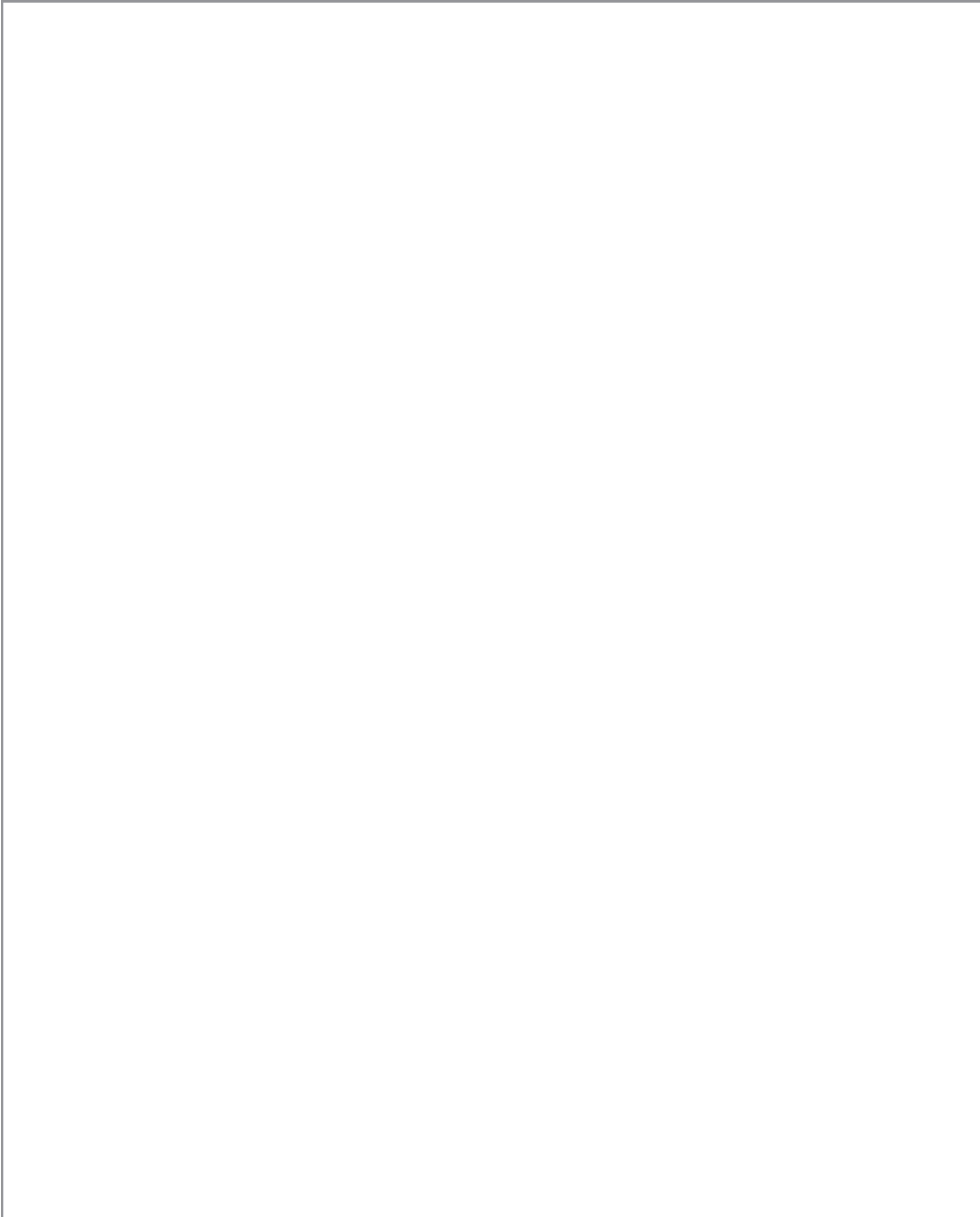
corporate governance and wealth creation

OCCASIONAL RESEARCH PAPER NO. 37



Corporate Governance and Wealth Creation

OCCASIONAL RESEARCH PAPER NO. 37

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Certified Accountants Educational Trust, London, 2004

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Contents

Abstract	6
Executive summary	7
1. Introduction	11
2. The survey response	15
3. Attitudes of directors to the purpose of corporate governance	17
4. The importance of corporate governance	21
5. Definitions of corporate governance	27
6. The influence of corporate governance on factors relevant to the generation of wealth	29
7. Directors’ opinions on the effect of changes in the Combined Code	35
8. The revised Combined Code and the role of non-executive directors	39
9. Conclusions	41
Appendix 1: Corporate governance	47
Appendix 2: The literature	51
Appendix 3: Methodology	57
Appendix 4: Comments on the purpose of corporate governance	59
Appendix 5: Comments about the changes in the Combined Code	61
Appendix 6: Definitions of corporate governance	65
Appendix 7: The survey questionnaire	69
References	77

Abstract

Recent corporate governance failures in the USA and in Europe have undermined trust in capital markets and in business. Major reforms have been introduced but they have been agreed on the basis of the ideas of regulators with some input from leaders in business. They have not been based upon objective evidence of what does and does not work.

Previous research suggests that good corporate governance may correlate with superior share price growth but shows that there are conflicting views about links between good corporate governance and other aspects of company performance. There is some evidence to suggest that certain accepted areas of 'best practice' actually correlate with poorer financial performance.

This research involved seeking and analysing the opinions of chairmen and finance directors (or chief financial officers) of listed companies: (a) on the purpose of corporate governance, (b) on the influence of good corporate practice on aspects of their company's corporate effectiveness which are linked to the creation of wealth, (c) on their attitudes to the revised Combined Code (2003) and (d) on which aspects of corporate governance are most important to their companies.

The research shows that there are divergent views on all these issues. In particular, some directors seemed to view corporate governance as a wasteful and time-consuming exercise intended to satisfy regulatory requirements, while others saw that corporate governance is also about wealth generation and has intrinsic value. Disturbingly, many respondents, particularly FTSE 100 directors, believed that the changes in the revised Combined Code could harm the competitiveness of UK companies.

The author believes that a new model of corporate governance, which all parties involved in corporate governance will accept, is needed. Such a model should take account both of the accountability aspects of corporate governance and of the means by which companies are directed, controlled and risk-managed in order to achieve company objectives.

Executive summary

Getting corporate governance right is important to economic prosperity. Yet there is little objective evidence that good governance will either (a) prevent further corporate failure or (b) contribute to improved organisational effectiveness. Nor is there convincing evidence that supports the changes required by revised corporate governance reform, particularly regarding the role of independent non-executive directors.

In fact, some evidence counters two important provisions of the new Combined Code, that boards of FTSE 350 companies should comprise at least 50% independent non-executive directors and that their length of tenure should not exceed nine years. Other research refutes a generally accepted, fundamental principle of good governance that the roles of chairman and chief executive should be separate.

The problem may stem in part from lack of consensus over what comprises good corporate governance and how it can be assessed. Similarly, while there are also many measures of financial performance there is no single appropriate measure of either performance or effectiveness.

AIMS OF THE RESEARCH

This research aims to inform debate by eliciting and analysing the opinions held by chairmen and finance directors of UK listed companies about corporate governance. Its particular focus is on the generation of wealth, exploring respondents' perceptions of the relationships between corporate governance and corporate effectiveness. It also investigates views on the new elements of the Combined Code.

PROFILE OF RESPONDENTS

The survey was completed by 91 chairmen and finance directors from the top 1,000 listed companies ranked by market value.

ATTITUDES OF DIRECTORS TO CORPORATE GOVERNANCE

It was found that 30% believed the 'main purpose of corporate governance' to be 'protecting shareholders against loss' and another 30% believed it to be 'optimising the long-term financial ability of the organisation to create wealth'. The remaining 40% viewed both purposes as 'equally important'.

Relatively more directors from larger companies linked the purpose of corporate governance with generating wealth. Within the FTSE 100, 47% of directors viewed the 'main purpose of corporate governance' as 'optimising' compared with only 20% of directors from companies outside the FTSE 350. Also, within the FTSE 100 twice as many directors believed the main purpose to be 'optimising' than 'protecting'.

More negative comments than positive were made about the purpose of corporate governance, eg, referring to corporate governance as 'over-prescriptive', 'burdensome' and 'box ticking'.

When asked to rank other purposes of corporate governance, almost all directors ranked 'ensuring accountability of management to organisation owners' as most important and 'improving share price' as least important. There were some interesting variations, however, the biggest being on the importance of 'satisfying the needs of regulators'. Directors who viewed the main purpose of corporate governance as protecting shareholders ranked 'satisfying the needs of regulators' as most important, whereas those who believed that the main purpose is to 'optimise wealth' ranked this as least important.

FTSE 350 directors believed 'satisfying the needs of regulators' to be third most important, whereas FTSE 100 directors and directors from outside FTSE 350 ranked this eleventh out of 13.

ASPECTS OF CORPORATE GOVERNANCE IMPORTANT TO COMPANIES NOW AND IN THE NEXT FIVE YEARS

Respondents were asked to rate the importance of 14 aspects of corporate governance to their organisation now and in the next five years. The four most important aspects of corporate governance to directors responding to the survey were '*strategy and goals*' and '*financial reporting (disclosure)*' followed by '*relationships with institutional shareholders*' and '*the quality of the external auditors*'.

Given the responses to the question on the purpose of corporate governance, it is surprising that '*strategy and goals*' ranked top in importance. One possible explanation is that many respondents did not associate corporate governance with strategy.

THE INFLUENCE OF CORPORATE GOVERNANCE ON FACTORS RELEVANT TO THE GENERATION OF WEALTH

Using a scale of one to five (where one is not at all influential and five is very influential), respondents were asked to indicate how much influence they think good corporate governance practice has on various aspects of a company's ability to generate wealth. Responses are summarised in Table 1.

The Table 1 shows that respondents believed that corporate governance has more influence on matters relating to finance and investment than on organisational performance, particularly in relation to '*obtaining investment from institutional investors*' and '*maintaining or improving relationships with the investment community*', which scored higher than any of the other criteria. '*Contributing to your*

Table 1: The influence of corporate governance on factors relating to the generation of wealth

	How influential is corporate governance practice in terms of...	Average
1	Maintaining or improving relationships with the investment community	3.71
2	Contributing to the organisation's overall reputation	3.67
3	Obtaining investment from institutional investors	3.53
4	Contributing to the organisation's long-term share price	3.16
5	Contributing to the organisation's strategic and/or operational effectiveness	2.99
6	Obtaining other finance at a reasonable cost of capital	2.98
7	Contributing to the organisation's profitability	2.50
8	Contributing to the organisation's attractiveness as a potential employer	2.37
9	Contributing to the organisation's attractiveness as a potential supplier	2.27

organisation's overall reputation' was the second highest criterion for influence, narrowly behind '*relationships with the investment community*'.

The response is skewed towards corporate governance having little influence on profitability, with 12% of respondents believing that corporate governance does not influence profitability at all, and only 2% viewing it as very influential. Within the FTSE listing categories, directors of FTSE 100 companies were more likely to believe corporate governance to be a significant influence on profitability than directors in the other categories.

DIRECTORS' OPINIONS ON THE EFFECT OF CHANGES IN THE COMBINED CODE

Responses suggest that the main changes in the revised Combined Code will have little positive effect on companies' ability to generate wealth. For example, 22% of directors agreed but 47% disagreed that '*a formal and rigorous annual evaluation*' of the board will help create wealth. Respondents indicated little satisfaction with the changes relating to independent non-executive directors (NEDs) and in particular the new view implied by the Code that independent directors cease to be independent once they have been a board member for nine years and should be removed. It may be stretching inference to interpret the results as meaning these Combined Code changes could destroy value but such an interpretation seems possible and may warrant further research. Respondents from FTSE 350 companies expressed the strongest views against removing independent NEDs after nine years.

Nearly 30% of respondents were of the view that the revised Code could reduce the international competitiveness of UK companies. When broken down by type of respondent, responses show that this view was expressed by 37% of finance directors, 21% of chairmen, and – most worryingly – 40% of respondents from FTSE 100 companies. Comments made about the Code reveal concern that the revised Code will lead to more, not less, emphasis on box ticking, which may explain the apprehension expressed about reduced international competitiveness.

THE REVISED COMBINED CODE AND THE ROLE OF NON-EXECUTIVE DIRECTORS

Under both Cadbury and the revised Code, NEDs should have an important role in helping to create wealth and it should be a cause of concern that only 37% of respondents considered that they do, while 30% did not. Only 27% of respondents from FTSE 100 firms agreed that '*NEDs play an important role in the organisation's ability to generate wealth*' compared with 41% of those from the FTSE 350 and 38% of those from outside the FTSE 350. This is a cause for concern because FTSE 100 companies have a higher proportion of NEDs on the board and FTSE 350 companies are being pushed to have more too.

DO INDEPENDENT NEDs PLAY AN IMPORTANT ROLE IN ESTABLISHING EFFECTIVE CORPORATE GOVERNANCE PRACTICE?

It seems that NEDs' main role is in establishing the appearance of governance practice rather than contributing to strategy and performance. There was strong agreement that independent NEDs play an important role in '*establishing effective corporate governance practice*': 79% of respondents agreed and only 3% disagreed with this statement.

INDEPENDENCE CRITERIA

The revised Code introduced new and more demanding criteria for establishing whether or not an NED is independent. Of those respondents who agreed that 'it is difficult to appoint truly independent NEDs', the highest proportion (35%) were from companies outside the FTSE 350. Many respondents accused the new approach of encouraging a 'tick box' attitude: 94%

agreed and only 1% disagreed that '*independence of mind* (ie objectivity and integrity) *is more important than independence in appearance* (ie meeting the compliance criteria)'.

THE EFFECT OF INCREASING THE PROPORTION OF INDEPENDENT DIRECTORS TO AT LEAST 50%

Derek Higgs (2003) recommends that boards should comprise at least 50% independent NEDs and this is now a requirement for FTSE 350 and above companies.

The results of this survey imply that many directors from boards who do not yet meet this requirement believe that doing so will lead to:

- NEDs becoming less involved in the business (30%)
- an adverse effect on team work and decision making (55%) and
- other directors having to leave the board in order to meet the 50% requirement (43%).

In conclusion, it appears that there are two distinct, but related, aspects of corporate governance: one is to do with direction and control and the other is to do with accountability to shareholders.

TWO SIDES OF CORPORATE GOVERNANCE

Some respondents viewed corporate governance simply in terms of a bureaucratic exercise while others viewed it as checks and balances to protect shareholders. A third group, however, viewed corporate governance as having a significant role in strategy and profitability.

This study suggests that the new Combined Code could have done more to ensure companies pay more attention to performance and make governance less of a box ticking exercise. Additionally, if the 29% of respondents who believed the revised Combined Code could reduce international competitiveness of UK companies are correct, the revised Code requires further change.

Corporate governance should be considered in the context of achieving objectives, how objectives are achieved and how risks are managed as well as how boards are accountable to, and engage with, shareholders. This research highlights the need to reconsider the approach to corporate governance and ensure that all parties in the process (including boards, shareholders and regulators) share a common understanding of what corporate governance is, what it should be expected to achieve and what it cannot be expected to achieve.

1. Introduction

The wave of corporate scandals in the early twenty-first century have led to unprecedented activity in corporate governance reform around the world. Globally, reform activities focus on:

- the structure of the board
- the role and independence of non-executive directors (NEDs)
- interaction of the board and NEDs with investors.

This implies that, although differences exist in the detail of reform activity undertaken (compare the US legislative response with the softer, principle-based approach adopted in most other countries, for example), there is global consensus on what constitutes good governance.

Less agreement is in evidence about the meaning and purpose of corporate governance. As is discussed in Appendix 1, a number of definitions exist (see, for example, Cadbury Committee 1992; OECD 1999; DoH 2001), but there are fine distinctions between them and none is universally accepted. Accordingly, corporate governance is viewed by commentators in various ways:

- in terms of structural arrangements rather than processes (Monks and Minow 2004)
- as an accountability issue having little to do with performance, strategy, objectives and performance measurement (eg International Federation of Accountants/Chartered Institute of Management Accountants 2004)
- as standards to meet or rules with which to comply (eg Pensions & Investment Research Consultants 2003)
- as a means of ensuring organisational effectiveness (eg Robinson 2001).

The principal aim of reform activity has been to restore trust in capital markets and those involved in them. Existing measures of governance, however, are better at considering structures and compliance with specified tests rather than performance or behaviour. The danger is that the lack of consensus over the role of corporate governance, particularly with respect to organisational effectiveness, may hinder the performance and thus the competitiveness of UK companies.

1.1 CORPORATE GOVERNANCE, BOARD BEHAVIOUR AND ORGANISATIONAL PERFORMANCE

However one considers corporate governance, getting it right would seem to be important to economic prosperity. Yet despite both this and the experience that poor corporate governance leads to organisational failure by destroying value, there is insufficient objective evidence that good governance will either (a) prevent further corporate failure or (b) contribute to improved organisational effectiveness.

Most of the research attempting to link governance with organisational wealth creation and thus with effectiveness has attempted to correlate governance practices and aspects of financial performance. This comprises the research into board or investor opinion on various aspects of governance and performance (see, for example, CBI/Touche Ross 1995; Dulewicz and Herbert 1997; McKinsey 2000 and 2002; Jenkins-Ferrett 2001), as well as statistical research aimed at identifying significant correlations between various governance and performance criteria (for example, Muth and Donaldson 1998; Bhagat and Black 2001; Gill 2001; Gompers et al. 2001; Newell and Wilson 2002; Bouer and Guenster 2003; Dulewicz

and Herbert 2003; Webley and More 2003; MacAvoy and Millstein 2003). No consensus, either in terms of results or method, has resulted.

Additionally, there is no convincing evidence supporting the changes required by revised corporate governance reform, particularly regarding the role of independent non-executive directors. Research conducted by Muth and Donaldson (1998), for example, suggests that where there are fewer independent non-executive directors and where the roles of chairman and CEO are combined, there is better financial outturn for shareholders. Dulewicz and Herbert (2003) find no evidence to support the principle that boards should have a majority of independent directors; their work also suggests a link between NEDs' length of tenure and financial performance.

This evidence not only refutes a generally accepted, fundamental principle of good governance: that the roles of chairman and chief executive should be separate, but also counters two important provisions of the new Combined Code, that boards of FTSE 350 companies should comprise at least 50% independent non-executive directors and that their length of tenure not exceed nine years.

There is some evidence that companies appearing to have good governance according to a variety of criteria also have a higher share price (see for example Newell and Wilson 2002). Share price depends on many factors, however, one of which is sentiment, so share price is a poor indicator of financial performance. As Monks and Minow (2004) argue, the basis of valuation of companies can 'in retrospect appear idiotic'.

Both company performance and corporate governance are not just combinations of many variables but are also the results of the enterprise of many people in an organisation working in a rapidly changing environment. Accordingly, attempts at measurement are problematic. There is lack of consensus over what constitutes good corporate governance and how it can be assessed. Similarly, although there are also many measures of financial performance, there is no single appropriate measure either of performance or effectiveness of governance.

There is a gap between accepted good practice regarding board behaviour and corporate governance and academic research of company performance; a full review of the literature in this area is given at Appendix 2.

