



The role of the Senior Independent Director

'... the SID also needs to be able to act as a lightning rod – picking up signs of emerging conflict or disquiet amongst fellow board members and giving voice to it at an appropriate time (particularly when the Chair is not responding to these tensions) so that issues don't fester.'

David Archer and Alex Cameron

70% of FTSE 350 Chairs under pressure to step down

'The purpose of a good Chair isn't to lead thinking for the board, but rather to be an independent facilitator. Someone capable of encouraging people to think around topics and seek knowledge and data to make good decisions, instead of relying on existing beliefs.'

Alison Gill

Content

News	3	Quality and effectiveness of audit An independent review has been launched calling for views and information on the purpose, scope, quality and effectiveness of statutory audit in the UK
International	4	Governance and performance in emerging markets Investors, including the IFC and other development finance institutions, increasingly look at governance as an indicator of firm quality and a factor in investment selection, according to recently published research
	5	CEO transitions in US companies Spencer Stuart's annual review, <i>2018 US CEO Transitions</i> , tracks CEO departures among Standard & Poor's (S&P) 500 companies. In addition to cataloguing the reasons for CEO departures the review examines information about the successors, including whether or not they are internal candidates
Global News	6	JSE proposes changes to Listings Requirements Global Capital Confidence Barometer New beneficial ownership register Top risks for Singapore SMEs
Features	8	The role of the Senior Independent Director Based on the discussions of a recent Round Table held with experienced board directors David Archer and Alex Cameron look at the importance of the role played by a good SID
	9	Lessons from Benjamin Graham Anthony Fitzsimmons argues that there are still lessons to be learnt today from Benjamin Graham's book <i>The Intelligent Investor</i> published in 1949
	10	70% of FTSE 350 Chairs under pressure to step down Alison Gill looks at what makes a good Chair of a board and why Chair independence matters

Feature

Lessons from Benjamin Graham

Anthony Fitzsimmons argues that there are still lessons to be learnt today from Benjamin Graham's book *The Intelligent Investor* published in 1949.

The first edition of Benjamin Graham's *The Intelligent Investor* devoted 30 pages to 'The Investor as Business Owner'. Two insights remain relevant. Graham contrasted the theory of shareholder rights with reality. Shareholders are notionally 'king', he wrote, with the power to 'hire and fire managements and bend them completely to their will'. In practice Graham saw them as 'a complete washout'. 'As a class they show neither intelligence nor alertness. They vote in sheep-like fashion for whatever management recommends and no matter how poor the management's record of accomplishment may be.'¹

The power of ultimate shareholders to influence management has diminished. Most individually owned shares are held through nominee accounts that, in practice, disenfranchise shareholders. Managers of collective investments provide patchy stewardship. Ultimate share owners could easily be re-enfranchised by legislation and technology. A resurgence of individual shareholders at AGMs would help boards to focus on public perceptions and the penetrating questions that astute shareholders ask. Most boards are heavily skewed, lacking key perspectives and having gaps in essential skills, knowledge and experience.² Savvy shareholders can force focus on systemic shortcomings sitting in boards' blind spots.

Turning to investment managers, the UK Stewardship Code is inadequate because it is voluntary and has limited scope. The FCA should develop robust rules that force institutional investors' incentives and behaviour into alignment with the interests of their ultimate clients, such as retail investors and future pensioners most of whom seek steady long-term growth. To support this, legislation, not just the UK Corporate Governance Code, should make it the unambiguous primary duty of directors to promote long-term sustainable success. With this as a national policy, there is logic in aligning voting power with duration of shareholding, giving full voting power only to long-term investors – and less to voracious Viking visitors.

But that leaves a fundamental question: how can good stewards and active investors get the information they need to do their job properly? The answer ought to be informative company reports. The FRC has made progress on company reporting frameworks but the scope and quality of information provided in annual reports depends on management openness.

Extending the scope of audit to the whole annual report will help ensure the accuracy of information provided. But it will not solve the problem of inadequate or absent information.

For those able to see through corporate hubris and market groupthink, it is easy to identify companies from which more information is needed. Graham suggested investigating those whose return or margin persistently lags their peers and those that have lost market share. He also highlighted the importance of management competence, a crucial tell-tale of future failure – along with leadership characteristics such as arrogance, hubris and dominance and boards that lack the skills needed to appoint and manage a CEO.

Graham's second insight is relevant here. He proposed that shareholders of 'underperforming' companies should be able to 'call in outside business engineers to pass upon the policies and competence of the management'. These outside experts would be 'selected by an independent committee of stockholders' with the report 'submitted directly to stockholders' and the cost borne by the company.

Audit could expand to fulfil this role. The Big Four's move away from calling auditees 'audit clients' is a start, as is their parallel move from providing other services to audit clients: but both are insufficient. With their appointment and tenure dependent on the auditee's board, they have powerful incentives not to rock the board's boat.

Sir Donald Brydon's inquiry into audit should follow the direction recommended by Graham. The auditor's relationship with quoted companies should become less close. Legislation should create independent Shareholders' Committees to appoint the auditor of quoted companies and to direct the audit and the investigation of any murky corners. They should receive audit reports on behalf of shareholders. Boards will still prepare the accounts and annual report but these will be audited by an entity that owes primary allegiance to shareholders.

This will remove the perverse incentives under which the audit profession has laboured for too long. It will allow auditors to use their professional skills and judgement to the full. And it should also help stem the steady stream of painfully predictable corporate crises that are every chairman's nightmare.

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 Anthony Fitzsimmons is Chairman of Reputability LLP and author of 'Rethinking Reputational Risk: How to Manage the Risks that can Ruin Your Business, Your Reputation and You' www.reputability.co.uk

1. The Intelligent Investor, First Edition (1949)

2. <https://www.reputabilityblog.com/2017/11/designing-better-boards.html>

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continued from page 8

what early warning signs you might need to address, and what questions you could ask to check out different perspectives on any concerns being raised. This sort of preparation helps a SID be ready to act as the calm voice of reason at times when emotions might be running high.

And finally

A good SID is not ambitious. It's not a 'Deputy Chair' role, although in some boards these roles are combined. One of our roundtable participants described an effective SID as 'a capable but reluctant Chair' – able to take on a board leadership role but only when the situation demands it.

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Index

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Organisations		Benjamin Graham	9
FCA	9	Companies	
FRC	9, 10	Aon	6
People		Bvalco	10
David Archer	8	EY	6
Sir Donald Brydon	3	International Finance Corp	4
Alex Cameron	8	Reputability LLP	9
Anthony Fitzsimmons	9	Socia Ltd	8
Alison Gill	10	Spencer Stuart	5

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