SECURING GOVERNANCE IN PRIVATELY OWNED AND FAMILY RUN BUSINESSES

Sharing real experiences and learning more about the challenges of the board room to support good practice

In the October 2018 Bitesize Governance session, we discussed the following three points in the context of the Wates Corporate Governance Principles for large companies.

- The codes designed for Listed Companies (i.e. QCA, FRC) and how they can be applied to private or family run businesses
- The differences between securing good governance in a private company and in a family run business, with an emphasis on the importance of succession planning
- The changes due to the involvement of a venture capital business or a major third party shareholder

On 13 June 2018, the FRC published a consultation on the Wates Corporate Governance Principles for Large Private Companies (Wates Principles). The Government's new regulatory requirement will require large private companies (more than 2,000 employees or turnover more than £200 million and balance sheet total more than £2 billion) to include a statement within their annual report that sets out which corporate governance code the company applies and also, how the company has applied that code. This represents a marked difference to the "comply or explain" approach of the UK Corporate Governance code as it requires companies to "apply and explain" their approach. The Wates Principles are intended to assist companies in this new reporting requirement, effective from 1 January 2019, and are currently under consultation, with final guidance expected by the end of 2018.

Looking at the Wates principles (overall), the room agreed that governance does not just benefit large companies but every company. However, it was also agreed that there is a lot for small businesses to deal with already, and corporate governance, in addition to other existing compliance requirements is a challenge, especially for private or family-owned businesses.

It was also questioned how companies comply with the Wates principles and it was generally agreed that it is difficult for the Board to implement policies around these. Comparisons were made with the Dutch corporate code where the document is much longer and comprehensive, with further guidance.

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Principle 1: Purpose

An effective board promotes the purpose of a company and ensures that the values, strategy and culture align with that purpose.

Firstly it was noted that the board needs to be aware of culture and what behaviours are incentivised in the business, and noted that this is not often the case in private or family run businesses. It was also acknowledged that diversity is important – but also raised that often the people whose behaviour is less than ideal are the ones with the ideas and the drivers of the company's success.

It was generally agreed by the delegates that boards are slowly buying into the idea of spending time in the business, and everyone acknowledged that values, strategy and culture have to come from the people at the top, which requires engagement with all stakeholders.

Principle 2: Composition

Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.

Delegates generally agreed that this point should be tailored to the needs of privately own companies, where size of boards are generally smaller.

It was also raised that, in family run businesses, there are sometimes problems with what to do with underperforming family members, and how this can be managed. It was noted that some families are trying to run companies without having the specialist skills to do so and this does lead to issues. It was however mentioned that the benefits of a family board could include longer terms, rather than those in other larger businesses, which are focused on an exit.

Another point made was that a family owned business' actions impacts more than just that family - decisions made in the boardroom impact on stakeholders, suppliers, the environment and supply chain.

Overall, it was agreed that it is of the utmost importance to provide the benefits of governance in a business – governance is about preparing for the worst and best possible outcomes.

It was also agreed by all the delegates that allowing the Board to make all decisions is dangerous – as they can't look at everything in detail, and they may not have the specialisms to do so. However that doesn't mean that issues like digital / tech should not be on the agenda to discuss strategically.

Finally, the larger the company, the more it was felt that there was a need for an independent director.

Principle 3: Responsibilities

The board should have a clear understanding of its accountability and terms of reference. Its policies and procedures should support effective decision-making and independent challenge

Delegates at the roundtable agreed that in terms of roles and responsibilities, there is an overarching need to make sure all Board members know what their responsibilities are – as well as the things that aren't part of their remit.

In terms of policies and procedures, it was noted that writing policies is difficult when there is a lack of resources required to do so.

It was suggested by a number of attendees that an independent non exec is the solution – however it would not occur to many businesses that this is the path to take.

Board evaluation and succession were deemed to be important matters. This is spelt out in the QCA Code, but appears to be silent in The Wates Principles.

Principle 4: Opportunity and risk

A board should promote the long-term success of the company by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks.

It was agreed by all the attendees that the usual approach to managing risks adopted by most companies (keeping a risk register) is not really effective risk management, in that it leads to a "tick-box" approach. It was also acknowledged that smaller companies are better at risk management because they are at the coalface. It was also agreed that concentrating on the risk register and what has happened can mean losing sight of the bigger picture. It is more important to identify which risks actually impact performance indicators. The issue of technology was also raised and delegates discussed the opportunities of harnessing technological risks to drive business efficiencies.

Principle 5: Remuneration

A board should promote executive remuneration structures aligned to the sustainable long-term success of a company, taking into account pay and conditions elsewhere in the company

All delegates acknowledged the importance of having a succession strategy but agreed it is a difficult conversation to have on many boards. The question was raised as to whether it is an easier or harder conversation to have in family run businesses. Succession strategy is of course a key issue.

On the point of remuneration, it was noted that large companies are often scared to be transparent – because they are looking to avoid media attention. However being open and transparent leads to better business management.

Many examples of 'good' remuneration practices were cited, include Clark's. It was also noted that sometimes seeing the CEO's rewards gives everyone else working in the business motivation. Benchmarking salaries with similar companies was also suggested.

Principle 6: Stakeholders

A board has a responsibility to oversee meaningful engagement with material stakeholders including the workforce, and have regard to that discussion when taking decisions. The board has a reasonability to foster good stakeholder relationships based on the company's purpose.

Delegates suggested that as 'meaningful engagement' an employee could sit on the board, however most delegates could not see most companies doing it, opting for a designated non-executive or workforce advisory panel to assume the role of liaising with the workforce.

What is key to achieving engagement is that that a particular person needs to actually contribute something worthwhile, and not just be there to tick a box.

As in our previous Bitesize Governance sessions, it was suggested that walking the floor of an organisation goes some way towards engagement with your employees. Delegates also discussed the benefits of a 360 degree appraisal system for Board members.

Conclusion

The Wates Principles are fairly straightforward and allow a broad approach for large private companies to "apply and explain" their corporate governance strategy. As a result it is expected that most companies will adopt the Wates Principles under the new reporting regime from 1 January 2019 for large private companies. The Wates Principles are drawn from existing corporate governance codes, such as The UK Corporate Governance Code and The QCA Code, and can be adapted and applied across all types of private companies if required, from family run SMEs to large, venture-capital backed private companies.

It is hoped that companies are able to articulate their own approach to corporate governance with individual tailored statements that have real meaning, rather than a relying on a statement doctored from elsewhere.

The one area where it was considered that further reference could be made in the Wates Principles related to Board evaluation, and in particular, succession planning.

About the Bitesize Governance Series

The aim of the series of roundtables is to support a shift in perception: changing the views organisations typically have of what good governance is, encouraging investors to care more about an organisation's health, well-being and governance and reinforcing the role of the company secretary in ensuring an organisation is properly governed.

We all understand the need to think in a fresh, collaborative manner and this is why Wedlake Bell, Bridgehouse Company Secretaries, First Flight Non-Executive Directors and UHY Hacker Young have come together to create the Bitesize Governance Series.

If you are interested in any of the issues mentioned in this paper and you would like to take part in a future Bitesize Governance event, please contact Natalie Maskell at UHY Hacker Young, or your usual contact at one of the promoting firms, for more information.

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