1.2 AIMS OF THE RESEARCH

Elements added to the revised Combined Code (Financial Reporting Council 2003) reflect a convergence of practice not supported by academic research. New ways of assessing corporate governance performance are required or, as implied by Muth and Donaldson (1998) and Dulewicz and Herbert (2003), more imaginative models are needed. This research is intended as a contribution to the development of such a model by considering views on corporate governance and the creation of wealth held by chairmen and finance directors of leading UK companies. It is concerned with the hypothesis that good corporate governance contributes to improved organisational effectiveness in generating wealth.

This report includes results and analysis of an opinion survey conducted in Spring 2004 among senior business figures in the UK. Through eliciting and analysing their views, the survey was conducted with the aim of informing debate about corporate governance and the effect of UK reforms. It sought to understand the attitudes of directors to corporate governance, particularly in relation to the generation of wealth, and to explore their perceptions of the relationships between corporate governance and

corporate effectiveness in the medium to long term. An additional aim was to ascertain and analyse views on these new elements of the Code and opinions on any consequent effect on company success.

It is hoped this will aid the development of a theory about how corporate governance affects organisational success and on directors' attitudes to governance and the revised Code. The research was also intended to form a basis for further study and it is planned to conduct interviews with a sample of survey respondents to validate and further inform the findings.

1.3 PHILOSOPHY

Monks and Minow (2004) define the ultimate purpose of the corporation as the creation of long-term value. This research explores links between good corporate governance and factors that can lead to the creation of long-term value. The research literature suggests that such links are not obvious, although it may be possible to select two sets of criteria that show a significant correlation. Such attempts to find statistical correlations may be of doubtful benefit, so this research was deductive and sought to learn what can be inferred from a better understanding of attitudes of listed company directors to (i) governance and (ii) any link between governance and the new requirements of the revised Combined Code with company performance.

The research also explores whether directors' opinions have changed since the CBI/Touche Ross survey in 1995, when 46% of directors in a survey said the Code of the time would have an adverse effect on UK boards, compared with only 16% who said it would have a beneficial effect. No surveys have been identified that explore directors' attitudes to the new Combined Code.

1.4 THE REPORT

This report presents the results of the research in the following order:

Chapter 2 reviews who completed the survey and gives a breakdown of respondents by job role and size of company (ie FTSE listing category).

Chapter 3 reports respondents' attitudes to the purpose of corporate governance. In attempting to understand directors' primary attitude to corporate governance, the survey asked respondents to choose the main purpose of corporate governance from three options:

(i) '*protecting shareholders against loss*'

(ii) '*optimising the long-term financial ability of the organisation to create wealth*', or

(iii) '*(i) and (ii) are equally important*'.

Responses, along with the classifications of job role and FTSE listing size, are then used in the analysis of responses to other questions. To avoid needless repetition, these three categories of attitude to corporate governance are abbreviated, where context allows, to (i) 'protecting', (ii) 'optimising' and (iii) 'equal'.

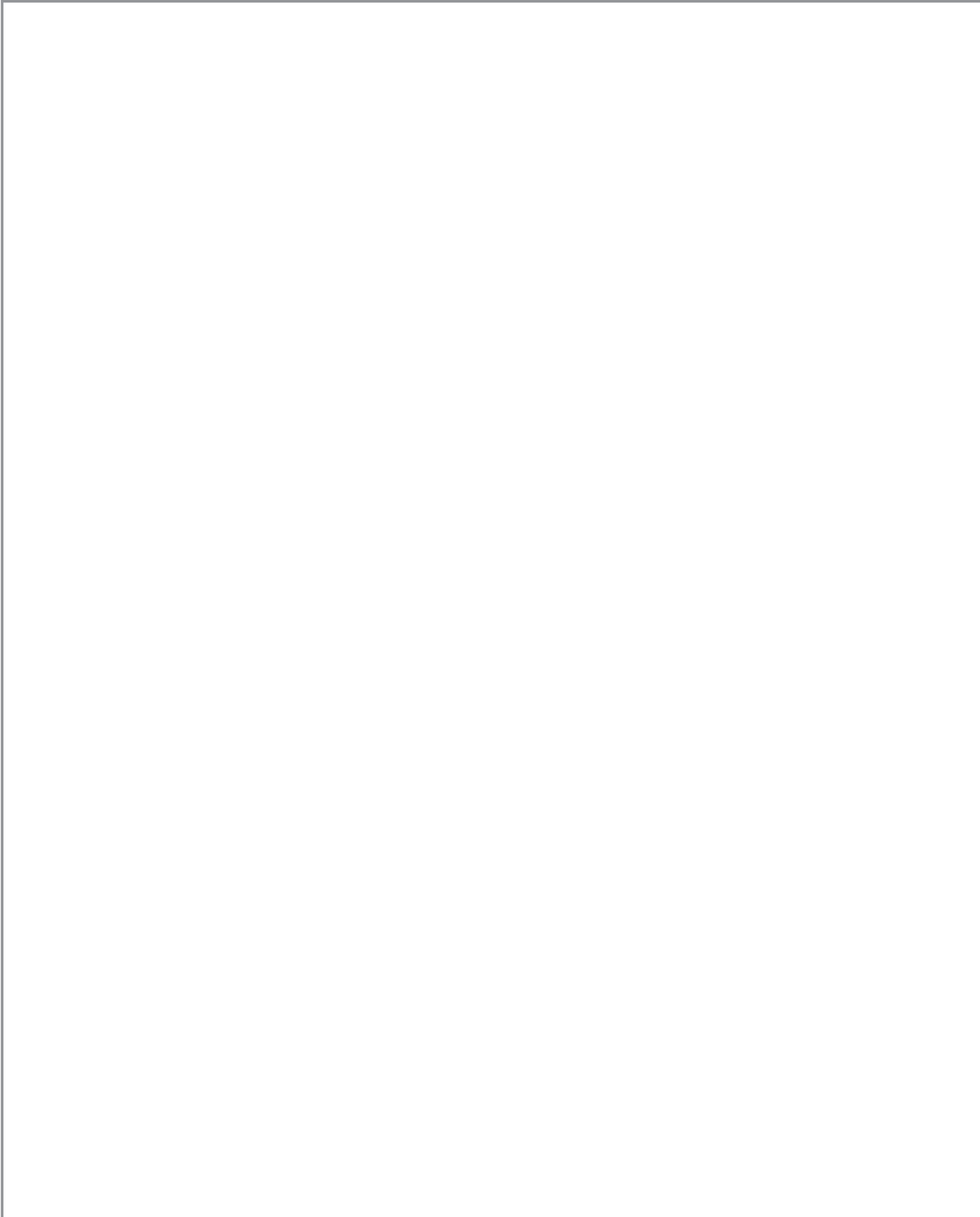
Chapter 4 reports the respondents' opinions of the aspects of corporate governance most important to their companies now and in the next five years.

Chapter 5 reports the respondents' own definitions of corporate governance

Chapter 6 discusses the influence of corporate governance on factors relevant to the generation of wealth.

Chapter 7 reports the respondents' opinions on the revised Combined Code.

Chapter 8 reports on views of the role of non-executive directors.



2. The survey response

The survey was completed by 91 of 1,650 chairmen and finance directors from the top 1,000 listed companies ranked by market value, a response rate of approximately 5.5%. Twenty-six respondents indicated their willingness to take part in a follow-up interview.

Slightly more chairmen than finance directors responded. Given that the survey emanated from a professional accounting association, response from finance directors had been expected to be greater than that from chairmen.

Of responses received, 21% were from the 100 companies comprising the FTSE 100 (representing 19% of that sector); 31% from the 250 FTSE 350 companies (representing 11% of that sector); and 48% from 650 companies outside the FTSE 350 but in the top 1,000 by market capitalisation (representing 7% of that sector). The relatively high response from FTSE 100 companies may suggest that such companies take corporate governance and their obligations towards transparency more seriously than smaller companies.

Figure 2.1: Job role of respondents

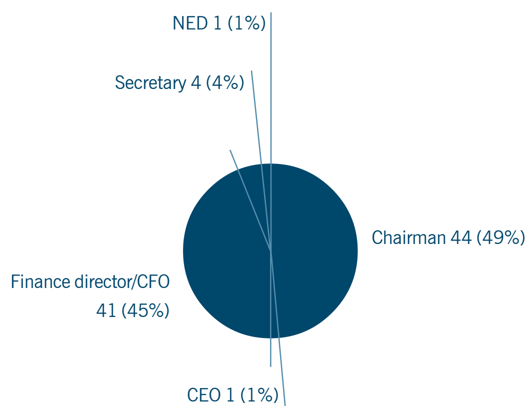
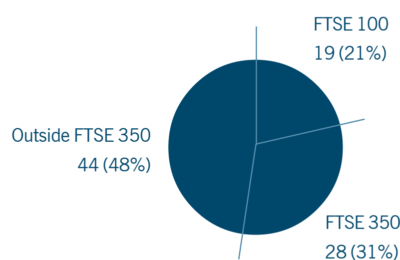


Figure 2.2: Position in FTSE listing



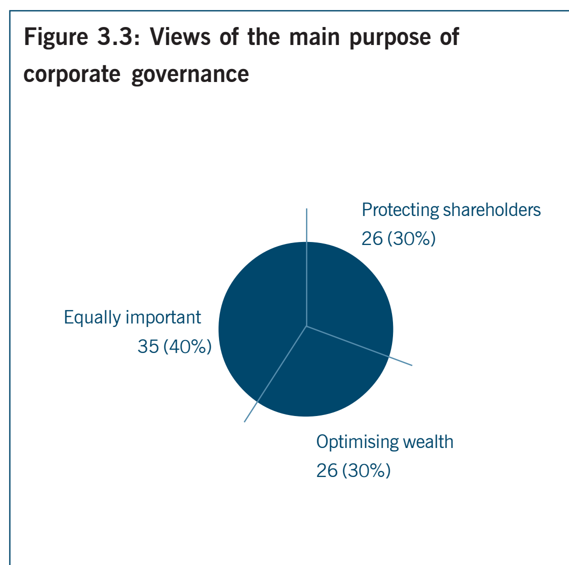
3. Attitudes of directors to the purpose of corporate governance

The main objective of this research was to understand directors' attitudes to corporate governance in relation to the generation of wealth. Individual attitudes towards particular aspects of corporate governance were expected to differ according to the view held of the main purpose of corporate governance. To identify these views for further analysis, respondents were asked to choose from three options for the main purpose of corporate governance.

Of those who responded, 30% indicated their belief that the 'main purpose of corporate governance' was '*protecting shareholders against loss*' while another 30% believed it to be *'optimising the long term financial ability of the organisation to create wealth'*; 40% viewed both purposes as *'equally important'.*

Relatively more directors from larger companies than smaller linked the purpose of corporate governance with generating wealth. Within the FTSE 100, 47% of directors viewed the 'main purpose of corporate governance' as 'optimising', compared with only 20% of directors from companies outside the FTSE 350. Also, within the FTSE 100 twice as many respondents believed the main purpose to be 'optimising' than believed it to be 'protecting'.

Figure 3.3: Views of the main purpose of corporate governance



A slightly higher percentage of chairmen viewed the main purpose as 'optimising' (30%) rather than 'protecting' (27%), compared with finance directors where the preference was slightly towards 'protecting' (34%) rather than 'optimising' (29%).

One respondent, who ticked 'equal' commented 'the dichotomy between "protecting from loss" and "optimising wealth" is more apparent than real. If wealth is not optimised, shareholders have suffered opportunity loss: wrapping the talent in a napkin and burying it did not please the master'. From 19 other comments on purpose, nine were negative about corporate governance, expressing associations such as 'over prescriptive', 'burdensome' and 'box ticking'. One comment stated baldly 'corporate governance will do nothing to prevent scandals'; another that 'the purpose is now concerned with being seen to obey the rules – although international shareholders still want short-term results'. Five positive comments were made, such as 'formalising good business practice' and 'the purpose should be to help the business to be successful about operating with proper ethics (lasting wealth creation)'. Four comments were regarded as neutral statements. Appendix 4 gives all comments made about purpose.

Anticipating that respondents would have other views about the purpose of corporate governance, the questionnaire invited respondents to rate the importance of 13 other purposes and an open question invited comments.

Table 3.1 (see page 18) shows how directors ranked the importance of other possible purposes of corporate governance.

The table shows there was near unanimity of ranking, with '*ensuring accountability of management to organisation owners*' as most important and '*improving share price*' as least important. There were some interesting variations, however, the biggest being on

Table 3.1: Rankings of importance of different purposes of corporate governance

	Unfiltered	FTSE 100	FTSE 350	Outside FTSE 350	Chairmen	FDs	Protection	Optimising wealth
Ensuring accountability of management to organisation owners	1	1	1	1	1	1	2	1
Providing assurance that internal control is effective	2	3	4	2	3	2	3	6
Maintaining ethical integrity	3	2	2	4	4	3	4	3
Improving risk management	4	5	10	3	6	5	5	7
Ensuring financial reporting is correct	5	4	6	4	2	8	6	4
Getting board appointments and succession right	6	6	5	9	5	8	7	9
Improving management	7	7	6	6	8	6	10	4
Improving the board	8	9	6	7	7	11	9	7
Improving strategic or organisational effectiveness	8	8	10	7	10	7	12	2
Satisfying the needs of regulators	10	11	3	11	11	4	1	13
Enabling non-executive directors to function effectively	11	10	6	9	9	8	8	10
Providing assurance to directors	12	13	12	12	12	12	11	11
Improving share price	13	12	13	13	13	13	13	11

the importance of '*satisfying the needs of regulators*'. Directors who viewed the main purpose of corporate governance as protecting shareholders ranked '*satisfying the needs of regulators*' as most important, whereas those who believed that the main purpose is to '*optimise wealth*' ranked this as least important.

Respondents from the FTSE 350 companies viewed '*satisfying the needs of regulators*' as third most important, whereas FTSE 100 directors, as well as those from outside the FTSE 350, ranked this eleventh out of 13. '*Satisfying the needs of regulators*' could be regarded as a bureaucratic exercise with no intrinsic merit; certainly it has little relevance to organisational performance.

It is perhaps scarcely surprising that directors who viewed the main purpose of corporate governance as 'optimising' wealth ranked '*improving strategic or organisational effectiveness*' as the second most important purpose. Those who viewed 'protecting' shareholders as the main purpose ranked this twelfth out of 13. This appears to highlight a sharp contrast of view. Improving strategic or organisational effectiveness is important to any organisation and 30% of respondents regarded this as the second most important purpose of corporate governance but an equal proportion regarded the subject as unrelated.

Further evidence for the possibility of two very different views of the purpose of corporate governance is found in the ranking of the importance of 'improving management'. Directors who considered 'optimising' to be the '*main purpose of corporate governance*' ranked 'improving management' fourth; directors who considered the main purpose to be 'protecting', ranked this tenth.

There are only two other areas that reveal a difference of at least six places in rankings by different groups. One is ranking of the importance of 'improving risk management' as a purpose of corporate governance. FTSE 350 directors ranked this tenth out of 13 whereas directors from outside the 350 ranked this as third most important. The other is '*importance of ensuring financial reporting is correct*'. Chairmen ranked this second in importance whereas finance directors ranked it eighth. This probably reflects concerns of chairmen about financial reporting post-Enron, whereas finance directors, who are more involved in the subject, may think that getting financial reporting right is a matter that chronologically preceded interest in corporate governance.

What is clear from the comments is that there is a wide range of views about the purpose and possible benefits of corporate governance. This appears to support Dulewicz and Herbert's (1997) view of an uneasy equilibrium between value-adding behaviour and matters designed to protect shareholders.

4. The importance of corporate governance

Respondents were asked to indicate how important various aspects of corporate governance are to their companies, both now and in the next five years.

The 14 aspects provided in the survey were based on the author's analysis of matters that have received attention in the press, from code drafters, from the accounting profession and from regulators following the demise of Enron. Several, but not all, of the aspects are relevant to wealth generation; others are more about accountability.

The question investigated the aspects directors considered to be important and allows analysis of responses by role, size of company and views on the primary purpose of corporate governance. A Likert scale was used to elicit views of importance, using a scale of 1 to 5 where 1 is not at all important and 5 is very important; 88 people answered this question.

In Table 4.1 (see page 22), the unfiltered results show that the most important aspects of corporate governance were '*strategy and goals*' and '*financial reporting (disclosure)*' followed by '*relationships with institutional shareholders*' and '*the quality of the external auditors*'. Table 3.1 (see page 18) shows that '*improving strategic and/or organisational effectiveness*' was ranked second by directors preferring 'optimising' as the main purpose of corporate governance and twelfth out of 13 by directors preferring 'protecting'. It is therefore surprising that '*strategy and goals*' ranked joint first in importance in Table 4.1. One possible explanation is that directors preferring 'protecting' did not associate corporate governance with strategy.

'*Compliance with corporate governance practices*' and '*disclosure of corporate governance practices*' appeared to be the criteria with least importance to respondents. Table 3.1 shows that 'protecting' respondents ranked '*satisfying the needs of regulators*' as the most important purpose of corporate governance. It is curious therefore that '*compliance with corporate governance practices*' was viewed as one of the least important in the responses, shown in Table 4.1. Perhaps we can infer that 'protecting' respondents also viewed corporate governance as being of little importance to companies? Similarly it is surprising that most categories of respondent viewed '*disclosure of corporate governance practices*' (a prime means of demonstrating accountability) as relatively unimportant, given their view that '*ensuring accountability of management to organisation owners*' is the most important purpose of corporate governance. It is important to avoid jumping to conclusions in trying to interpret these results; follow-up interviews with respondents will investigate this issue further.

Tables 4.2, 4.3 and 4.4 (see pages 23–25) show responses in relation to the main purpose of corporate governance (ie 'optimising' or 'protecting'), job role and listing size.

In view of stark differences between 'protecting' and 'optimising' directors elsewhere it is perhaps surprising that ranking differences in Table 4.2 exceeded five in only two instances. One is in '*board accountability and performance*', which respondents preferring 'protecting' ranked eleventh and those preferring 'optimising' ranked fourth in the next five years, although the ranking for 'at present' was tenth by both categories of respondent. The other is '*succession management for the board*', where there was little difference in ranking for 'the next five years' but which respondents preferring 'protecting' ranked eleventh now and those preferring 'optimising' ranked fifth.

