Whither Corporate Governance in the 21st Century?

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In this personal perspective on corporate governance, Denis Cassidy draws on his board-level experiences, including his chairmanship of Liberty PLC., and Newcastle United PLC.

I have been employed through half of the twentieth century and been a director of many different types of corporation, in a variety of roles, through the last quarter of it. So I have an acute personal perspective. I do not argue that this makes my views authoritative or better, or for that matter any worse, than anyone else's, but they have been shaped by experience which many people cannot match.

In parallel I have taken an active interest in the changing social structures, and attitudes which have been shaped in the UK and more generally in Europe and the developed industrial world.

Thus, in the relative calm of the early days of a new century I have found it worthwhile to review what has happened, to examine what have been the agents for change, and to extrapolate what is likely to happen and to contrast that with what one would most like to happen.

Frankly in terms of corporate governance little changed before the 1950s – most of the changes of any significance being post the Second World War. To refine that even further, change has accelerated from 1970 onwards. That may be axiomatic of the Middle Eastern oil crisis of 1973/1974 but it had its roots in the thirst for social change which emerged post the First World War but was suppressed until radical change began to occur post 1945.

During this period – 1945–1974 – consumer and employee power exploded. Trades Unions were in their pomp, collective bargaining was at its height – and I speak with feeling having served as a Personnel Director between 1974–1979. Consumers became more demanding, more self-confident, more aware of their power and since in many cases these were the same people – that is both employees and consumers – the force for change was irresistible. During this period discrete "rights" movements began to emerge. That of Human Rights, Amnesty International, fem-lib, gay liberation, animal rights, CND, Greenpeace, which swept away or made earlier radical reforming views seem insignificant tokens. And running through this was the emergence of the most powerful core of change – that of creating a more ethical society; one in which "the establishment" or faceless "power blocks" would be forced to listen to and increasingly bend to individual or minority group concerns. Businesses and businessmen had to reconsider their attitudes to those in society who were neither customers nor employees.

For businesses the watershed probably came with the succession to power of Mrs Thatcher and her Conservative Government of 1979 following the oil crisis of 1973, the hyper inflation of the mid 1970s and the huge weight of Labour/Trade Union legislation of 1974–1979.

Three business-related imperatives were developed by the Government during the Thatcher years:

1. To dismantle Trade Union power.
2. To control inflation and attempt to regenerate entrepreneurial spirit.
3. To limit emergent "corporate greed".

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The merger mania of the mid 1980s – in which I was, not alone, caught up, and which led to my personal rethinking of corporate governance principles – alarmed Downing Street and epitomised by the Guinness affair, set in motion a search for more transparency, more accountability and more ethical behaviour by the Boards of publicly quoted companies. But to whom were they accountable? Who demanded this ethical shift? These socio-political/economic thrusts were undoubtedly stimulated by different yet convergent dissatisfactions with ''society'' and sought a move towards, even a demand for, a more ethical society. Fundamentally however the Government's imperative was more pragmatic than philosophical.

Nevertheless it struck a chord with more moderate businessmen, it offered a placatory message to vociferous opponents in the Churches, Trades Unions, the Parliamentary opposition and minority activists as it sought to allay wider public fears.

One manifestation was that it led to a search for more acceptable corporate practice and the report of the Cadbury Committee in 1992 carried high expectations. It was greeted in some business quarters by disproportionate hostility, inter alia, to the imposition of ''independent, objective, non-executive directors'' to police the excesses of highly paid, uncontrolled executive directors. Irrational though it may have been, BTR's Chairman & Chief Executive, Owen Green's public opposition to the concept of non-executive directors – *''I won't have outsiders in my Boardroom''* and *''Audit Committee? I will not have an Audit Committee''*, coming from a highly regarded Chairman of, at the time, a highly successful internationally based business acted as a rally point for the anti-change lobby. This may have been one of the reasons why the Cadbury report was so ambivalent about one of the more important issues, particularly given the genesis of Cadbury itself in the Guinness affair – *''should the Chairman of a public company also be the Chief Executive?''*. And if not, why not?

