should not have been overlooked.

The truth is, however, that, when company failures occur, there are always (with the benefit of hindsight) ways in which the relevant board could have ensured it was better informed. An emissions cheat device is not designed, implemented and then installed into 11 million cars, and false accounting entries are not made on a near-industrial scale, through the actions of a single person.

Whilst directors may not always have direct knowledge of an issue, they are in a key position to influence the motivations (through financial incentives and behavioural expectations) and extent of individual freedoms (through effective controls) of their Group-wide colleagues. To exert that influence wisely so as to create the right conditions for business to be conducted to consistently high standards throughout the organisation requires experience, skills, knowledge and whole raft of other qualities which directors need to cultivate individually, collectively and continuously.

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