Although responding chairmen on average marked the factors higher than the finance directors, there is little difference in Table 4.3 in the highest and lowest rankings. The only notable difference in ranking is for '*the calibre and effectiveness of the*

Table 4.1: The importance of different aspects of corporate governance to companies

	At present			In next five years		
	Response average	Standard deviation	Rank	Response average	Standard deviation	Rank
Financial reporting (disclosure)	4.33	0.98	1	4.4	0.97	2
Strategy and goals	4.33	1.08	1	4.42	0.98	1
The quality of the external auditors	4.08	0.97	3	4.21	0.88	4
Relationships with institutional shareholders	4.05	0.95	4	4.26	0.82	3
The risk management processes	3.91	1.00	5	4.2	0.82	5
The calibre and effectiveness of the audit committee	3.85	0.95	6	4.0	0.85	9
The independence of the external auditor	3.83	0.99	7	3.93	0.99	11
Getting directors' remuneration right in relation to suitable performance criteria	3.79	0.95	8	4.08	0.85	7
Board accountability and performance	3.78	1.01	9	4.08	0.83	8
The composition of the board	3.78	1.02	10	3.98	0.93	10
Succession management for the board	3.67	1.09	11	4.16	0.91	6
Independence of non-executive directors	3.41	1.18	12	3.69	1.02	12
Compliance with corporate governance practices	3.35	1.02	13	3.64	0.98	14
Disclosure of corporate governance practices	3.27	1.11	14	3.65	1.07	13

Table 4.2: The importance of different aspects of corporate governance to companies (filtered by main purpose of corporate governance)

	At present				In next five years			
	Protecting shareholders		Optimising wealth		Protecting shareholders		Optimising wealth	
	Response Average	Rank	Response Average	Rank	Response Average	Rank	Response Average	Rank
Financial reporting (disclosure)	4.35	1	4.15	2	4.42	1	4.28	4
Strategy and goals	4.12	2	4.38	1	4.23	3	4.48	1
The risk management processes	3.92	3	3.96	4	4.19	4	4.32	2
Relationships with institutional shareholders	4.08	3	3.84	7	4.31	2	4.17	6
The quality of the external auditors	4.00	4	4.15	2	4.04	7	4.32	2
The independence of the external auditor	3.85	6	3.92	5	3.92	10	4.00	8
The composition of the board	3.81	7	3.73	10	3.96	5	4.00	8
Getting directors' remuneration right in relation to suitable performance criteria	3.81	7	3.84	7	4.08	6	3.96	11
The calibre and effectiveness of the audit committee	3.77	9	3.77	9	3.85	12	3.96	10
Board accountability and performance	3.73	10	3.73	10	3.88	11	4.28	4
Succession management for the board	3.69	11	3.85	6	4.12	5	4.16	7
Disclosure of corporate governance practices	3.54	12	3.23	14	3.96	8	3.52	13
Compliance with corporate governance practices	3.38	13	3.27	13	3.77	13	3.48	14
Independence of non-executive directors	3.12	14	3.62	12	3.65	14	3.71	12
Sum of averages	**53.2**		**53.41**		**56.38**		**56.64**	

The sum of averages indicates where one analysis subgroup has tended to give higher absolute scores for governance than another.

Table 4.3: The importance of different aspects of corporate governance to companies (filtered by role)

	At present				In next five years			
	Chairmen		Finance directors		Chairmen		Finance directors	
	Response average	Rank	Response average	Rank	Response average	Rank	Response average	Rank
Financial reporting (disclosure)	4.41	1	4.26	1	4.49	1	4.32	2
Strategy and goals	4.36	2	4.26	1	4.42	2	4.39	1
The quality of the external auditor	4.14	3	4.05	3	4.26	5	4.21	3
Relationships with institutional shareholders	4.12	4	3.95	4	4.38	3	4.13	4
The calibre and effectiveness of the audit committee	4.11	5	3.54	10	4.23	8	3.74	11
The independence of the external auditor	4.0	6	3.64	6	4.09	11	3.76	9
The risk management processes	4.0	6	3.74	5	4.28	4	4.05	5
Getting directors' remuneration right in relation to suitable performance criteria	3.95	8	3.59	8	4.21	9	3.92	7
Board accountability and performance	3.93	9	3.56	9	4.26	5	3.87	8
The composition of the board	3.84	10	3.64	6	4.12	10	3.76	9
Independence of non-executive directors	3.77	11	2.97	14	4.0	12	3.37	13
Succession management for the board	3.77	11	3.46	11	4.26	5	4.0	6
Compliance with corporate governance practices	3.59	13	3.08	12	3.81	14	3.47	12
Disclosure of corporate governance practices	3.43	14	3.03	13	3.88	13	3.37	13
Sum of averages	**55.42**		**50.77**		**58.69**		**54.36**	

Table 4.4: The importance of different aspects of corporate governance to companies (filtered by FTSE listing)

	At present			In next five years		
	FTSE 100	FTSE 350	Outside	FTSE 100	FTSE 350	Outside
	Rank	Rank	Rank	Rank	Rank	Rank
Financial reporting (disclosure)	1	1	2	1	6	2
Strategy and goals	2	1	1	2	5	1
The risk management processes	3	8	5	3	11	3
Getting directors' remuneration right in relation to suitable performance criteria	4	11	8	4	8	7
Relationships with institutional shareholders	4	3	4	5	2	4
The quality of the external auditors	6	4	3	6	1	5
The calibre and effectiveness of the audit committee	6	4	10	6	7	10
Board accountability and performance	8	7	9	9	3	8
The composition of the board	9	10	7	10	9	9
Succession management for the board	9	8	11	6	4	6
The independence of the external auditor	9	6	6	11	9	10
Independence of non-executive directors	12	14	12	12	13	12
Compliance with corporate governance practices	13	12	13	13	13	13
Disclosure of corporate governance practices	14	13	14	13	12	14

audit committee', which chairmen regarded as relatively more important than did finance directors.

Opinions of respondents (Table 4.4, see page 25) within the FTSE 100 seem to have more in common with those of respondents outside the FTSE 350 than with those of respondents within the FTSE 350. FTSE 100 and outside-FTSE 350 respondents had common top two and bottom two priorities. There are more differences of five or more in ranking between FTSE 100 respondents and FTSE 350 respondents. There is a particular difference in attitudes held towards risk management, which FTSE 350 respondents regarded as less important, relatively, than either FTSE 100 or outside-FTSE 350 respondents.

It is not surprising that respondents from FTSE 100 companies were more concerned with directors' remuneration, given the media focus on FTSE 100 chief executives as 'fat cats'. It would be useful to research why the responses of FTSE 350 directors are so dissimilar to the other two groups. Perhaps FTSE 350 company executives sense greater pressure, having fewer resources than their FTSE 100 counterparts to devote to corporate governance compliance issues.

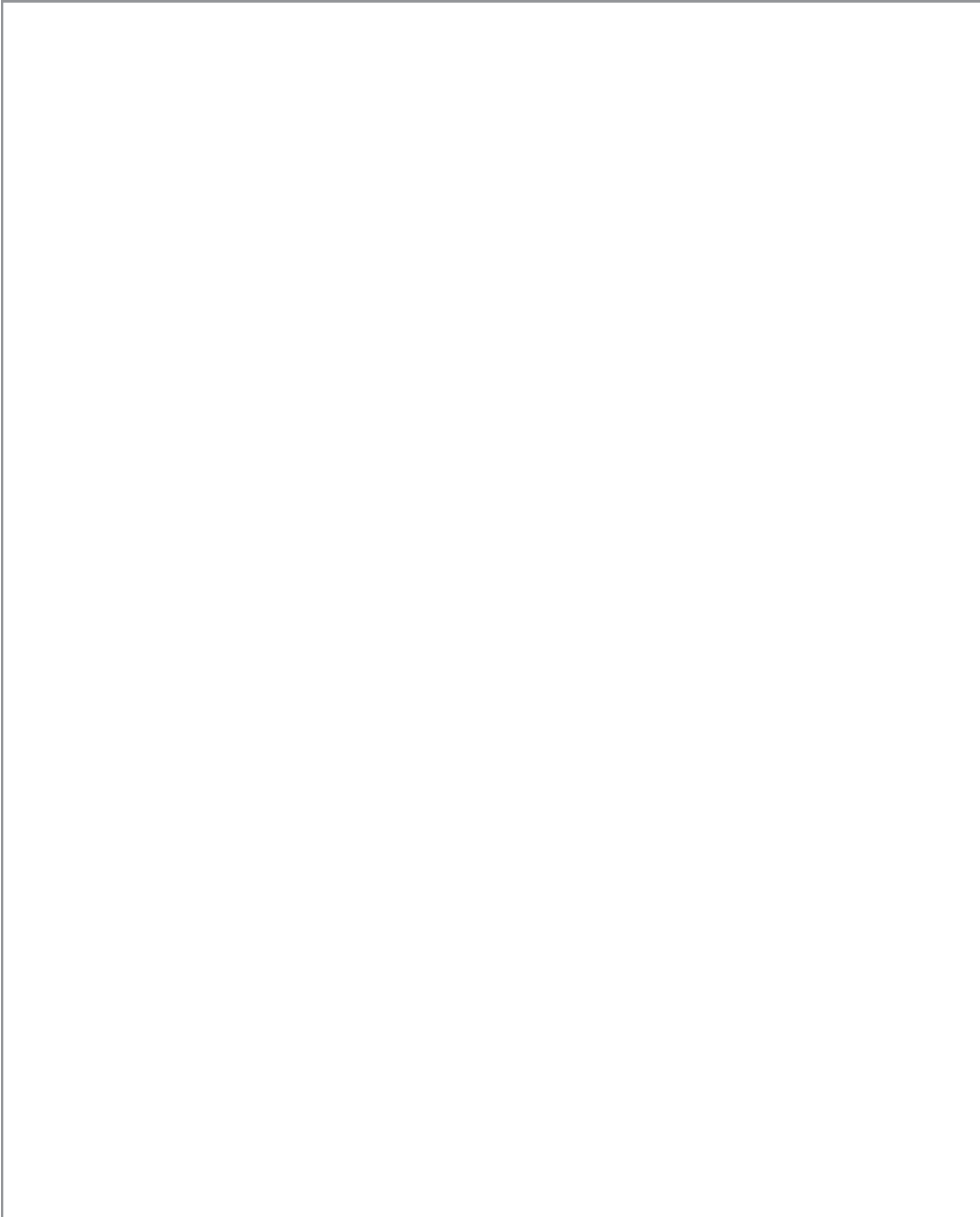
5. Definitions of corporate governance

Respondents were asked to give their own definition of corporate governance. Sixty-four definitions were given, reproduced in Appendix 6. A form of template analysis was carried out in which the frequency of key words or concepts in the definitions was noted. The results in Table 5.1 show the variety of responses. Many of these are considerably more detailed than the Cadbury definition, although several definitions are similar. Nearly half the respondents referred to shareholders and a third referred to the concept of integrity, honesty or ethics. A fifth used phrases such as value, performance and profit – one respondent simply defined corporate governance as 'ensuring long-term wealth creation'. Just over 10% of respondents defined corporate governance negatively, using words such 'burden', 'box ticking' and 'bureaucracy'.

The wide variety of definitions appears to confirm that respondents held very different views of what corporate governance is. It is unsurprising therefore that there were different views on whether corporate governance contributes to the generation of wealth.

Table 5.1: Definition of corporate governance – template analysis

Phrases and concepts used by respondents	Frequency of occurrence	Rank
shareholders	28	1
ethics, integrity, honesty	18	2
value, profit, performance	12	3
control	11	4
processes	10	5
stakeholders	9	6
objectives, strategy	8	7
accountability	7	8
box ticking, bureaucracy, burden	7	8
transparency	7	8
checks and balances	6	11
risk management	6	11
balance	5	13
best practice	5	13
monitoring	3	15
roles and responsibilities	3	15
independence	2	17
'protecting shareholders'	2	17
stewardship	2	17
structures	2	17
challenge	1	21
external scrutiny	1	21
formalise	1	21
reporting	1	21



6. The influence of corporate governance on factors relevant to the generation of wealth

Monk and Minows (2004) argue that what matters is a company's ability to obtain capital necessary for production of goods and services which can be sold for a profit. They assert that there is no magic monitor of this ability, but indicators that can predict tomorrow's value are more important than imperfect measures of today's value.

The questionnaire asked respondents to indicate how much good corporate governance practice influences nine aspects of direct and indirect relevance to a company's ability to generate wealth. Ninety respondents answered this question.

Respondents were requested to score using a Likert scale of 1 to 5 where 1 is 'not at all influential' and 5 is 'very influential'. Descriptive labels were not offered for scores 2 to 4 but for analysis purposes the scale is assumed to mean:

1 not at all influential
2 slightly influential
3 moderately influential
4 significantly influential
5 very influential.

Table 6.1 (see page 30) shows the average response and standard deviation for the unfiltered results and the average responses filtered according to main purpose of corporate governance and FTSE listing. The responses filtered by job role have not been shown as there is relatively little difference between the scores of chairmen and those of finance directors.

Note that respondents who considered 'optimising' as the main purpose allocated scores on average almost 11% higher than those who considered the main purpose to be 'protecting'. FTSE 350 respondents allocated scores on average some 6% less than others.

Figures 6.1, 6.2 and 6.3 (see pages 31–32) show the frequency distribution of unfiltered responses for all nine questions.

6.1 PROFITABILITY

The response is clearly skewed towards the view that corporate governance has little influence on profitability: 12% of respondents were of the opinion that corporate governance has no influence at all on profitability and only 2% viewed the effect as very influential.

Table 6.2 (see page 33) shows that those who said the main purpose of corporate governance is to '*optimise ability to create wealth*' believed that corporate governance has more influence on profitability than those who said that the main purpose is to '*protect shareholders*' or those who said that both are '*equally important*'.

Within the FTSE listing categories, respondents from FTSE 100 companies believed that corporate governance has more influence on profitability than did others. Additionally, they believed it has more influence on profitability than did all those indicating the purpose is to 'optimise'.

6.2 LONG-TERM SHARE PRICE

Figure 6.1 (see page 31) shows that respondents believed that corporate governance has more influence on long-term share price than on profitability. The unfiltered average is 3.16. Once again the group who saw the strongest influence was the one that preferred 'optimising wealth' as the main purpose of corporate governance. Respondents from companies outside the FTSE 350 were most concerned about the influence on share price but those from within the FTSE 350 appear to have been less concerned than those in either of the other categories.

It is curious that in Table 3.1 (see page 18), most directors ranked '*improving share price*' bottom of a list of possible purposes of corporate governance even though there is some evidence that corporate

Table 6.1: How influential is corporate governance practice in…

	No filter		Main purpose		FTSE listing		
			Protecting	Wealth	FTSE 100	FTSE 350	FTSE 350+
Score	Average	Standard deviation	Average	Average	Average	Average	Average
Performance							
Contributing to your organisation's long-term share price	3.16	0.94	3.0	3.4	3.11	3.07	3.23
Contributing to your organisation's strategic and/or operational effectiveness	2.99	0.95	2.77	3.36	2.89	3	3.02
Contributing to your organisation's profitability	2.5	0.94	2.23	2.76	2.84	2.37	2.43
Finance and investment							
Maintaining or improving relationships with the investment community	3.71	0.95	3.69	3.92	3.68	3.59	3.8
Obtaining investment from institutional investors	3.53	0.95	3.6	3.56	3.21	3.37	3.77
Obtaining other finance at a reasonable cost of capital	2.98	1.03	2.96	3.08	2.89	2.74	3.16
Reputation							
Contributing to your organisation's overall reputation	3.67	0.94	3.46	3.84	3.89	3.41	3.73
Contributing to your organisation's attractiveness as a potential employer	2.37	1.04	2.12	2.52	2.63	2.3	2.3
Contributing to your organisation's attractiveness as a potential supplier	2.27	1.11	2.15	2.36	2.37	2.19	2.27

governance does contribute to improved share price and directors considered that corporate governance has an influence on share price. If boards exist to create value for shareholders, one might expect this purpose to have a higher ranking.

6.3 STRATEGIC AND/OR OPERATIONAL EFFECTIVENESS

The unfiltered average score is 2.99 and scores are almost symmetrically distributed around this average. Again, those who said the main purpose of corporate governance is to '*optimise ability to create wealth*' believed that corporate governance has the strongest influence. Respondents from companies with a smaller market value appear to have had slightly stronger views than those from larger companies about the influence of corporate governance on strategic and/or operational effectiveness.

Although the questions posed were slightly different, these results appear unsupportive of Jenkins-Ferrett's (2002) finding that 83% of directors in South Africa rated corporate governance as important or of utmost importance in contributing to organisational performance. Additionally, they suggest that UK attitudes have changed since 1995, when CBI/Touche Ross found that 90% of chairmen and CEOs surveyed believed that the Cadbury Code had no positive effect on financial performance.

Figure 6.2 (see page 32) shows that respondents believed that corporate governance has more influence on matters relating to finance and investment than on organisational performance. This is seen particularly in relation to '*obtaining investment from institutional investors*' and '*maintaining or improving relationships with the investment community*', which scored higher than any of the other criteria. Those who viewed the

Figure 6.1: Company performance

How influential is good corporate governance practice in contributing to profitability, long-term share price and strategic and/or operational effectiveness?

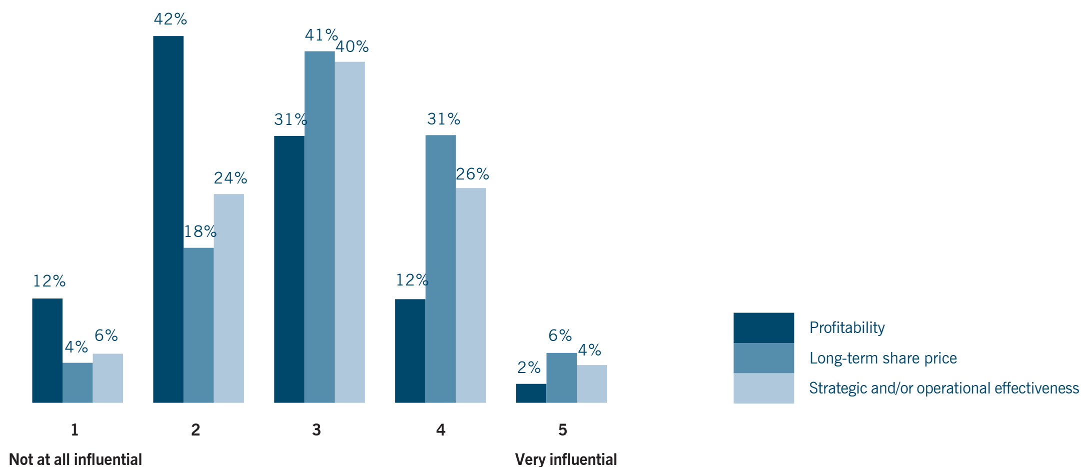


Figure 6.2: Finance and investment

How influential is good corporate governance practice to obtaining investment from institutional investors, obtaining other finance at a reasonable cost of capital and maintaining or improving relationships with the investment community?