To be so prescriptive about the need for **three** independent non-executive directors whilst being ambivalent on the dangers of the aggregation of power at the top of a business seems, even more in retrospect to be, odd. However the Cadbury Report was acknowledged by most as being no more than the sensible application of principles which would reassure the external world about what was, and should have been, happening in business processes. The formation of Remuneration Committees and Audit Committees was no more than a codification of what the best businesses already did. Yet the changing nature of business, the global strategies being pursued and accelerating privatisation conspired to create a further wave of dissatisfaction – that of individual (executive director) greed as opposed to corporate greed. ''Fat cats'' displaced ''corporate raiders'' and ''asset strippers'' as the unacceptable face of capitalism. This despite the legitimisation of remuneration review processes through the newly created committees.

Whilst much of this concern was misplaced – and I speak as a former director of two hugely successful privatisations – the Government's response was to add Greenbury (1995) to Cadbury, somewhat ironic given the combined Chairman/Chief Executive role of the eponymous fashioner of better or best remuneration practice. But corporate governance was by then being recognised as only one thread of an ethical behaviour garment – was it a ''hair shirt'' or a ''coat of many colours''? The other threads were emerging more clearly – corporate responsibility, accountability and the stakeholding community.

The need to self impose a policy of corporate responsibility was driven initially by a few corporate activists contrasting sharply with established less aware public corporations – illustrated by say Body Shop in contrast to ICI and the smoking beagles, or Shell and the North Sea oil platform, or Barclays Bank in South Africa. But the thrust was obvious; to limit the freedom of businesses to determine the most profitable course of action – by attacking the pockets of shareholders by public actions rather than appealing to Board's directors.

The stakeholder concept was a flowering of a much earlier conversion; that of *maximisation* of profit for shareholders should, in a practical sense, be translated as *optimisation* of profit as Boards sought wisely to achieve long-term sustainable growth rather than short-term profit maximisation.

But as we neared the century end an even more powerful lobby was emerging – to develop the stakeholder concept to encourage Boards (who run businesses), shareholders (who own them), customers and suppliers (who collectively support them), and the communities in which they operate (who support or suffer their presence) to seek consensual policies.

As the dominant UK political party of the twentieth century, the Conservatives, failed to convince the electorate in 1997, New Labour swept to power followed by a further reworking of corporate governance rules – now by the Hampel Committee – in 1998.

My conclusion from, sometimes, painful personal experience, is that these stages of development have begun to blur rather than clarify best corporate governance practice. Whatever the protestations, we are now very much in the mode of ''box ticking'' and business is being dragged into convergence, not with ethical standards but with the mechanics of the convergence, not with ethical standards but with the mechanics of the Accountancy Standards Board. I believe that is real and regrettable, and it is to the real roots of this movement that business should return – to ethical consideration rather than Thatcherite pragmatism. What kind of society do we want? What kind of businesses behaviour do we want? How do we articulate our concerns about how businesses should behave. Are we treating the symptoms, rather than the disease, by concentrating on the role of the Board instead of the role of the shareholder?

But have we, the believers in the benefits of better corporate governance, simply set our sights too high? Have we forgotten the lead given by the Bank of England in 1989 (Discussion paper No. 44) on this subject? Paraphrased, it was for shareholders to be more actively involved with and more interventionist in, the affairs of businesses in which they invest. To achieve better governance through closer shareholder supervision and control.

That plea – for shareholders to intervene in the management of the business more often – is diametrically opposed and therefore in serious conflict with the concept of empowering boards to act decisively, whilst being more transparent in their actions and the rationale that underlies those actions. That, afterall, was the thrust of the Cadbury report and its successors. Of course the *owners* cannot be disenfranchised, but should not limitations on shareholders' use of their power be sought to keep pace with ethical business development and the stakeholder concept? And are these interventionist owners of shares merely ''*shareholders*'' and stewards of pension fund investments, for, if so, are they empowered to act in disregard of employee considerations?

Looking back at the high profile errors and omission of the past 25 years, we should ask – who were the principal ringmasters in the circus? Was it directors?, such as those of ICI, Guinness or Shell – or was it the ''City''? That tag for highly visible yet frequently anonymous, with notable exceptions, creators of mergers and acquisitions, financial engineers, asset strippers, institutions, whom I've already argued are but the stewards of pension fund investments masquerading as owners.