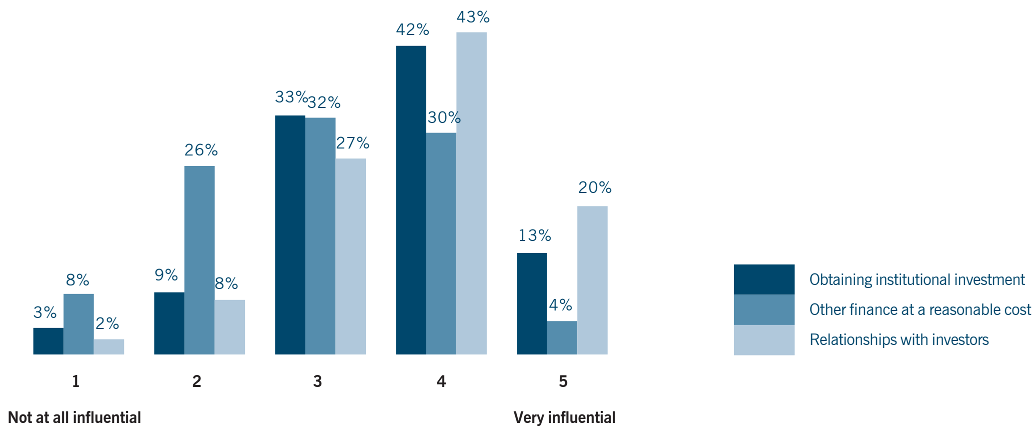
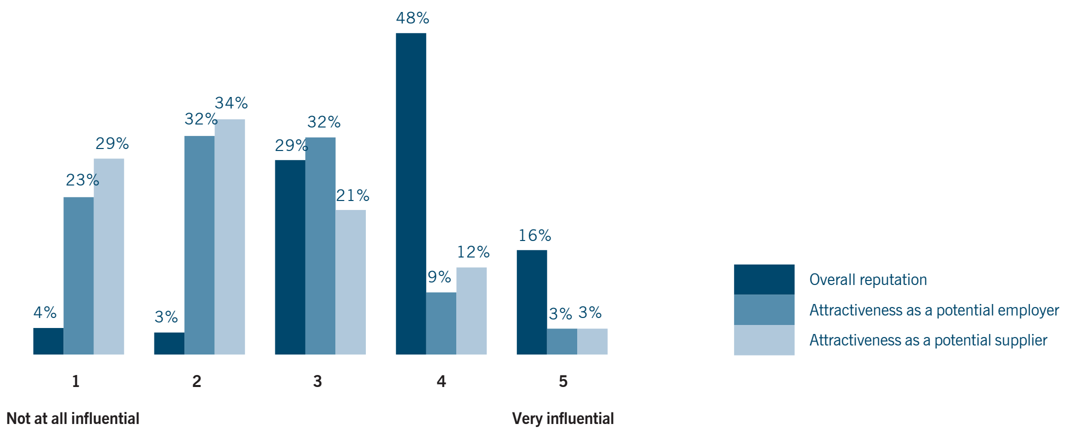


Figure 6.3: Reputation

How influential is good corporate governance practice in contributing to overall reputation, and attractiveness as a potential employer or supplier?



main purpose of corporate governance as being to *optimise ability to create wealth* also indicated a view that corporate governance has more influence on '*maintaining or improving relationships with the investment community*' than on any of the other eight options. The same respondents gave higher scores for influence than those who viewed the main purpose as being to 'protect shareholders', for all nine options except '*obtaining investment from institutional investors*' although the difference is insignificant.

Higher scores were given by respondents from companies outside the FTSE 350. This suggests that corporate governance is viewed as having greater relevance to finance and investment in smaller companies.

'*Contributing to your organisation's overall reputation*' is the second highest criterion for influence, narrowly behind '*relationships with the investment community*'. Reputation in the eyes of employees and customers is not, however, part of respondents' consideration of overall reputation, as these criteria appear bottom of the nine choices.

6.4 ROLE IN ORGANISATION

As mentioned above, there are few notable differences in the scores of chairmen and finance directors responding. Chairmen tended to give more weight than finance directors to the influence of corporate governance: an average score of 3.09 compared with 2.97. The biggest differences are for '*contributing to your organisation's strategic and/or operational effectiveness*' (chairmen's mean 3.14 compared with 2.83 for finance directors) and '*Maintaining or improving relationships with the investment community*' (chairmen's mean 3.86 compared with 3.59 for finance directors). Finance directors gave more weight only to '*obtaining finance at reasonable cost of capital*' (3.1 compared with 2.95).

Table 6.2: How influential is corporate governance in contributing to profitability?

		Influence			
Main purpose of corporate governance	**Average score**	**3 Moderately**	**4 Strongly**	**5 Very**	**Total % scoring 3 to 5**
Protecting shareholders	2.23	23%	8%	0%	31%
Optimising wealth	2.76	40%	16%	4%	60%
Equally important	2.6	34%	11%	3%	48%

7. Directors' opinions on the effect of changes in the Combined Code

Respondents were asked to indicate their agreement or disagreement with various statements about the main changes in the 2003 Combined Code on a scale of 1 to 5 (where 1 was 'disagree strongly' and 5 was 'agree strongly'). The purpose of the question was to elicit views on whether the changes will help companies improve their ability to generate wealth and on the effect of certain other changes. All 91 respondents answered this question; responses are shown in Table 7.1 (see page 36).

The requirement for boards to have an annual evaluation was first included in a corporate governance code by the King Committee of the Institute of Directors (2002) in South Africa and was already included as best practice in 1995 by the UK Institute of Directors in its *Standards for the Board* (2001). At the time of writing (2004), the Institute of Internal Auditors is asking its members whether their boards conduct an evaluation. Initial findings based on 109 responses from private and public companies in the US, Canada, Australia and UK are that 36% conduct a formal or informal assessment and a further 15% are developing an assessment procedure.

It is surprising that only 22% of respondents agreed but 47% disagreed that such evaluation would help create wealth. It is possible that those who disagreed with the statement did so because they had already carried out an evaluation. If this is the case it could indicate that they did not find evaluation beneficial. In testing the IoD standards, Dulewicz and Herbert (1997) report that 72% of their respondents regarded evaluation of senior management as vital and that 77% regarded the adoption of performance measures for the board as vital. In later research, Dulewicz and Herbert (2003) identify that such activities have a slightly negative correlation with financial performance. Perhaps such a review is unhelpful to performance. Intuitively, however, one would expect annual evaluation of the board, if done well, to result in a more successful company.

Responses to statements in Table 7.1 (see page 36) suggest that the main changes in the revised Combined Code will have little effect on companies' ability to generate wealth. The survey anticipated that respondents might hold such views and so investigated whether respondents believed that the changes will be unhelpful to companies' ability to create wealth.

Respondents were invited, if they had disagreed with any of the statements in Table 7.1, to indicate their level of agreement with various statements concerning changes in the Combined Code. Their opinions are given in Table 7.2 (see page 37).

It appears that many respondents were particularly unhappy with the requirement that at least 50% of NEDs should be independent, the independence criteria and in particular the new view, implied by the Code, that independent directors cease to be independent once they have been board members for nine years and so should be removed. It may be stretching inference to interpret the results as meaning these Combined Code changes could destroy value but such an interpretation seems possible and may warrant further research. Respondents from FTSE 350 companies expressed the strongest reservations about removing NEDs after nine years.

It should be a cause for concern that nearly 30% of respondents said that the revised Code could reduce the international competitiveness of UK companies. This view was held by 37% of finance directors, 21% of chairmen and, most worryingly, by 40% of respondents from FTSE 100 companies. As discussed in the review of literature (Appendix 2), in 1995 the CBI/Touche Ross survey found that 46% of chairmen and chief executives said that the Cadbury and Greenbury codes would have an adverse effect on boards. The CBI/Touche Ross survey (1995) also found that 90% of respondents said that the Codes would have no positive effect on financial performance. In this (current) research, only 53% disagreed with the

Table 7.1: Opinions on changes in the Combined Code (positive statements)

	Response average	Standard deviation	Disagree %	Agree %
It will be easier for the organisation to create wealth if we give more attention to corporate governance performance and practice than to compliance with corporate governance rules	3.53	0.9	10%	58%
Overall, the 2003 Combined Code will improve the accountability of UK companies to shareholders	3.43	0.91	13%	51%
Overall, the 2003 Combined Code will lead to improved ethical integrity within UK companies	3.1	1.08	24%	40%
The new requirement for the board to undertake a formal and rigorous annual evaluation should help improve my organisation's ability to create wealth	2.6	1.05	47%	22%
The 2003 Combined Code will lead to the improved international competitiveness of UK companies	2.43	0.94	53%	12%
The stronger requirement for institutional shareholders to consider explanations by companies why they are not complying with a particular Code provision will be helpful to my organisation's ability to create wealth	2.33	1.02	57%	15%
Having at least half a board of independent NEDs will help to improve my organisation's ability to create wealth	2.24	1.01	62%	12%
The greater detail, given in the Code, on the role of NEDs, will help to improve my organisation's ability to create wealth	2.19	0.94	64%	8%
Ensuring that independent NEDs do not serve on the board for longer than nine years will help to improve my organisation's ability to create wealth	2.08	1.06	64%	12%
The new criteria for considering the independence of NEDs will help to improve my organisation's ability to create wealth	2.07	0.85	69%	6%

Table 7.2: Opinions on changes in the Combined Code (negative statements)

	Response average	Standard deviation	Disagree %	Agree %	No. of responses
Overall, I feel I am spending too much time on the corporate governance process at the expense of wealth generation	3.97	0.99	9%	72%	78
Removal of independent NEDs so that they do not serve on the board for longer than nine years is not helpful to my organisation's ability to create wealth	3.69	1.07	16%	59%	80
The new criteria for considering the independence of NEDs are not helpful to my organisation's ability to create wealth	3.59	1.09	19%	58%	80
Increasing the proportion of independent NEDs to at least 50% is not helpful to my organisation's ability to create wealth	3.36	1.19	24%	48%	80
The enhanced instructions to institutional shareholders to consider explanation by companies in the event of non-compliance with a Code provision are not helpful to my organisation's ability to create wealth	3.28	1.01	20%	39%	80
Overall, the 2003 Combined Code could reduce the international competitiveness of UK companies	2.85	1.01	40%	29%	80
Overall, the 2003 Combined Code could reduce the accountability of UK companies to shareholders	2.3	1.04	66%	8%	77
Overall, the 2003 Combined Code could reduce ethical integrity within UK companies	2.1	0.89	68%	6%	80

statement '*the 2003 Combined Code will lead to the improved international competitiveness of UK companies*'. Although the questions are different, this suggests that directors' opinions may be slightly less negative than they were nine years ago.

Of those respondents who viewed the main purpose of corporate governance as 'protecting', 40% believed that the revised Code could reduce international competitiveness, whereas 30% of those who viewed its main purpose as 'optimising' believed this. This is nonetheless alarming: the fact that as many as 30% of those believing that the main purpose of corporate governance is to optimise wealth also believed that the revised Combined Code could reduce international competitiveness may indicate a perception of flaws in the Code.

From some of the comments made about the Code changes, it seems that besides disagreement with criteria for independence, a number of respondents were concerned that the revised Code will lead to more, not less, emphasis on box ticking. This may be part of the concern about reduced international competitiveness.

As one chairman commented: 'The whole process of corporate governance, which should have as its aim wealth creation, has been sidetracked onto red tape procedure and perception. British business will not be more successful as a result of this'.

Although the majority of the 26 comments received about the revised Code were negative and there were clearly a number of matters for concern about the revised Code, some respondents were positive about it, saying for example that, 'directionally it is right' or, 'changes tend [to be] in the right direction'.

All the comments on the revised Code are included in Appendix 5.

8. The revised Combined Code and the role of non-executive directors

As many of the revisions in the Code concern the role of non-executive directors (NEDs), this survey also explored views on the role of NEDs and ascertained whether respondents' companies already complied with one of the key new requirements of the Combined Code: that at least 50% of a board, excluding the chairman, should comprise independent NEDs.

8.1 DO NEDs CONTRIBUTE TO THE GENERATION OF WEALTH?

Respondents were asked to indicate on a scale of 1 to 5 their agreement or disagreement with eight statements about non-executive directors, where 1 is 'disagree strongly' and 5 is 'agree strongly'. A significant part of the changes to the Combined Code relates to the role of independent NEDs. The purpose of this question was to elicit views on NEDs, including views on their role in the creation of wealth. Ninety respondents answered this question, shown in Table 8.1 (see page 40).

Views on whether '*NEDs play an important role in the organisation's ability to generate wealth*' were mixed, with slightly more agreeing than disagreeing that they play an important role. It is worth remembering that, in the Cadbury Report (1992), the role of NEDs is defined as being to 'bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct'. The Higgs Report (Higgs 2003) and the revised Combined Code (Financial Reporting Council 2003) both continue to include the strategic role but add that NEDs should also 'satisfy themselves on integrity of financial information and that financial controls and systems of risk management are robust and defensible'. It is clear from both Cadbury and the revised Code that NEDs should have an important role in helping to create wealth and it should be a cause of concern that 30% of respondents said they do not. One respondent commented that 'non execs do not know the company well enough to make a real difference. The people the institutions want, ie names, are not necessarily best for review', another commented that s/he disagreed that NEDs can have a strong influence on wealth creation.

Of those respondents who believed that the main purpose of corporate governance is 'optimising', 44% agreed that '*independent NEDs play an important role in the organisation's ability to generate wealth*' compared with only 27% of respondents who viewed it as 'protecting'. The averages are 3.32 and 2.77 respectively. Looking at the three FTSE listing categories, there is an interesting variation in numbers agreeing with this statement. Only 27% of FTSE 100 respondents agreed that '*NEDs play an important role in the organisation's ability to generate wealth*', compared with 41% of respondents from FTSE 350 companies and 38% of those from outside the FTSE 350. FTSE 100 companies generally have had a higher percentage of NEDs on their boards, and have had experience of them for longer than smaller companies. It is curious that those with most experience of working with NEDs had a lower opinion of the their role in helping to generate wealth. Additionally, it is interesting to note that FTSE 350 respondents, found to be more sceptical about corporate governance than the other two FTSE groupings, had the most favourable opinions of NEDs.

Chairmen believed much more strongly than finance directors that '*NEDs play an important role in the organisation's ability to generate wealth*'. The averages were 3.41 and 2.78 respectively. Fifty per cent of chairmen, compared with only 22% of finance directors, agreed with the statement. This is a significant difference which is worth further study.

8.2 DO INDEPENDENT NEDs PLAY AN IMPORTANT ROLE IN ESTABLISHING EFFECTIVE CORPORATE GOVERNANCE PRACTICE?

There was much stronger agreement that '*independent NEDs play an important role in establishing effective*

Table 8.1: The contribution of NEDs

	Response average	Standard deviation	Disagree %	Agree %
Independence of mind (ie objectivity and integrity) is more important than independence in appearance (ie compliance with a checklist)	4.54	0.67	1%	93%
The role of independent NEDs is much more challenging now than it was three years ago	4.4	0.78	3%	90%
Independent NEDs play an important role in establishing effective corporate governance practice in the organisation	3.99	0.74	3%	79%
Independent NEDs should play a stronger role in corporate governance	3.14	0.91	24%	36%
Independent NEDs play an important role in the organisation's ability to create wealth	3.11	1.10	30%	37%
It is difficult to appoint truly independent NEDs	2.7	1.16	46%	26%
Independent NEDs do not devote enough time to their role in companies	2.64	1.02	47%	16%
Institutional investors have too much influence over appointing independent NEDs	2.46	0.85	57%	8%

corporate governance practice': 79% agreed and only 3% disagreed with this statement. One respondent said: 'the Higgs Code does not influence positively wealth creation, however I believe it strongly reinforces stewardship and accountability mitigating against unnecessary risk taking. I think there is a real danger of stifled entrepreneurial spirit and risk-averse low refunds for shareholders. The question is what do investors want?'

Of those respondents who believed that the main purpose of corporate governance is 'optimising', 92% agreed that '*independent NEDs play an important role in the organisation's ability to generate wealth*' compared with only 27% of those respondents who viewed its purpose as 'protecting'. This finding is surprising.

Of respondents from FTSE 100 firms, 94% agreed that NEDs play an important role in '*establishing effective corporate governance practice*' compared with 82% of those from the FTSE 350 and 70% of those from outside the FTSE 350 (see Table 8.1 page 40). It would seem that, particularly in larger companies, NEDs' main role is now in helping to establish effective governance practice (or its appearance) and not contributing to the other aspects, such as strategy and performance, described by Cadbury.

Of the chairmen who responded, 84% agreed that NEDs play an important role in '*establishing effective corporate governance practice*', whereas only 74% of finance directors held this view.

8.3 INDEPENDENCE CRITERIA

The revised Code introduced new and more demanding criteria for establishing whether or not an NED is independent. Of those who agreed that '*it is difficult to appoint truly independent NEDs*', the highest proportion (35%) of respondents were from companies outside the FTSE 350. Many commentators have accused the new Code of encouraging a 'tick box' approach. Of our respondents, 94% agreed and only 1% disagreed that '*independence of mind is more important than independence in appearance (ie compliance with a checklist)*'. One respondent commented 'you have correctly drawn attention to the difference between compliance with checklists and integrity in practice. One size does not fit all. But improvements are still necessary and the changes tend in the right direction'. Many other respondents highlighted a concern with the 'tick box' approach.

There was strong agreement that '*the role of independent NEDs is much more challenging now than three years ago*' but very little agreement that '*institutional investors have too much influence in appointing independent NEDs*'. Given the criticism of NEDs in the USA following Enron and other scandals, it is reassuring that there was little agreement (15%) with the suggestion that NEDs do not devote enough time to their duties.

8.4 WHAT PROPORTION OF THE BOARD COMPRISES INDEPENDENT NEDs?

One of the key changes in the Combined Code is that, excluding the chairman, boards of companies within the FTSE 350 should comprise at least 50% independent NEDs, with tighter criteria for assessing independence. Other questions asked respondents about the effect of this requirement.

Results show that 37 respondents (41%) were from a board with fewer than 50% independent NEDs; 53 (59%) were from those with 50% or more independent NEDs.

Two of the respondents whose boards had fewer than 50% independent NEDs were from FTSE 100 companies (which constituted 11% of that segment of 19), with ten such respondents coming from companies in the FTSE 350 (37% of that segment of 27).

Of the 57 respondents whose boards had 50% or more independent NEDs, 19 were from outside the FTSE 350 (ie 43% of the 44 respondents from that sector).

8.5 THE EFFECT OF INCREASING THE PROPORTION OF INDEPENDENT DIRECTORS TO AT LEAST 50%

Respondents whose boards had fewer than 50% independent NEDs were asked to indicate their agreement or disagreement with various statements on a scale of 1 to 5 where 1 is ‘disagree strongly’ and 5 is ‘agree strongly’. The purpose of the question was to obtain opinions on the effect of implementing the recommendation by Derek Higgs that boards should comprise at least 50% independent NEDs (Higgs 2003). The first two statements relate to the effect on board effectiveness and the third considers another possible consequence. Forty respondents answered this question.

These results imply that a significant proportion of respondents believed that increasing the proportion of independent NEDs to 50% could mean that NEDs would become less involved in the business, that this could adversely effect teamwork and decision making and that other directors would have to leave the board in order to meet the 50% requirement. On this last point, finance directors (55% agreeing) held the view much more strongly than chairmen (31% agreeing).

Both the respondents from FTSE 100 companies whose boards did not meet the 50% criteria indicated that they would have to reduce the number of non-independent NEDs or executive directors (to achieve the required ratio of NEDs). Responses from the FTSE 350 and smaller companies were not notably different. One respondent commented that, as a result of a reduction in the number of executive directors on boards, the pool for NEDs will get even smaller.

Table 8.2: Effect of increasing % of NEDs to 50%

	Response average	Standard deviation	Disagree %	Agree %
Increasing the number of independent NEDs so that they comprise at least half of the board could adversely affect team work and decision making on a unitary board	3.23	1.21	33%	55%
We would have to reduce the number of executive and non-independent NEDs to ensure that half of the board are independent NEDs	3.08	1.19	35%	43%
Increasing the number of independent NEDs so that they comprise at least half of the board could mean that individually, independent NEDs become less involved in the business	2.78	1.17	48%	30%

9. Conclusions

9.1 ATTITUDES OF DIRECTORS TO CORPORATE GOVERNANCE

It appears that there are two distinct but related aspects of corporate governance: one concerns direction and control and the other concerns accountability to shareholders.

The Cadbury definition, 'the system by which an organisation is directed and controlled' (Cadbury Committee, 1992), implies an aspect which can be termed 'internal governance'. In the Cadbury Report it is clear that directors, rather than shareholders, direct and control. Cadbury recommends that boards assess the effectiveness of internal control, which is essentially the internal governance of the company. Internal control is generally defined as the means by which an organisation achieves its objectives (COSO 1992; Canadian Institute of Chartered Accountants 1995; Institute of Chartered Accountants in England and Wales 1999). Cadbury's definition presupposes that companies have objectives and that boards should strive to achieve them.

The other aspect is that companies, or their boards, should be accountable to their shareholders (and arguably to other stakeholders) for the achievement of objectives. The Cadbury Report therefore addresses the accountability of boards to shareholders. Since Enron, the focus of professional, business and media debate on corporate governance has been on accountability and there has been very little debate on internal governance.

Respondents viewed '*strategy and goals*' (Table 4.1, see page 22) as one of the two most important aspects of corporate governance to their companies, both now and over the next five years. However, in responses to questions about the purpose of corporate governance, '*improving strategic or organisational effectiveness*' (Table 3.1, see page 18) ranks eighth and '*ensuring accountability of management to owners*' ranks first.

If pursuit of '*strategy and goals*' is the most important aspect of corporate governance, why does it not rank higher in the purpose of corporate governance and why did most respondents say that corporate governance practice has little effect in contributing to '*strategic or operational effectiveness*' or 'profitability' (Table 6.1, see page 30)?

The research suggests that directors hold polarised opinions on corporate governance. Some respondents saw it as having a significant role in strategy (Table 3.1, see page 18). Others clearly viewed corporate governance in terms of accountability or as a bureaucratic exercise. As one chairman commented: 'The whole process of corporate governance, which should have as its aim wealth creation, has been sidetracked onto red tape . . .'. This divergence of view is unhealthy.

Both aspects of corporate governance are important to the achievement of objectives. A balanced view is essential if corporate governance is to contribute to, rather than harm, UK company competitiveness. The concept is shown diagrammatically in Figure 9.1 (see page 44).

9.2 RELATIONSHIPS BETWEEN CORPORATE GOVERNANCE AND CREATION OF WEALTH

This study is concerned with the hypothesis that good corporate governance contributes to improved organisational effectiveness in generating wealth. Opinions of respondents indicate that good corporate governance has some effect but that effect is not strong. Only two respondents out of 90 viewed corporate governance practice as very influential in contributing to 'profitability' and 11 considered that there was no influence (Figure 6.1, see page 31). Only four viewed corporate governance as 'very influential' in contributing to '*strategic and/or operational effectiveness*', five believed there is no influence and 22 more were probably saying that it has very little

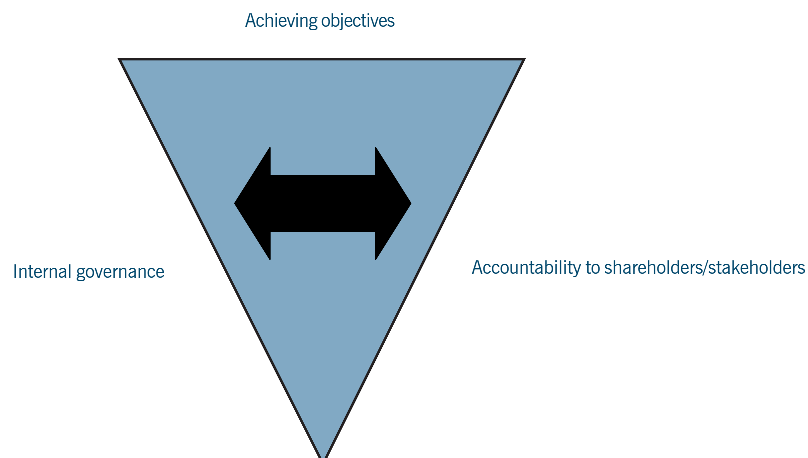
influence. This implies that most respondents viewed little relationship between corporate governance and the factors which lead to creating wealth. Yet words such as value, profit and performance feature strongly in respondents' own definitions of corporate governance.

There seems to be a correlation between those who viewed the purpose of corporate governance as creating wealth and those who scored profitability and effectiveness more highly. Given the low score for influences on profitability, it is perhaps surprising that the number who viewed '*optimising ability to create wealth*' as the main purpose of corporate governance is equal to the number saying that the main purpose is '*protecting shareholders against loss*'.

The responses seem to indicate, despite some paradoxical answers, that for most respondents corporate governance is largely about accountability and integrity but a significant minority view it as concerned also with ensuring the creation of wealth. This again supports the theory of two complementary aspects of corporate governance.

Of those surveyed, 37% agreed that '*independent NEDs play an important role in the organisation's ability to create wealth*' compared with 30% who disagreed (Table 8.1, page 40). Those who viewed the main purpose of corporate governance as '*optimising ability to create wealth*' showed stronger agreement than those who viewed corporate governance as being about '*protecting shareholders*'. Chairmen also expressed a generally higher level of agreement than finance directors. Although FTSE 100 companies had a higher proportion of independent NEDs, they had lower level of agreement with this statement than directors from smaller companies. This result is more surprising as FTSE 350 directors' scores indicate that they considered that corporate governance has less influence on profitability than did directors of other companies.

Figure 9.1: A new model for corporate governance



It would seem from Table 8.1 (see page 40) that NEDs' main role is considered to be in '*establishing effective corporate governance practice*' (79% agreeing compared with 3% disagreeing).

9.3 DIRECTORS' VIEWS ON THE NEW ELEMENTS IN THE COMBINED CODE

The answers to the questions about the changes in the revised Code (Tables 7.1 and 7.2, see pages 36–37) suggest that the changes in the new Combined Code will not help organisations' ability to create wealth, although 51% of respondents agreed that it will '*improve accountability to shareholders*'.

Most of the changes in the new Combined Code are about non-executive directors. In Table 8.1, the responses to the statement '*independence of mind is more important than independence in appearance*' may imply some unhappiness with the new, more prescriptive independence criteria in the Combined Code: 93% of respondents agreed that '*independence of mind is more important than independence in appearance*'. There was also general agreement (90% of all respondents and 100% among FTSE 100 respondents) that the '*role of NEDs is more challenging now*' (Table 8.1), and 58% of respondents agreed that the '*new criteria for independence are not helpful in creating wealth*' (Table 7.2, see page 37).

Two of the 19 respondents from the FTSE 100 and 40% of all respondents considered that their boards did not meet the new Code requirement of having at least 50% independent NEDs (see section 8.4). Of the respondents whose boards did not meet the new criteria for independence, 30% agreed that, in meeting the criteria, '*individually, independent NEDs could become less involved in the business*'; 55% agreed that '*board teamwork and decision making could be adversely affected'* and 43% agreed that they would have to '*reduce the number of executive non-independent NEDs*' (Table 8.2, see page 42); 62% disagreed that meeting this criterion would '*help to improve my organisation's ability to create wealth*' (Table 7.1, see page 36) and 48% agreed that this criterion is not helpful (Table 7.2, see page 37). These findings are disturbing.

Many respondents also evidently objected to the new provision that makes it difficult for NEDs to stay on the board after nine years: 59% agreed (Table 7.2) that this is not helpful to creating wealth. One respondent commented 'this will harm the effectiveness of NEDs seriously because it reduces the value of experience, corporate memory and most importantly the independence which comes from having seen it before'. Two other respondents were also critical of the time limit and many commented that there is too much box ticking.

The response in Table 7.1 to 'O*verall the 2003 Code will lead to improved ethical integrity within UK companies*' suggests that the new Combined Code will have little effect on improving the ethical integrity of companies, although fortunately only 6% agreed that integrity could be harmed (Table 7.2).

Whichever view one holds about the purpose of corporate governance, we should be concerned that 29% of respondents, including 40% of respondents from the FTSE 100, said that the revised Combined Code could reduce international competitiveness of UK companies.

9.4 A NEW MODEL FOR CORPORATE GOVERNANCE

It is important that any model of corporate governance addresses performance as well as accountability. The survey suggests that the new Combined Code, whatever its authors' intentions, is seen by respondents as being more of a 'box ticking' exercise than concerned with performance. This, plainly, is unfortunate.

It seems that, if the 29% who believed that the revised Combined Code could reduce international competitiveness of UK companies are correct, the revised Code requires further change. Hampel (1998) is concerned that corporate governance pays too much attention to compliance and not enough to performance and this would seem to be a problem still – or at least it is how governance is being interpreted.

It is suggested that a more holistic approach is required to model corporate governance practice. Such a model could be based on the diagram in Figure 9.1 (see page 44). Corporate governance should be considered in the context of achieving objectives, how objectives are achieved and risks managed (internal governance) and how boards are accountable to, and engage with, shareholders.

We suggest that this research highlights the need to reconsider the approach to corporate governance and ensure that all parties in the corporate governance process (boards, shareholders, regulators) share a common understanding of what corporate governance is and what it can and cannot be expected to achieve. Although the results of this research suggest that there is great diversity of opinion, they can be only indicative rather than conclusive. The intention is to follow up this survey with a series of semi-structured interviews with those respondents who have agreed to take part in further research, to explore their views in greater depth.

Appendix 1: Corporate governance

The Cadbury definition, 'the system by which an organisation is directed and controlled' (Cadbury Committee, 1992), is similar to a general definition of management. The NHS Governance Standard (DoH 2001) recognises this by adding to the Cadbury definition the words 'at its most senior levels, in order to achieve its objectives and meet the necessary standards of accountability, probity and openness'.

The OECD (1999) states governance 'involves a set of relationships between a company's management, its board, its shareholders, and other stakeholders, and provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined'. This makes it clear that governance includes setting and achieving objectives and monitoring performance.

There is general consensus on these definitions but many corporate governance commentators seem to interpret them differently. These include interpreting governance:

1. in terms of structural arrangements rather than processes (Monks and Minow 2004)

2. as an accountability issue, having little to do with performance, strategy, objectives and performance measurement (eg International Federation of Accountants/Chartered Institute of Management Accountants 2004)

3. as standards to meet or rules to comply with (eg Pensions & Investment Research Consultants Limited 2003)

4. as a means for ensuring organisational effectiveness (eg Robinson 2001).

Robinson explains that the real essence of corporate governance lies in the actual decisions made by boards and in the entrepreneurial ability which is essential to long-term success.

PERCEIVED CORPORATE GOVERNANCE FAILINGS

Hevesi, New York State Comptroller, announced in 2003 that earlier corporate scandals in the US had resulted in a 15% fall in the value of the average pension fund of New York State employees (New York Times 2003). The actual fall in value of pensions between 2000 and early 2003 was substantially more. Therefore, however one considers corporate governance, getting it right is important to economic prosperity.

It is implied in a number of sources that the main problem is lack of trust in capital markets and those involved in them. Surveys in 2003 showed that the US public had little confidence in the ethical integrity of US business leaders. For example, the Conference Board (2003) quotes an American survey in July 2002 that asked about the prevalence of wrongdoing. The survey found that 46% of the public surveyed believed that 'every company does this kind of thing but only a few more will get caught' and 38% believed that many other companies would be exposed. Gallup/CNN (2002) asked if corporate executives take improper actions to benefit themselves at the expense of their corporation: 79% responded that this practice was either 'very or somewhat widespread'. Gallup also found that only 23% of respondents believed that CEOs of large corporations could be trusted, compared with 75% who thought people who run small businesses could be trusted.

Surowiecki (2002), citing writing by Adam Smith, Daniel Defoe, Richard Tilly, John Mueller and Avner Greif, argues that capitalism is founded on, and cannot function without, trust, honesty and decency.

According to the Fédération des Experts Comptables Européens (known as FEE) (2003), many of the corporate failures can be attributed to a lack of integrity and, as a result, the public's trust in corporations, investment analysts, bankers, lawyers and accountants has been seriously undermined. FEE concludes that there is now a clear need to restore confidence by enhancing corporate governance, in order to provide financial information of the highest quality. Reforms have been directed at restoring trust.

RESPONSES BY REGULATORS IN THE UNITED STATES AND IN EUROPE

The main reform in the US is the Sarbanes–Oxley Act (United States of America Congress 2003) supported by consequent rule making by the US Securities and Exchange Commission (SEC) and new corporate governance rules by the New York Stock Exchange and the NASDAQ exchange. These measures include rules for companies on board structure, including the requirement that at least 50% of the board comprises independent non-executive directors, and rules on the constitution and duties of audit committees.

The European Commission commissioned a comparative study of corporate governance codes (Weil and Manges 2002) relevant to the European Union. Every Member State except two had at least one code; 35 codes in all met the study's definition. The study, noting that the codes emanate from nations with diverse cultures, financing traditions, ownership structures and legal origins, found the codes 'remarkable in their similarities, especially in terms of the attitudes they express about the key roles and responsibilities of the supervisory body and the recommendations they make concerning its composition and practices'.

Following this study, the EC commissioned its group of 'high level' company law experts, previously established in 2001 to review company law, to include corporate governance issues as part of their review. In 2002 the 'group of experts' made a number of recommendations (EC 2002), embodied in an action plan which was issued in an EC Communication in 2003. The action plan contains proposals to improve companies' disclosure of corporate governance practices and procedures; to define the composition and activity of the board and board committees, including the audit committee; to strengthen the role of independent non-executive directors; to foster an appropriate regime for directors' remuneration; and to enhance disclosure by institutional investors of their investment and voting policies. In 2004 the EC consulted on all these areas and new recommendations are being issued.

In the UK, the Department of Trade and Industry sponsored the Higgs Review (Higgs 2003) of the role and effectiveness of non-executive directors (NEDs) and the Smith Review (Smith 2003) of audit committees, which led to a revised Combined Code issued by the Financial Reporting Council (2003). The new Code builds on the previous 1998 code and contains principles and provisions to clarify and enhance the role of non-executive directors, particularly their work on audit committees; to improve disclosure to shareholders of governance practice; and to ensure that institutional shareholders give proper consideration to such disclosures. One important new principle has been added – that every board should 'undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors'.

Prior to Higgs, the Hampel Committee (Hampel 1998) had said that NEDs are normally appointed primarily for their contribution to strategy but the committee had found acceptance that they should also have a monitoring function.

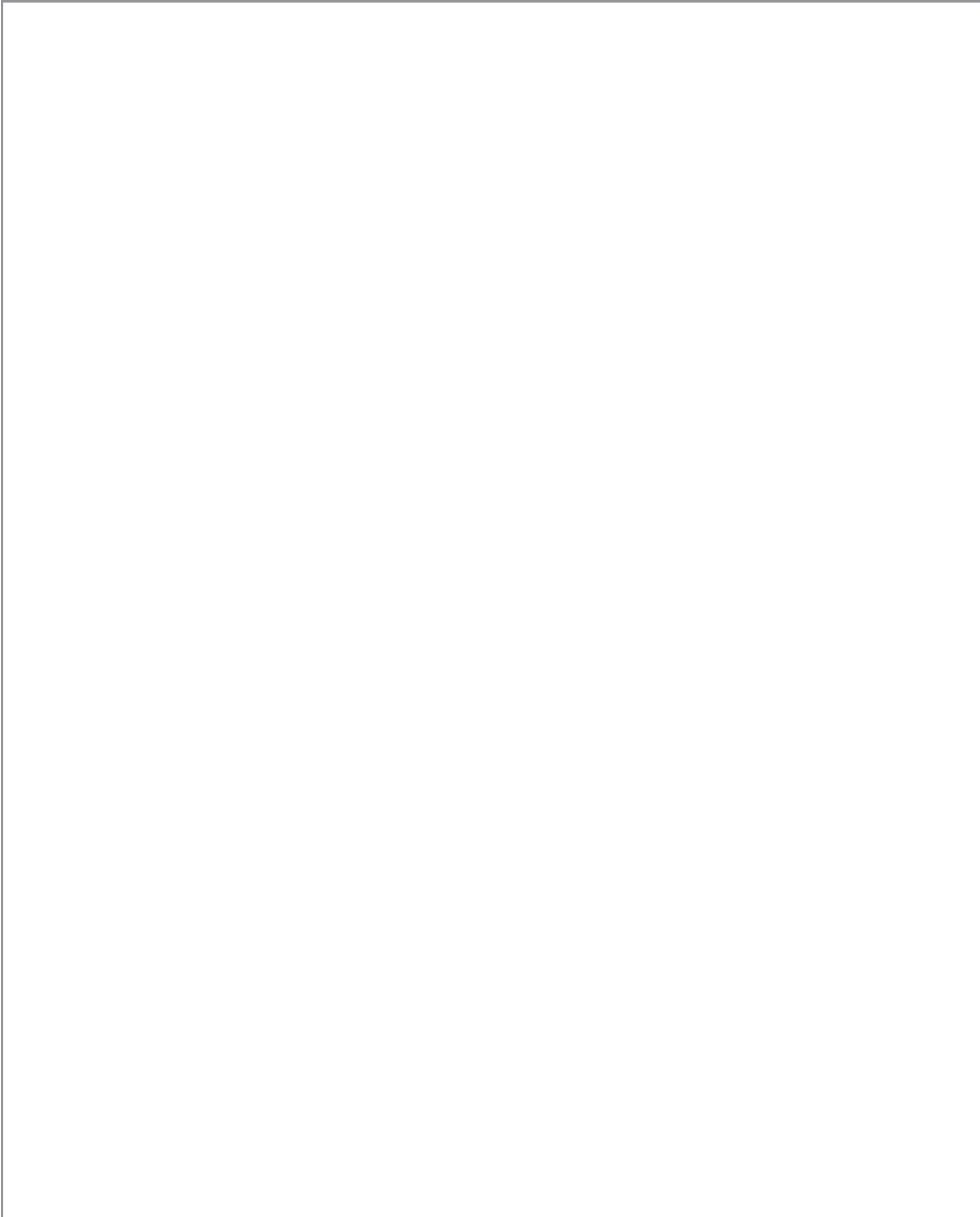
ELEMENTS NEW TO THE COMBINED CODE (2003)

The new Code continues to include principles supported by provisions and requires disclosure on a 'comply or explain' basis. It contains the same number of principles (13) and slightly more provisions (48 compared with 47). It is more detailed, however: many of the provisions are longer and there are also 26 new supporting principles, details of whose application within companies must be reported.

One principle regarding disclosure of directors' pay has been dropped, as the matter is now a Company Law requirement, and there is one new principle – that boards should conduct an evaluation.

The main changes are as follows.

- Independent NEDs should comprise at least half the board for companies within the FTSE 350.
- Audit committees should comprise exclusively independent NEDs.
- The board should undertake a formal and rigorous annual evaluation.
- There are new, more detailed criteria for considering the independence of NEDs.
- There is greater detail generally on the role of NEDs.
- There is strong guidance that independent NEDs should not serve on the board for longer than nine years.
- There is a stronger requirement for institutional shareholders to consider explanations by companies as to why they are not complying with a particular Code provision.
- Greater detail of corporate governance is required to be disclosed by companies.