Thus it is, I believe, the role of shareholders which requires examination and change if corporate governance is to be developed further in a way consistent with our changing society. The evidence suggests that in addition to explicitly supporting an ethical stance by the Boards of businesses in which they invest, shareholders should empower businesses which subscribe to such principles to act decisively, and refrain from intervention. What is the point of insisting that Boards have independent non-executive directors, have a clear separation of duties at the top of a business, have transparent processes and appoint Board committees which can be questioned by shareholders within or without general meetings in the fields of remuneration, nomination and audit, if shareholders then seek to intervene in matters in which frankly they have little or no experience. Furthermore, is there any consistent evidence from the last 25 years that when shareholders intervene they achieve an improvement in results?

There is some evidence that a number of major investing institutions have considered this and its implications and could be persuaded to lead debate and progressive change. Others have already adopted a different yet complementary approach by creating investment funds comprising only those companies judged by them to be ''ethical''.

The time is right for these concepts to be merged with the further development of corporate governance processes. Just as the basic principles of Cadbury were unthreatening to most of the Footsie 250 when they were first promulgated, so it will continue as further progress is made. There will of course be rogues, there will be errors but the trend is reasonably encouraging. However, the same cannot be said of the majority of listed companies which are outside the top 250.

Smaller companies still find it difficult to embrace the concept of independent non-executive directors. Those who willingly or reluctantly do so find it difficult to attract experienced contributory non-executive directors principally because larger companies do not encourage their younger executive directors to take on such responsibilities. Yet this can provide invaluable benefit to both businesses as well as the individual. One of the characteristics of smaller quoted businesses is the dominance of founding or family shareholdings which often creates serious governance problems. Yet given the oft stated belief that now more than ever they provide the seedcorn for future business growth – as demonstrated for example by information technology/internet stocks – it is an issue which we should consider carefully. We should ''stop preaching to the converted'' – the FTSE 250 – and address this particular problem urgently. I argue that the small company issue is closely allied to the need for further change in the attitude of shareholders/investors to proper governance.

Rather than look back at a series of events which illustrate this over the past 20 years, I prefer to examine with intimate knowledge two cases, both of which have occurred in the past three years. The common thread is of shareholders intervening in the management of a small quoted business for reasons, which were neither justifiable nor consistent with ethical behaviour. Moreover intervention created an obvious disadvantage or disenfranchisement for minority shareholders.

The first case concerns Liberty PLC, an upmarket West End retailer with subsidiary related businesses. Liberty had been created in 1875 and descendants of the original founder held approximately 44% of the equity. 27% was held by five members of the Stewart-Liberty family who included the widow of a former chairman and two of her stepsons who were executive directors. 17% was held by a large number of other family members not actively involved in the business but represented by a non-executive director. A South African investor – Bryan Myerson – who had made substantial financial gains from acquiring a substantial holding of shares in a similar kind of UK retailing business before disruptively using the EGM process to trigger takeover by a third party, acquired a 14% stake in 1991 with family money – a substantial investment of >£10m. In pursuit of the same outcome he began once again to agitate through the unusual – if legal – use of EGMs to expel the ruling family. Since the Stewart-Liberty family shareholders effectively controlled the Board, and there was very limited institutional holding, ''trench'' warfare between the two parties developed over a period of some years with adverse impact on the business. During a prolonged struggle two family directors left the board although one remained in the business.

Late in 1994 I was invited to chair the business which I agreed to accept after a lengthy period of due diligence. At that stage both warring parties were extremely anxious that I should accept. Peace appeared to have broken out. I sought and received from both parties a pledge of non-interference since it was obvious sacred cows would have to be sacrificed if profitable growth was to be restored. I recruited two experienced executives, reshuffled the Board and we began rapidly a process of reinvigoration. By the summer of 1997 the business was on an upward profitable trend, many seriously loss-making or irrelevant activities had been disposed of, a new operational management team had been recruited and a five year marketing and development plan announced. The share price rose steadily.

The Board was then approached by Myerson with his own plan which included actions to marginalise the family and in the process to create – at least that was his ambition – a substantial gain on the original investment for the investor and a bonus (of several million £'s) to be shared by the three key executives. The Board and its advisers collectively considered the plan, and without too much difficulty concluded that they could not act in their own and a single investor's interests against those of the family and minority shareholders.