Appendix 2: The literature

Several studies have attempted to find links between corporate governance and financial performance in terms of both share price and profitability. This literature review first considers research of board or investor opinion on various aspects of governance and performance, and then considers statistical research intended to identify significant correlations between various governance and performance criteria.

OPINION SURVEYS

Surveys of major international investors in global markets by McKinsey (2000 and 2002) report 75% of institutional investors surveyed as saying that board practices are at least as important as financial performance when evaluating investment and over 80% of investors would pay more for the shares of a well governed company. These studies have often been cited as proof that good governance pays. Only six criteria were used to identify proper board practices, however, the questions were hypothetical and the answers not capable of being proved. The study does not provide academic evidence and, at best, provides a hypothesis for further research. Nor is investment performance a useful indicator of company financial performance or effectiveness; as Monks and Minow (2004) state, 'the public can value companies on bases that in retrospect appear idiotic'. Past financial performance is just one of many factors influencing share price.

Opinions about what constitutes good governance also change, highlighting the lack of objective evidence underpinning corporate governance practice. For example, in the McKinsey research, one of the six indicators of good governance is that a 'large proportion of directors' remuneration is stock/options'. Until recently, stock options were regarded as a desirable way to align executives' interests with those of shareholders. Experience has shown, unfortunately, that some executives have been too motivated by potential profits and produced misleading financial information. Share options are no longer associated with good corporate governance.

In another opinion survey, of directors of South African listed companies, Jenkins-Ferrett (2001) reports that 85% of respondents believed corporate governance was of 'utmost importance' to 'important' in contributing towards investor confidence in the company, and 83% rated corporate governance as of 'utmost importance' to 'important' in contributing to an organisation's performance. In contrast, CBI/Touche Ross (1995) report that 90% of the chairmen and chief executives of 347 listed UK companies believed that the UK Cadbury Code had had no positive effect on their financial performance. Indeed, 46% said that the Code and the recommendations of the Greenbury Committee on Directors' Remuneration in 1995 would have an adverse effect on UK boards, compared with 16% who said they would have a beneficial effect.

Dulewicz and Herbert (1997) sampled opinions of the chairmen of 134 listed companies to test a model of good practice for directors (Institute of Directors 2001); they identify 16 key output-related tasks of boards. Many of these tasks are relevant to corporate governance. In the view of respondents (percentages given in brackets), the most important of these were:

1. to determine the company's vision and mission to guide and set the pace for its operations and future development (91%)

2. to take account of the legitimate interests of shareholders and other stakeholders who have the capacity to affect attainment of the company's objectives (86%)

3. to review and evaluate present and future opportunities, threats and risks in the external environment, and current and future strengths and weaknesses of, and risks to the company (82%)

4. to determine corporate and financial strategic options, review and select those to be pursued, and decide the resources, contingency plans and means to support them (82%)

5. to ensure that internal control procedures provide valid and reliable information for monitoring operations and performance (81%).

They note that there is strong evidence that the potential for improvement in risk assessment is inversely related to the proportion of non-executives. They conclude that there is an uneasy equilibrium between value-adding behaviour and matters of disclosure and compliance designed to protect shareholders.

STATISTICAL GOVERNANCE RANKING RESEARCH

Newell and Wilson (2002) undertook research which supports McKinsey's surveys. The research identifies that, across emerging capital markets, companies with better corporate governance (using 10 criteria for assessment) had higher price-to-book ratios, suggesting that investors will pay a premium for a well governed company. The fact that share price may be higher for apparently well governed companies does not, however, necessarily relate to any higher intrinsic value or degree of company performance.

Gill (2001), looking at emerging capital markets, ranks companies on corporate governance practice according to 57 criteria, of which 16 required a subjective, and the remainder an objective, assessment. The subjective tests were designed to overcome the obvious shortcoming of ranking companies purely against 'tick box' criteria to which a company can pay only lip service. Gill finds that better governed companies performed significantly better in terms of ROCE, ROE, EVA/invested capital and share price.

Gompers et al. (2001) report a positive relationship between a self-designed governance index and company value for 1500 US listed companies. They also show that weaker shareholder rights are associated with lower profits, lower sales growth, higher capital expenditure and more corporate takeovers. Bouer and Guenster (2003) demonstrate a statistically significant relationship between corporate governance ratings assessed by Deminor SA, a Brussels based rating agency, and company valuation of 300 blue chip European companies. They show a negative correlation between corporate governance rating and both net profit margin and return on equity.

Webley and More (2003) report a significant correlation between companies which (appear to) have an embedded code of ethics and financial performance. They found that, between 1997 and 2000, a sample of UK listed companies with a code of ethics had on average double the economic value added per year, and more than five times the market value added per year than a sample of listed companies without a code. There is nothing explicitly mentioned about ethics in the Combined Code.

Muth and Donaldson (1998) report that where there are fewer independent non-executive directors and where the roles of chairman and CEO are combined there is better financial outturn for shareholders. This refutes a generally accepted fundamental principle of good governance that the roles of chairman and chief executive should be separate. The findings also counter an important provision of the new Combined Code, that 50% of the board of a FTSE 350 company should comprise independent non-executive directors.

The Conference Board Commission on Public Trust and Private Enterprise (Conference Board 2003) also recommend that independent NEDs should make up at least 50% of a board. The New York Stock Exchange now requires this. The Commission included Arthur Levitt, former chairman of the SEC and a leading

advocate of corporate reform, and other leading business people. The Commission has detailed documented discussions supporting each of its recommendations, but the author (of this research report) has been informed that this particular recommendation was taken as 'a given' and not debated.

Bhagat and Black (2001), in a long-horizon study of performance data of 900 companies, find evidence that firms with low profitability respond to the problem by increasing the number of independent directors but present no evidence that more independent boards perform better. They report 'hints' in their data that such companies perform worse. Gimble (2004) recounts that some investors appear to have made above-market-average returns by investing in companies with poor corporate governance, on the basis that their governance would improve.

Bhagat and Black would seem to be refuted, however, by research by MacAvoy and Millstein (2003), who surveyed 300 large US public companies and studied 128 in their final sample. They correlate their own measure of economic value added against their assessment of boards' independence and professionalism, informed significantly by governance ratings compiled by CalPERS in 1997. Unfortunately they do not describe how their own governance assessment was informed by the CalPERS survey. The findings suggest that over 10 years from 1991 to 2001, better governed companies performed significantly better.

In their literature review, MacAvoy and Millstein note that US boards have become more professional and have recruited more outside directors in response to concerns by investors, and that in the 1970s and 1980s boards were more interested in creating bigger companies than in creating shareholder value. They explained that these reforms led to improved shareholder value in the 1990s but that in the latter part of that decade something went wrong. In their view, this was essentially because of a lack of objectivity by management and a lack of information received by boards. This commentary in part supports and explains Bhagat and Black's finding that companies increase the proportion of outside directors in response to poor profitability.

MacAvoy and Millstein's finding that board professionalism and independence corresponds with better economic value added is, however, problematic. Their metrics for a professional board appear too simple. They assert that a board is professional if just one of the following criteria is met:

1. there is independent board leadership (ie separate chair and CEO)

2. directors meet without management

3. there are established rules or guidelines for conducting the corporation and the relationship between the board and management.

Their opinion that 'these indicia identify companies that have independent boards that practice professionalism and in that sense are well governed' is questionable. All these criteria are well established in UK companies but no one would argue that these alone are sufficient to indicate good governance. Enron was given an 'A' (high) governance rating by CalPERS because it 'was in the process of creating a board that would have the independence and resourcefulness to monitor the company', but MacAvoy and Millstein say, with hindsight, that this was not justified. Enron, however, met the first and probably the third of their criteria. MacAvoy and Millstein's findings are at odds with other research, and their assessment of professional and independent boards seems potentially flawed.

Research by Dulewicz and Herbert (2003) has also

challenged the now generally accepted principle that at least 50% of board members should be independent NEDs. In research aimed at understanding whether good practice tasks in the IoD' model (referred to above) correlates with financial performance, they put forward a number of hypotheses to test three theories of corporate board governance practice: agency theory, stakeholder theory and stewardship theory. In their analysis of 86 UK listed companies, they find statistically significant differences on CFROTA performance (cash flow return on total assets) between those companies with a separate chairman and chief executive and those where the roles were combined, with the latter performing less well. This supports one of the main principles of UK governance, in contrast to US practice and contradicts Muth and Donaldson. They find no evidence, however, to support the principle that boards should have a majority of independent directors: they find a small, but not statistically significant, negative correlation between CFROTA and the proportion of NEDs on the board and a statistically significant negative correlation between sales and the proportion of NEDs. They also find a significant correlation between NEDs' length of tenure and CFROTA, which goes against one of the additional recommendations of the Combined Code, that non-executive directors should not serve more than nine years.

Dulewicz and Herbert go on to research links between boardroom practice and CFROTA. They applied four tests of good practice under each of the headings: vision, mission and values; strategy and structure; supervision of management; and responsibility to shareholders and other stakeholders. They find no positive correlation between any of the tasks and performance for current board practice and a negative relationship for four tests:

1. determining and reviewing company objectives to match the mission and values and to form the basis of company strategy (significant at 0.05 level)

2. reviewing and evaluating present and future opportunities, threats and risks in external environment, and current and future strengths and weaknesses of, and risks to, the company (significant at 0.01 level);

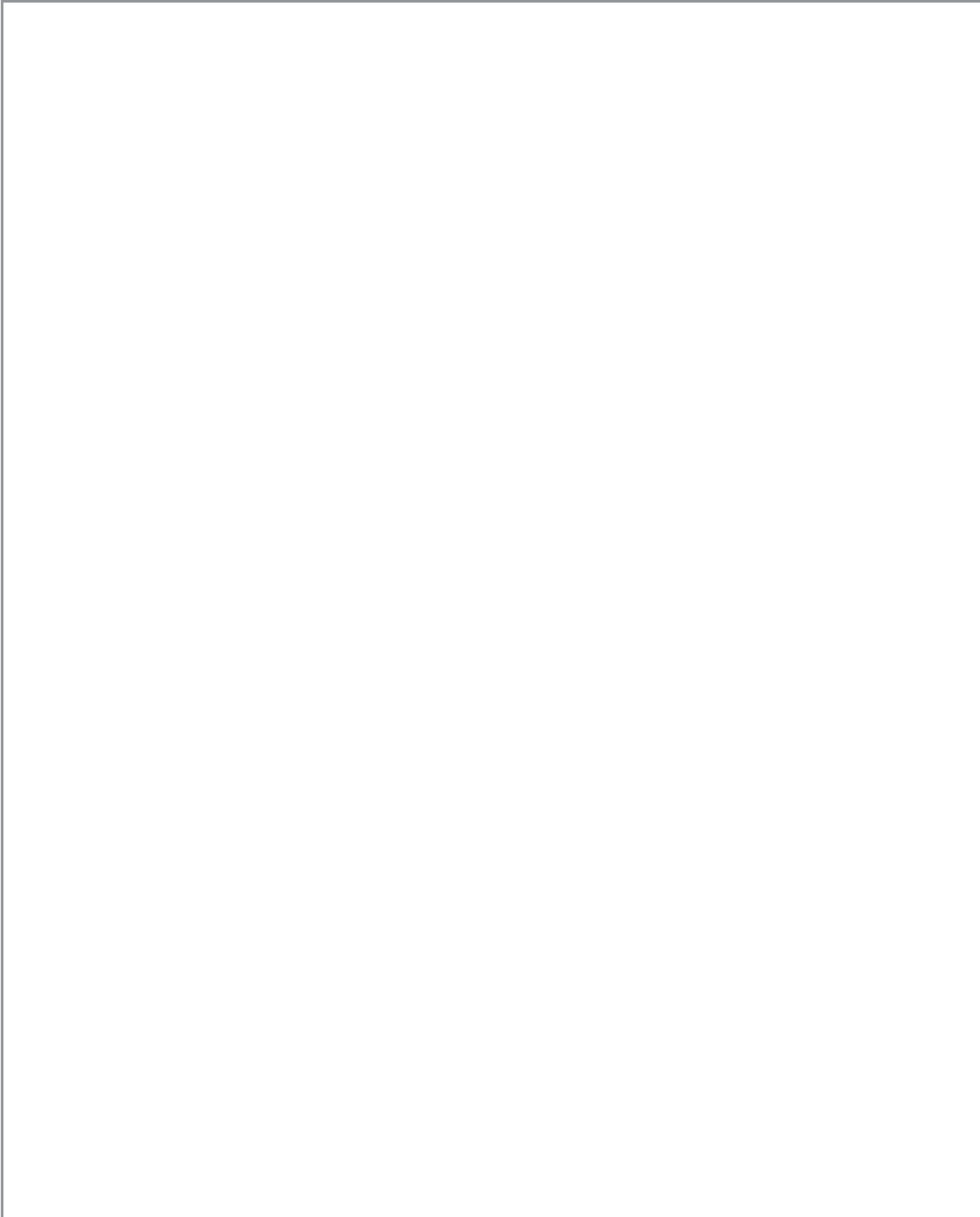
3. ensuring that internal control procedures provide valid and reliable information for monitoring operations and performance (significant at 0.01 level);

4. delegating authority to management and monitoring the latter's implementation of policies, strategies and business plans (significant at 0.01 level).

Dulewicz and Herbert do not offer any explanation for these findings. Intuitively one might expect companies which engage in such practices to be more successful; these practices might be considered normal by professional boards if not actually essential to good management. The absence of the fourth practice – proper delegation and monitoring – was a contributory cause to the Enron type of problem and was presumably also lacking at the board of Hollinger, where the executives received large financial sums without the approval of the board. Assuming that the figures are validly derived, a possible explanation could be that boards engage in these practices more when they are aware of problems and use these practices to help them address the problems.

Dulewicz and Herbert also consider potential for board improvement, finding that seven of the tests correlate positively with CFROTA and have no negative correlations. They identify the chairman's role as being pivotal. Curiously, they also find statistically significant positive relationships between potential CFROTA and the third and fourth practices listed above. It would seem that companies perform best where the chairman believes there is the most room for improvement.

Dulewicz and Herbert's analysis of their research suggests that some of the accepted principles of good governance and some of the accepted principles of good management make no difference to performance. They argue that a more imaginative model is required to understand board behaviour.



Appendix 3: Methodology

A questionnaire was sent to 1,650 chairmen and finance directors of companies from the top 1,000 listed companies by market value. The London Stock Exchange FTSE 100 (2004) accounts for approximately 80% of the total UK market value and the FTSE 350 accounts for a further 14%. The population sampled would have accounted for at least 95% of the UK stock market by value.

QUESTIONNAIRE

The questionnaire was designed:

- to identify directors' perceptions of corporate governance
- to identify their view of its purpose and areas they considered important to governance and to their company
- to seek opinions on links between governance and aspects of performance and between new areas in the Combined Code and company success.

A draft questionnaire was designed and piloted with a non-executive director from a listed company. The questionnaire took 30 minutes to complete and the trial respondent was of the opinion that many directors would be willing to take this time to respond to such a questionnaire if posted with a suitable personal covering letter. It is apparent that a director's initial perception of what governance is, and what it is for, will influence the way in which other questions are answered.

The questionnaire was then reviewed internally within ACCA, the author's employer. A response rate of 5% was predicted. Finance directors were targeted as it was believed that finance directors would be more likely to respond to a survey from an accountancy body than other executive directors; chairmen were targeted because of their pivotal role in corporate governance at their companies.

The research aimed to elicit and understand differences in the views of different types of director. It could have been informative to obtain views of non-executive directors; however, many non-executive directors are executive directors of other listed companies and it was believed that responses from this group might reflect to some degree an executive perspective and not be truly indicative of a non-executive director standpoint. It was also believed that non-executive directors would be less likely to respond.

The questionnaire was designed so that answers could be analysed or filtered into different categories, such as job role, FTSE listing position, and responses to other questions. Consideration of different responses from different groups was a key part of understanding their attitudes. Open questions were also set and, where appropriate, template analysis was carried out to interpret the responses.

A database of the chairmen and finance directors of the top 1,000 companies by market value was obtained. This turned out to have only 1,650 names from companies, as many directors had expressed a preference not to be mailed.

The survey questionnaires and covering letters together with prepaid reply envelopes were posted in late February and early March 2004.

It is unlikely that respondents formed a statistically significant sample because directors without a strong (positive or negative) interest in corporate governance may have been less likely to respond to a questionnaire or grant an interview. Nevertheless, the results will serve to inform debate and help develop a theory linking organisational performance to governance.

FUTURE RESEARCH

The questionnaire and this research were designed to be self-contained and provide information of value. It is recognised, however, that the questions required subjective assessment by respondents and results could be misinterpreted. It is therefore intended to undertake interviews with a sample of survey respondents to discuss research findings. Nearly 30% of the respondents indicated they would be willing to take part in interviews to discuss the research.

It is also hoped to use the interviews to explore directors' views on why certain board practices might correlate with poor performance, as identified by Dulewicz and Herbert (2003). It was not practicable to attempt to explore this matter in the questionnaire because this could distract attention from the main focus of the survey.

Appendix 4: Comments on the purpose of corporate governance

Respondents were invited to add their own comments on the purpose of corporate governance. These are reproduced below:

Again we are formalising good business practice.

It has made life very complicated for NEDs.

Over prescriptive measures may backfire. There should be different levels of governance for small cap/very top too.

Transparency provides internal as well as external accountability, which builds morale in the company.

Playing box ticking on behalf of those who want knighthoods.

The effect of Higgs is to delay the time at which we will bring younger executives onto the board, as the difficulty of finding quality non-executive directors has been increased.

Use of NEDs as a tool for the implementation of corporate governance has repeatedly been proven to be ineffective. Better measures to provide corporate governance would be to assist executive directors, by registration, or some other means.

It is consuming too much time. (This questionnaire is an example!) Ethical and effective companies have now an added unnecessary burden; unethical companies (as ever) will find a way to continue despite 'corporate governance'.

To be seen to be doing something in reaction to high profile scandals. It will do nothing to prevent such scandals.

Should be kept voluntary – statutory obligations are a very blunt instrument and lead to stifling of entrepreneurial talent.

None of these (except satisfy needs of regulators).

It is part of the purpose of corporate governance to encourage clear and simple goals and to identify the means to implement them effectively to the benefit of all stakeholders – otherwise the answer to Q.10 (optimising wealth) will not be achieved.

See my answer to Q.9 [framework of policies and protocols]*. Good corporate governance is fundamental in any business where ownership is separate from management, to ensure that the executive always acts properly, competently and in the owners' interest.*

The dichotomy between 'protecting from loss' and 'optimising wealth' is more apparent than real. If wealth is not optimised shareholders have suffered opportunity loss: wrapping the talent in a napkin and burying it did not please the master.

The pendulum has swung from one extreme (the cosy club which I doubt exists much anywhere) to red-tape-burdened, bureaucratic procedure. The purpose is now concerned with being seen to obey the rules – although international shareholders still want short-term results.

I find Q.8 to Q.11 difficult as to whether they relate to NEDs (whom I think can make a valuable contribution) or the new code (which to an extent creates a distraction and endangers the unitary board).