What followed, rather bizarrely, was a covert agreement between the former antagonists, Myerson and the Stewart-Liberty family, followed by the renewed use of the EGM tactic to remove me as Chairman and subsequently other members of the Board.

Throughout this process the Board remained unanimous, publicly opposing the dissidents' attempts to acquire control of the business without paying a premium. Such action split the family vote, yet faced with 47% of the equity voting for change of control the Board lost the battle!! The EGM at which this was decided was a travesty of a democratic, ethical process – the dissidents refusing demands from other shareholders to reveal their plans, their credentials or answer some general questions.

What followed the change of control was a collapse in the share price, cessation of all dividends, termination of the development plan with substantial sunk costs, an exodus of the management team (in some cases voluntarily, in others enforced) and a massive reduction in shareholder value. The EGM was won by the dissidents holding 47% of the vote (from their start point of >46%). It is virtually impossible, given share registers which include private investors, PEPs/ISAs, tracker funds and other non-voting institutions (owners or stewards?) to defeat a large minority. There is no doubt in my mind that though the steps taken were legal, they were unethical. They were driven by the personal motivation and pursuit, however illusory, of gain by a handful of shareholders. There must be a case for considering whether or not such resolutions should require an absolute majority in favour of the (dissident's) resolution. Thus unregistered preferences should rank for the Board rather than be neutral to take account of tracker funds, non-voting institutions, PEPs and private investors.

The second case concerns that of Newcastle United PLC. The ''PLC'' was created in 1996 and in the spring of 1997 given a Stock Exchange listing crystallising the value that had been created by the re-establishment of the Football Club coincidental with the growing attraction of premiership football as both an investment and leisure pursuit. The launch price of the offer was 135p per share.

The Hall family, principally Sir John who had been the architect of the resurrection of the club and his only son had a paper wealth of some £110m as a result, and the Shepherd family approximately £15m. The sponsors of the float, NatWest, ensured that three external non-executive directors with established business reputations were appointed and the listing obligations of the London Stock Exchange were embraced by the new board led by a new independent Chairman. The listing rules and the matching shareholders' agreement committed the majority shareholder, Cameron Hall Developments (CHD), not to interfere in the management of the business and to protect and minority rights – both standard governance practice. Both CHD and Shepherd Offshore Ltd were represented on the PLC Board by Douglas Hall, Freddy Shepherd and Russel Jones, the Managing Director of CHD. Furthermore, all three held key roles in the principal operating subsidiary – Newcastle United Football Club; Shepherd as Chairman, Hall as Vice Chairman and Jones as Property Director.

Coincidental with the flotation process, the highly regarded manager (Kevin Keegan) resigned and was replaced by an equally respected football coach, Kenny Dalglish. Since this happened prior to the flotation there was no evidence of a formal search process having been undertaken, nor of a clear brief being given to the incoming manager of the Board's expectation. There was a substantial variance between these actions and the pledges of proper corporate behaviour. By the time flotation was achieved, Dalglish was in charge and thereafter the club declined quickly after the previous five year record of profitable and successful performance as a leading European football club to one struggling to stay in the premiership. A daunting prospect for recently enthusiastic investors.

But worse was to follow. A major scandal erupted centred on tabloid newspaper revelations of an alleged catalogue of misdeeds by the two principal shareholder directors. This led to their immediate resignation from the Board of the PLC and the Football Club. The resulting unsettlement was accompanied by further decline on and off the field. The Club was committed to huge capital expenditure to redevelop the stadium, results were poor, sponsorship and TV deals were under pressure, and in consequence the income streams began to suffer, shareholder support began to sag, and the share price fell sharply. Two hugely respected non-executive directors resigned and I was invited, as the one remaining non-executive director, to chair the Board. I declined until full agreement had been reached on future behaviour.

After the appointment of three further non-executive directors – two of whom were nominees of the Hall and Shepherd families, one of whom was independent – the two shareholders and former directors involved in the scandal confirmed, in writing, that they would now respect corporate governance rules which were tightened and that they would not seek a return to the PLC Board. The Board agreed, with my full support, to invite them to rejoin the wholly owned subsidiary Football Club Board. That appeared to be the optimum route to avoid further damage to the Club's future financial and footballing prospects.

However, within weeks BSkyB made an agreed bid for Manchester United PLC and given Newcastle United's share price, substantially below the flotation level of 135p, the two former PLC directors sought to be reappointed to the PLC and were known to have engaged in conversations with third parties about the sale of their shares. Apart from breaching an agreement on which the ink was barely dry, this action suggested minority interests were unlikely to figure highly in their considerations.

A divided Board – inevitable given the relationships of some of its members – at first agreed to reject their demands for reappointment but later a majority capitulated in the face of the two shareholders (Hall and Shepherd) formally serving the Board with notice of a resolution seeking re-election at the AGM. Given that they held 65% of the voting shares, it was clear they could, and duly did, achieve this. As Chairman, together with the independent, non-executive and the Shepherd family nominee non-executive, I advised the other board members that we were unable to continue as directors given the unwarranted breach of the written agreement without which the Board would not have approved Hall and Shepherd rejoining the Football Club Board. Subsequently the Chief Executive was appointed Chairman & Chief Executive.

Within days it was announced that agreement had been reached with a cable TV company, NTL, to acquire the CHD shares at a price of 111.6p – substantially higher than the prevailing market price – provided that the MMC allowed the agreed acquisition of Manchester United by BSkyB to proceed. In the event it did not, and the Newcastle United PLC Board remains in place without an independent presence. In addition the Shepherd family solicitor has been appointed as a part time Executive Director.

The listing obligations emphasized so much pre-flotation and corporate governance processes have been trampled on! Minority shareholders have been treated with contempt. In the period since, the share price has declined further and now trade at less than half the flotation price.

My earlier question remains – to what or whom are shareholders accountable?

I do not believe there is any evidence that individual investors have the skill to, and therefore should not have unfettered rights to, interfere in the management of a business. No one can question however that they should have the right to seek to change management if management cannot deliver. Between those two objectives lies the difference between public statements and private motivations.

My conclusion therefore is that the promise of better corporate governance provided by The Cadbury Committee has not been fulfilled but if I and no doubt others had looked more closely at some of the original political and financial imperatives, perhaps that is less surprising than it appears in retrospect. Nevertheless, the aspiration of society towards fairer and more open processes accompanied by the move towards wider share ownership ought to be matched by corporate governance practices which satisfy wider ethical and social aspirations rather than simply meeting the financial objectives of the shareholders. But stated baldly that suggests a naive approach to the reality of ownership. It does not. It does the reverse, and I argue that financial power must be subject to some voluntary limitations in pursuit of a better society. Otherwise there is little doubt in my mind that financial objectives will continue to override ethical considerations.

Corporate governance has lost its ethical edge and is degenerating into a meaningless ''box ticking'' exercise. My hope would be that the whole process could be regenerated by a more ethical approach applied equally to the stakeholding community. ''Respecting Human Rights in Business'' would be a much better objective than a code of Corporate Governance Best Practice. The optimist in me suggests that this will happen, although it may take another century. The pragmatist in me says it is unlikely that money and power will concede control. Surely it is time for the ''City'' to shift its stance on these issues.

Perhaps all those involved could agree an appropriate agenda which I suggest could be:

1. Listed companies to be encouraged/required to include a statement of ethical principles adopted by the board in the Annual Report & Accounts.
2. London Stock Exchange/Financial Services Authority/Bank of England to review, and enforce strict adherence to, listing obligations to prevent abuse by dominant shareholder directors.
3. DTI/LSE to consider change in proxy voting rules to recognise *non voting* impact of nominee and similar holdings.
4. FTSE 250 companies to be encouraged/required to release executive directors for one non-executive position in smaller listed companies.
5. Investing institutions to be encouraged/required to publish their code of ethical practice to include recognition of stakeholder ''rights''.

We shall see.

Biography

Born and educated on Tyneside, Denis worked for Dunlop before joining B.h.S. in 1970. He was appointed to the Plc board in 1974, his first directorship. He led the B.h.S. merger with Habitat/Mothercare to form Storehouse in 1986. After taking two Non executive directorships he resigned from Storehouse in 1987, as Deputy Chairman. Since then he has held a portfolio of Chairmanships and other directorships.

These have included board appointments at B.A.A., The Boddington Group, Ferguson International, Headway, Kingsbury Group, Liberty, Newcastle United, Oliver Group, Seeboard and S.I.S.