The purpose should be to help the business to be successful about operating with proper ethics (lasting wealth creation).

Giving the NEDs and the chairman the ultimate power to change management if the need arises and curtail management's tendency to pursue its full interest before it does damage to shareholders' long-term interests.

Compliance with often excessively rigorous rules must not be allowed to be a substitute for experience, integrity and common sense.

These [Q.11.11 and Q.11.12] *should be done anyway as a consequence of being a director. The absence of these takes us back to the early twentieth century.*

Comment on Q.8: Surely any decent company will attach a high priority to all these items now and in the future?

Appendix 5: Comments about the changes in the Combined Code

Respondents were invited to add their own comments about the changes in the Combined Code.

Your questions are biased towards establishing that corporate governance does not create wealth. Not that I disagree!

You need to know the business to be able to make a contribution to decision making or be a professional – accountant/lawyer – who can opine on accounting and legal matters. A balanced Board is more important than a lot of boxes ticked.

Non-execs do not know the company well enough to make real difference. The people the institutions want, ie names, are not necessarily best for review.

The Higgs Code does not influence positively wealth creation, however, I believe it strongly reinforces stewardship and accountability, mitigating against unnecessary risk taking. I think there is a real danger of stifled entrepreneurial spirit and risk-averse low refunds for shareholders. The question is what do investors want?

The new code is too prescriptive and bureaucratic. The 'comply or explain' principles are already being ignored by many investors.

It is far too prescriptive and will inevitably lead to a 'box-ticking' mentality as opposed to a real engagement with the important underlying issues that the code is trying to address.

The 'one size fits all' basis of the code makes it less sensible to apply all its provisions to small companies.

There are a lot more boxes to tick.

Irrelevant to wealth generation but expensive and time consuming.

Good corporate governance is beneficial to any organisation. The CC has simply formalised many processes already happening informally. While taking issue with certain elements of the Code, directionally it is right. Institutions now need to give credit to FTSE 350 firms that are achieving good corporate governance performances without necessarily ticking all the boxes. Their acid test should be 'is this business being run honestly and with integrity?'

When you have a list of rules it inevitably becomes a tick box mentality. Look at the Pirc report – all tick boxes. It adds cost and does not increase accountability.

May have more relevance to FTSE 250+ companies where directors' conduct and remuneration are of greater concern to institutional shareholders. I am co-founder and non-exec of a plc which entered small cap index last year. The Higgs code imposes rules on small entrepreneurial companies out of proportion in terms of cost of compliance with any tangible benefit. We shall explain rather than comply, where we do not. No institutional (or private) shareholder has ever raised (to date) corporate governance issues with us, so I doubt it is a major issue for our shareholders either!

The changes seem burdensome in this introductory period but they will become part of normal working practice within a year or two and, if diligently and intelligently implemented – not mere compliance with a checklist – will enhance the overall quality of management with concomitant increase in the creation of wealth by sound businesses.

Overall the changes are welcome. There is the danger that the prescriptive nature of some of the processes will merely produce a 'box ticking' response, notably in smaller companies that do not have substantial in house counsel or company secretarial resources.

You have correctly drawn attention to the difference between compliance with checklists and integrity in practice. One size does not fit all. But improvements are still necessary and the changes tend in the right direction.

There are four serious and damaging flaws to the Combined Code: 1. Institutions will not be conscientious about 'comply and explain' – there is already ample evidence of that. 2. The six-year rule will harm the effectiveness of NEDs very seriously – it removes the value of experience, corporate memory and most importantly independence that comes from having seen it before. 3. The concept of a senior NED is divisive – it's meant to be. 4. The whole process of corporate governance, which should have as its aim wealth creation, has been sidetracked onto red tape procedure and perception. British business will not be more successful as a result of this.

Divisive – endangers unitary board. Unclear – eg appears to change role of chairman – he falls in neither NED or Exec Director camp and is in danger of reduced status/influence. Changes Balance of Power – possibly to disadvantage of company, eg the required NED membership of committees with extensive terms of reference, vesting power in these committees seems to lose sight that they are merely committees of the board. Code requirements are time consuming to the detriment of time spent on strategy and operational issues.

My disagreement with the questions/code change relate to the effect on 'creating wealth'. Most of the changes (eg time limits) do nothing for this. The key is to have good independent NEDs who are effective – most code rules are about appearances not fact. Note, however, answer to Q.5#1[which indicated strong agreement on board evaluation].

Nine years should be a guide for considering independence, not a cut off. Other factors such as age, committed attitude, willingness to speak up and differ with the executive far more important than time served.

Little disagreement with the thrust of the changes but some concern on future interpretation by outside bodies.

I am chairman of an investment trust; in this case the nine-year rule is considered to be outweighed by the need for board members with market experience. Creation of wealth is only an indirect result of strict adherence to an artificial set of rules.

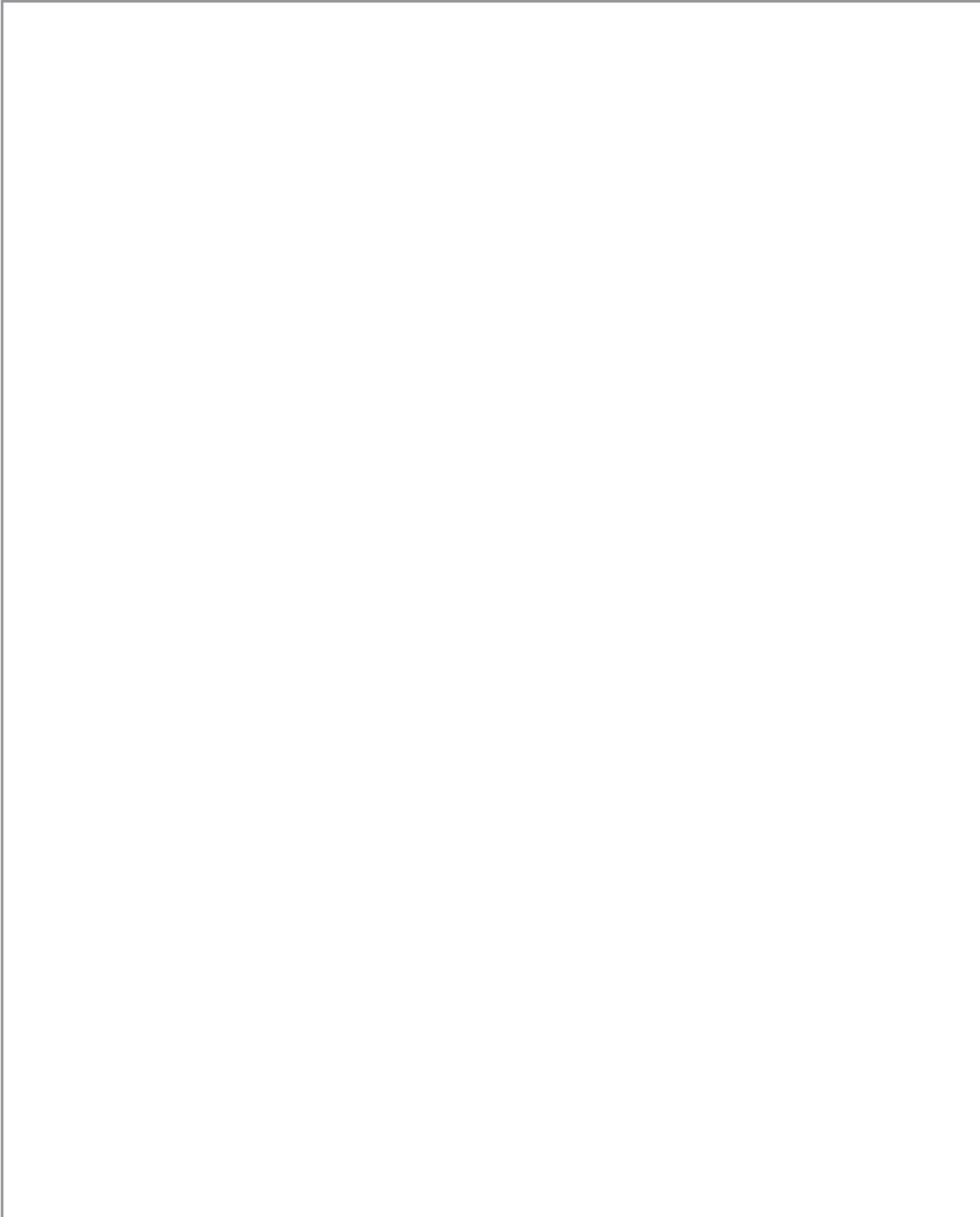
Challenges remain in applying the principles successfully in a small company WITHOUT creating bureaucracy.

It will still be possible for companies to have a box-ticking approach.

If people are prepared to be dishonest, no amount of corporate governance will deter them [hence this respondent's score 1 to Q. 5.10] .

The 2003 CC is very prescriptive – some companies are taking the 'tick box' approach, which will do nothing to improve profitability. We have (we believe) been well ahead of the CC in best practice – as a result the 2003 CC will have little impact on bottom line: but may cost more! The 2003 CC provided the new 'baseline'. That means that, eg NAPF or PIRC standards have been pushed way beyond the new baseline and that is getting expensive/ uncompetitive.

Too many of the questions above imply that NEDs can have a strong influence on wealth creation, a proposition with which I disagree. By and large, the revised Combined Code does formalise better corporate governance and once compliant – or having a reasonable explanation – a company board should not be overwhelmed by it.



Appendix 6: Definitions of corporate governance

Respondents were asked to give their own definition of corporate governance. A template analysis was carried out on the definitions given. The categories used to analyse the definitions are shown in Part A below, together with the frequency with which the concepts occurred; they are ranked in order of frequency.

PART A: TEMPLATE ANALYSIS

Frequency		Rank
A = accountability	7	8
B = box ticking, bureaucracy, burden	7	8
Ba = balance	5	13
Bp = best practice	5	13
C = checks and balances	6	11
Ch = challenge	1	20
Co = control	11	4
E = ethics, integrity, honesty	18	2
Ex = external scrutiny	1	20
F = formalise	1	20
I = independence	2	17
M = monitoring	3	15
O = objectives, strategy	8	7
P = 'protecting shareholders'	2	16
Pr = processes	10	5
R = risk management	6	11
Re = reporting	1	20
Ro = roles and responsibilities	3	15
S = stewardship	2	17
Sh = shareholders	28	1
Sk = stakeholders	9	6
St = structures	2	17
T = transparency	7	8
V = value, profit, performance	12	3

PART B: DEFINITIONS OF CORPORATE GOVERNANCE

1. Ensuring risk is adequately managed — R
2. My definition 'it formalises good business practice, creates checks and balances and should reduce the risk of disasters from unforeseen events that should perhaps have been foreseen' — Bp C F R
3. Making risk management within a public company more transparent to shareholders — R T
4. Corporate governance is the system by which business organisations are directed and controlled, clearly identifying the roles and responsibilities of the various participants/ processes and structures — Co Pr Ro St
5. Regulation gone mad. Tick boxing — B
6. A set of guidelines and procedures to encourage highest ethical and business standards — E
7. Ensuring balance and check based on sound principles and practice — Bp C
8. Stewardship, stewardship, stewardship! — S
9. Integrity — E
10. The ability for all directors to express their views and opinions openly and honestly and to engage in debate and discussion to determine policy and strategy — E O
11. Checks and balances in the organisation to ensure: transparency: a broad vein is taken on the business's strategy, business risk, management and profits. Accountability to the shareholders – the ultimate owner — A C O Sh T
12. Process for ensuring good governance in the interest of the providers of capital — Pr Sh

13. Corporate governance is a process designed to promote the adoption of best practice in business affairs Bp Pr
14. An increasing burden on UK corporates, not completely relevant, and not totally reflective of processes required in the UK to ensure sound management of business B
15. The integrity with which the board operates both individually and as a team in taking decisions for the good of the major shareholders in the business E Sh
16. The demonstration of commitment and openness, which promotes the performance of the company in both short and long term E V
17. Playing box ticking on behalf of those who want knighthoods B
18. Ensuring the company delivers true shareholder value V
19. Protecting the shareholders P Sh
20. Conduct imposed upon companies by the Combined Code B
21. Unnecessary for MOST public companies! B
22. Ensuring that the direction of the business is focused on meeting the needs of its shareholders over the medium to long term, and on achieving operational objectives in the short term O Sh
23. Preservation of the integrity of the business in terms of strategy, performance and ethical standards E O V
24. The objective of corporate governance must be to improve or enhance the profitability of the business V
25. Providing checks and balances to ensure optimum board performance C V
26. The ethical integrity of the board both collectively and in their individual roles within the company E Ro
27. Operating a business with honesty and integrity in dealing with all its stakeholders, through ensuring proper process and accountability in all aspects A E Pr Sk
28. Proper development and control of the business by the Board on behalf of the shareholders, with the aim of delivering good shareholder value Co Sh V
29. The set of processes and people who ensure that a company is managed ethically, effectively and with sufficient transparency for its owners to make informed judgements concerning its performance and prospects E Pr Sh T
30. The way in the company's business is directed and controlled Co
31. Integrity and transparency of board action and decision E T
32. Corporate governance is the process by which plcs decide what, how and by whom they will satisfy their stakeholders in pursuing sustainable shareholder value Pr Sh Sk V
33. Creating an organisation totally open, with directors balanced between exec and non-exec, and non-exec balanced between those with detailed knowledge of industry and generalists, regardless of so-called independence. An effective board not a theoretical board Ba I T
34. Structures which encourage the board to act together to provide constructive challenge to the executive team to ensure that they are managing business in the best medium- and long-term interests of shareholders Ch Sh St
35. Ensuring honesty and openness to investors and good communication internally while minimising business risks E R Sh
36. Corporate governance is the system by which companies and their organisations are directed and controlled and held accountable A Co
37. Should provide external shareholders with confidence that company is being managed properly. Non-exec directors provide executives with experienced sounding board and

shareholders with expectation that the board contains sufficient experience and confidence to hold executives to account A Ba Sh

38. The practice, not just appearance, of ensuring that an organisation is managed on a basis of consistency with the interests of its stakeholders Co Sh

39. The process by which the highest standards of honesty, transparency and effectiveness in pursuit of business goals are implemented by management and directors and communicated to all stakeholders E O Sh T

40. Ensuring long term wealth creation V

41. A system of checks balances and disclosures designed to ensure that boards are thoroughly accountable to shareholders for their actions and performance A C Sh

42. Conducting one's business in the right manner and effectively communicating those standards of conduct E T

43. The framework of policies and protocols which governs the overall conduct of the business in all its internal and external activities Pr

44. Proper direction in the interests of shareholders and all stakeholders Co Sh Sk

45. Practical problems being dealt with over complex detailed rules rather than practical process regarding umbrella accountability B

46. Corporate governance, as the phrase implies, is the process by which a board of directors of a company looks after the shareholders' interests (stewardship) and responsibilities and by which it enhances those interests (wealth creation/ shareholder value). Shareholders hold the directors responsible for the stewardship of a company's affairs, delegating authority to directors to manage the company on their behalf and holding them accountable for its performance. It encompasses both wealth creation and stewardship. NB the combined code is concerned almost entirely with the latter A Pr Ro S Sh V

47. The contribution to the board of independence of mind, external strategic and operational business experience, additional intellectual challenge and assurance of high integrity Ba E I

48. Ensuring proper accountability, proper monitoring/ evaluation of the company, the business, the team, etc and above all promoting best practice in terms of strategic planning and measurement/ reporting of performance. A Bp M O Re

49. Being seen to control the executive in the shareholders' best long-term interests Co M Sh

50. Effective control of the executive management from directors down through the organisation to ensure that value is created where possible, that unnecessary risks are not taken and that over-exerting senior executive directors do not force through transactions that can be damaging to the company Ba Co R V

51. Having adequate and refined process in place in order to be able to defend the company's position when under scrutiny (by shareholders or the media) in the public market place Pr Mo Sh

52. Providing a framework for boards to do the right things – for investors, employees and for the community Pr E Sh Sk

53. Ensure that the interests of ALL shareholders are protected P Sh

54. Ensuring effective management of shareholders' funds through competent, ethical practices and openly demonstrating the integrity of the board, collectively and as individuals E Sh

55. Proper governance of the company in the interests of all shareholders Co Sh

56. Ensuring that the board sets the right goals and monitors progress, attaining those by the correct benchmarks. Being a custodian of the ethics of the company including its treatment of staff and relationships with customers and the wider community E O M Sk

57. The whole system of properly managing an organisation to create value for shareholders and to protect other stakeholders Co Sh Sk V

58. Ensuring the interests of the corporate stakeholders are properly balanced in a sustainable way. The shareholders are the primary stakeholders Ba Sh Sk

59. As endless hassle which takes up far too much board time, with repeated reports at far too frequent intervals. One in five or seven years would be adequate B

60. The demonstration to shareholders of the values and ethos which the management of the company utilises to all value on behalf of all stakeholders E Sh Sk

61. The way in which the board seeks to manage its business effectively, in order to deliver its goals. It is the control framework within which the business operates, designed to manage risk and deliver objectives and ultimately shareholder returns O R Sh V

62. Good practice in running of a company Bp

63. To ensure that the company's management acts in the best interests of shareholders and other stakeholders Sh Sk

64. Effective management control of business interests of shareholders Co Sh

Appendix 7: The survey questionnaire

Part A: Your view on the relationship between corporate governance and wealth creation.

Q.1 How influential do you think good corporate governance practice is in terms of each of the following?
(On a scale of 1 to 5 where 1 is not at all influential and 5 is very influential.)

		not at all influential				very influential
1.	Contributing to your organisation's profitability	1	2	3	4	5
2.	Contributing to your organisation's long-term share price	1	2	3	4	5
3.	Contributing to your organisation's strategic and/or operational effectiveness	1	2	3	4	5
4.	Obtaining investment from institutional investors	1	2	3	4	5
5.	Obtaining other finance at a reasonable cost of capital	1	2	3	4	5
6.	Maintaining or improving relationships with the investment community	1	2	3	4	5
7.	Contributing to your organisation's overall reputation	1	2	3	4	5
8.	Contributing to your organisation's attractiveness as a potential employer	1	2	3	4	5
9.	Contributing to your organisation's attractiveness as a potential supplier	1	2	3	4	5
10.	Other (please specify) ______________________	1	2	3	4	5

Q2. Please indicate the extent to which you agree or disagree with each of the following statements about independent NEDs in relation to corporate governance.
(On a scale of 1 to 5 where 1 is disagree strongly and 5 is agree strongly.)

		disagree strongly				agree strongly
1.	Independent NEDs play an important role in the organisation's ability to create wealth.	1	2	3	4	5
2.	Independent NEDs play an important role in establishing effective corporate governance practice in the organisation.	1	2	3	4	5
3.	Independent NEDs should play a stronger role in corporate governance.	1	2	3	4	5
4.	It is difficult to appoint truly independent NEDs.	1	2	3	4	5
5.	Independence of mind (i.e. objectivity and integrity) is more important than independence in appearance (i.e. compliance with a checklist).	1	2	3	4	5
6.	The role of independent NEDs is much more challenging now than it was three years ago.	1	2	3	4	5
7.	Institutional investors have too much influence over appointing independent NEDs .	1	2	3	4	5
8.	Independent NEDs do not devote enough time to their role in companies.	1	2	3	4	5

Q.3 What proportion of your board, excluding the chairman, comprises independent NEDs (as defined in the 2003 Combined Code)?

Less than 50% ☐ **...continue to Q4**

50% or more ☐ **...skip to Q5**

Q.4 The Higgs Report recommended that independent NEDs should comprise at least half of the board, excluding the chairman. The revised Combined Code introduced a provision to this effect for all companies within the FTSE 350.

Thinking of the effect that meeting this recommendation will make to the working of your board, please indicate the extent to which you agree or disagree with each of the following statements.
(On a scale of 1 to 5 where 1 is disagree strongly and 5 is agree strongly.)

		disagree strongly				agree strongly
1.	Increasing the number of independent NEDs so that they comprise at least half of the board could mean that individually, independent NEDs become less involved in the business.	1	2	3	4	5
2.	Increasing the number of independent NEDs so that they comprise at least half of the board could adversely affect team work and decision making on a unitary board.	1	2	3	4	5
3.	We would have to reduce the number of executive and non-independent NEDs to ensure that half of the board are independent NEDs.	1	2	3	4	5

Q.5 Thinking of what effect the changes introduced in the 2003 Combined Code will have on your organisation's ability to create wealth, please indicate the extent to which you agree or disagree with each of the following statements.

(On a scale of 1 to 5 where 1 is disagree strongly and 5 is agree strongly.)

		disagree strongly				agree strongly
1.	The new requirement for the board to undertake a formal and rigorous annual evaluation should help improve my organisation's ability to create wealth.	1	2	3	4	5
2.	Having at least half a board of independent NEDs will help to improve my organisation's ability to create wealth.	1	2	3	4	5
3.	The new criteria for considering the independence of NEDs will help to improve my organisation's ability to create wealth.	1	2	3	4	5
4.	The greater detail, given in the Code, on the role of NEDs, will help to improve my organisation's ability to create wealth.	1	2	3	4	5
5.	Ensuring that independent NEDs do not serve on the board for longer than nine years will help to improve my organisation's ability to create wealth.	1	2	3	4	5
6.	The stronger requirement for institutional shareholders to consider explanations by companies why they are not complying with a particular Code provision will be helpful to my organisation's ability to create wealth.	1	2	3	4	5
7.	It will be easier for the organisation to create wealth if we give more attention to corporate governance performance and practice than to compliance with corporate governance rules.	1	2	3	4	5
8.	Overall, the 2003 Combined Code will improve the accountability of UK companies to shareholders.	1	2	3	4	5
9.	The 2003 Combined Code will lead to the improved international competitiveness of UK companies.	1	2	3	4	5
10.	Overall, the 2003 Combined Code will lead to improved ethical integrity within UK companies.	1	2	3	4	5

If you disagreed with *any* of the statements at Q5 (i.e. a score of '1' or '2' was given), then please answer Q6, otherwise please skip to Q7.

Q.6 Please indicate whether you agree or disagree with each of the following statements.
(On a scale of 1 to 5 where 1 is disagree strongly and 5 is agree strongly.)

	Statement	disagree strongly 1	2	3	4	agree strongly 5
1.	Increasing the proportion of independent NEDs to at least 50% is not helpful to my organisation's ability to create wealth.	1	2	3	4	5
2.	The new criteria for considering the independence of NEDs are not helpful to my organisation's ability to create wealth.	1	2	3	4	5
3.	Removal of independent NEDs so that they do not serve on the board for longer than nine years is not helpful to my organisation's ability to create wealth.	1	2	3	4	5
4.	The enhanced instructions to institutional shareholders to consider explanation by companies in the event of non-compliance with a Code provision are not helpful to my organisation's ability to create wealth.	1	2	3	4	5
5.	Overall, the 2003 Combined Code could reduce the accountability of UK companies to shareholders.	1	2	3	4	5
6.	Overall, the 2003 Combined Code could reduce the international competitiveness of UK companies.	1	2	3	4	5
7.	Overall, the 2003 Combined Code could reduce ethical integrity within UK companies.	1	2	3	4	5
8.	Overall, I feel I am spending too much time on the corporate governance process at the expense of wealth generation.	1	2	3	4	5

Q.7 What other comments would you like to make about the changes introduced in the 2003 Combined Code?

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Part B: Your attitude to corporate governance.

Q.8 Please indicate to what extent the following aspects of corporate governance are important to your organisation (a) at present, and (b) in the next five years?

(Write in a score between 1 and 5, where 1 is not at all important and 5 is very important.)

		(a) at present	(b) in the next five years
1.	Financial reporting (disclosure)	____	____
2.	The composition of the board	____	____
3.	Board accountability and performance	____	____
4.	Compliance with corporate governance practices	____	____
5.	Disclosure of corporate governance practices	____	____
6.	Independence of non-executive directors	____	____
7.	Getting directors' remuneration right in relation to suitable performance criteria	____	____
8.	Succession management for the board	____	____
9.	The independence of the external auditor	____	____
10.	The quality of the external auditors	____	____
11.	The calibre and effectiveness of the audit committee	____	____
12.	Strategy and goals	____	____
13.	The risk management processes	____	____
14.	Relationships with institutional shareholders	____	____
15.	Other aspects (please specify)	____	____

Q.9 Based on your experience as a chairman or director, how would you *define* corporate governance in your own words?

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Q.10 Which of the following do you consider to be the *main* purpose of corporate governance?
(Tick a *single* answer only.)

Protecting your shareholders against loss. ☐

Optimising the long term financial ability to create wealth for the organisation. ☐

Equally important. ☐

Q.11 Listed below are some other purposes, often cited, for corporate governance. Please indicate how important you consider each.
(On a scale of 1 to 5 where 1 is not at all important and 5 is very important.)

		not at all important				very important
1.	Providing assurance to directors	1	2	3	4	5
2.	Improving the board	1	2	3	4	5
3.	Getting board appointments and succession right	1	2	3	4	5
4.	Ensuring accountability of management to organisation owners	1	2	3	4	5
5.	Improving share price	1	2	3	4	5
6.	Improving risk management	1	2	3	4	5
7.	Improving management	1	2	3	4	5
8.	Improving strategic or organisational effectiveness	1	2	3	4	5
9.	Providing assurance that internal control is effective	1	2	3	4	5
10.	Satisfying the needs of regulators	1	2	3	4	5
11.	Enabling non-executive directors to function effectively	1	2	3	4	5
12.	Ensuring financial reporting is correct	1	2	3	4	5
13.	Maintaining ethical integrity	1	2	3	4	5
14.	Other purposes (please specify) ______________________	1	2	3	4	5

Q.12 What other comments about the *purpose* of corporate governance would you like to make?

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Part C: and finally...

C1 What is your role in the organisation?

Chairman ☐

Finance Director/CFO ☐

Other (please specify) ______

C2 What is the approximate position of your organisation, by market value, in the London Stock Exchange listings?

Within FTSE 100 ☐

Within FTSE 101 to 350 ☐

Outside FTSE 350 ☐

C3 As an additional part of this survey, we would like to conduct a small number of in-depth interviews, either face-to-face or via the telephone. Interviews would take no longer than 40 minutes and be conducted by Paul Moxey, Head of Corporate Governance and Risk Management – ACCA.

Would you be willing, in principle, to take part in a brief interview?

Yes ☐ No ☐

If yes, please provide:

your name: ______

a daytime telephone number: ______

Thank you for taking the time to complete this questionnaire.

To receive a copy of the final report resulting from this survey, please complete the following. All information disclosed will be treated in the strictest confidence.

☐ *Please send me an electronic copy of the report by e-mail:*

E-mail: ______

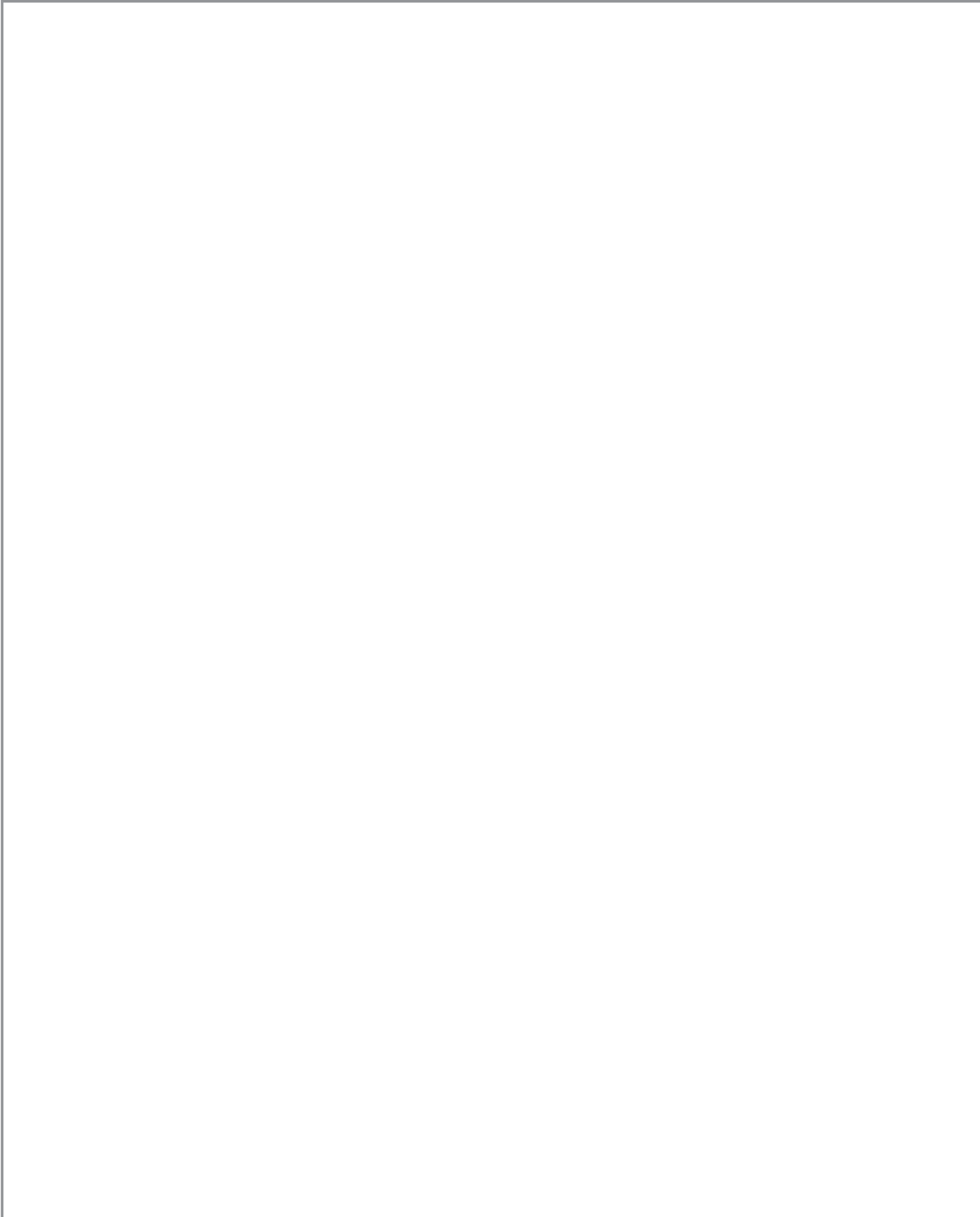
☐ *Please send me a paper copy of the report:*

Name: ______

Address: ______

______

Please return the completed questionnaire in the pre-paid envelope provided or send to:
Paul Moxey, Head of Corporate Governance and Risk Management
ACCA, 29 Lincoln's Inn Fields, London WC2A 3EE
tel: 020 7396 5794 e-mail: p.moxey@accaglobal.com



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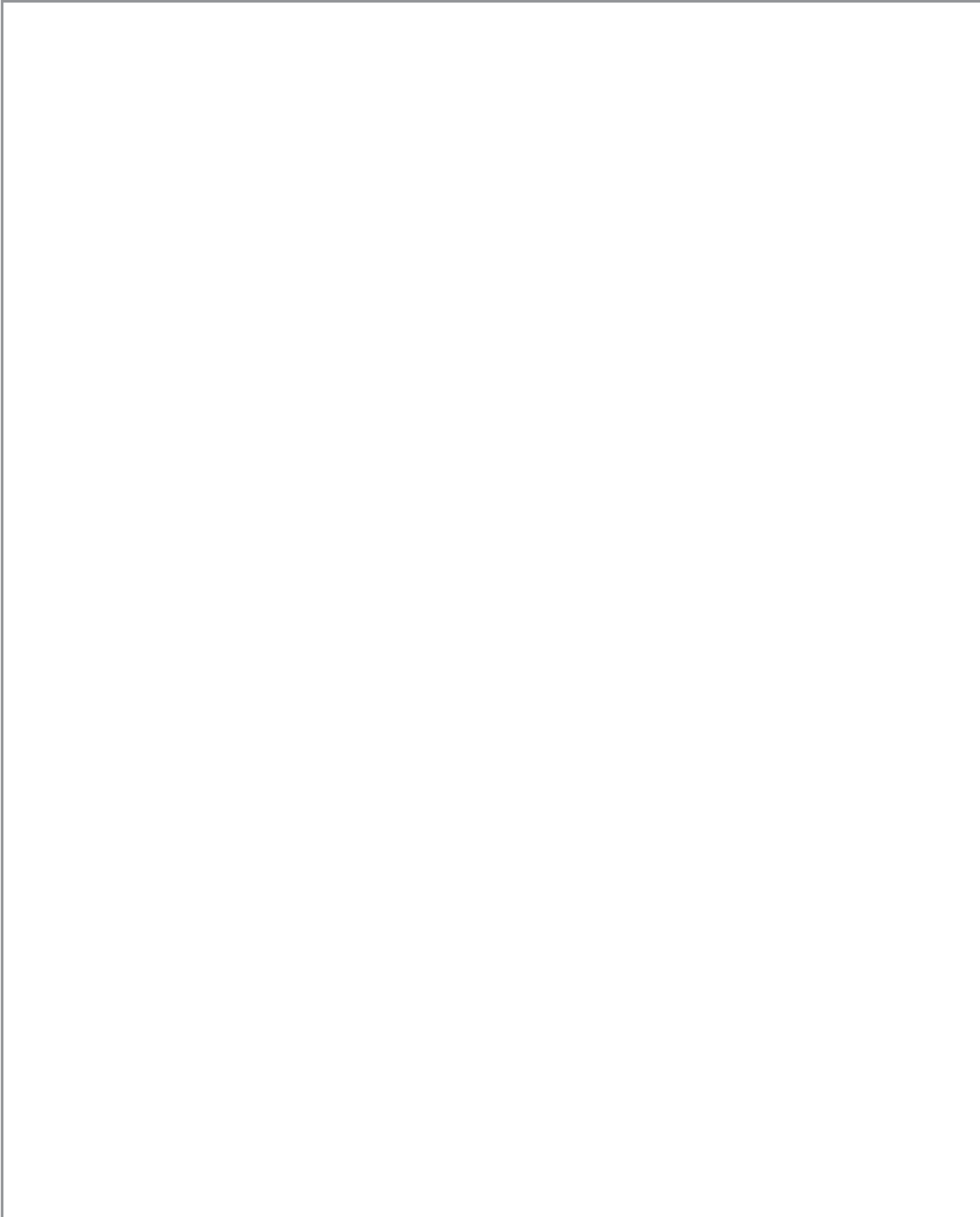

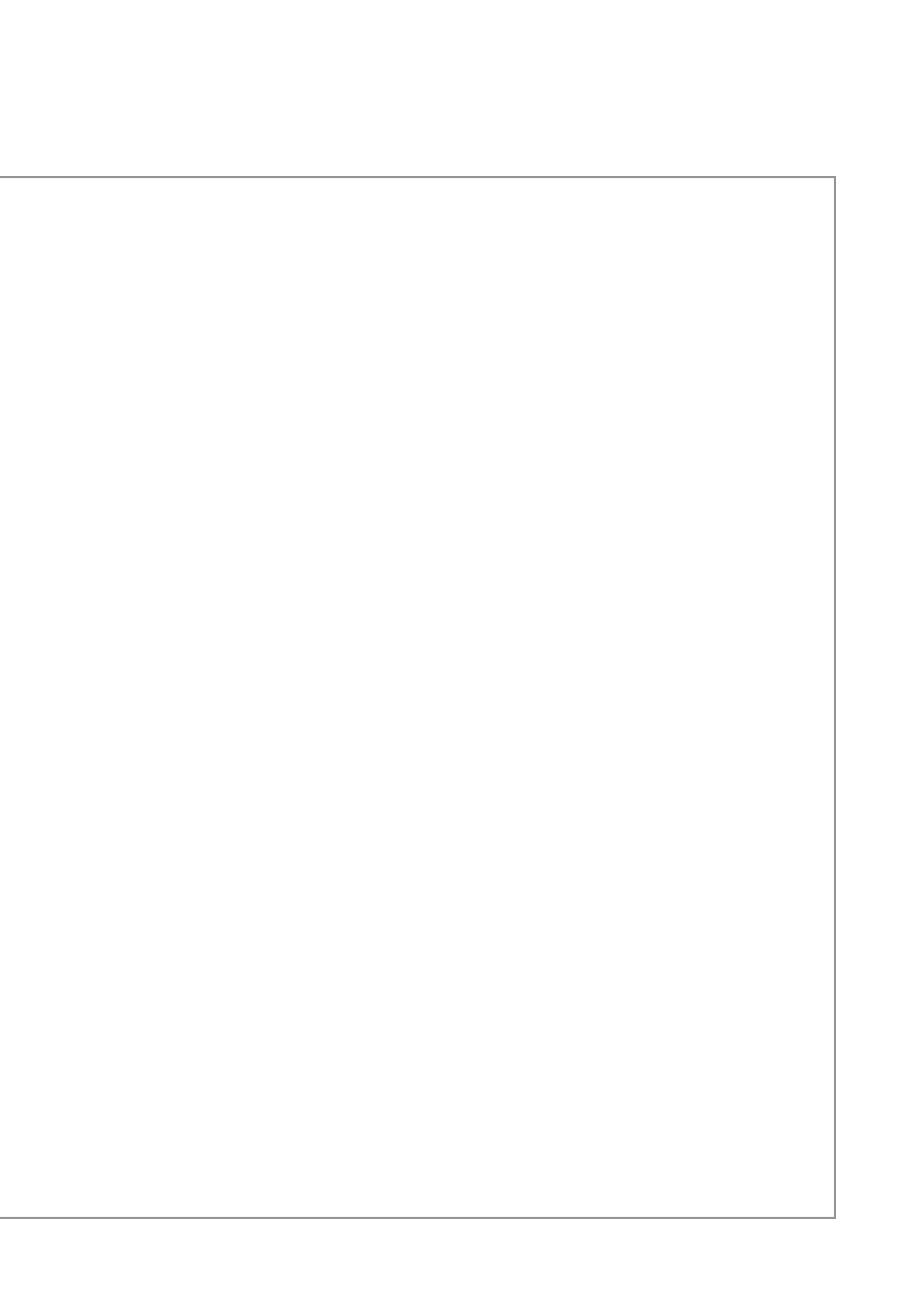

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