

## **Board Reviews: issues facing FTSE 350 companies in selecting an external evaluator (Briefing Paper #1)**

### ***Background***

The principal revisions to *UK Corporate Governance Code*<sup>1</sup> (the Code), including the requirement that an evaluation of the boards of companies with a Premium Listing should be externally facilitated at least every three years, have now been in place for well over three years. The majority of FTSE 350 companies will now have undertaken such a review and many FTSE 100 companies have undertaken their second. The upcoming financial reporting season in 2014 will reveal, for the first time, those companies that have not complied with the Code and the reason they have assigned.

The market for external board review is still considered embryonic. The annual Grant Thornton review<sup>2</sup> notes that some 43 different providers were revealed across its 2013 survey, which covered 82 companies which had named the external reviewer. It is self-evident that there is a wide variety of practice and methodology, making it more difficult for Boards of Directors and their Company Secretaries to select a provider.

This Briefing Paper considers some of the published material on the experience of companies to date and suggests how the critical task of selecting an appropriate firm or person to conduct an external Board Review might be approached.

### ***Market for External Evaluators***

The majority of respondents in an early survey by the ABI<sup>3</sup> suggested a negative view of the choice available in the market. However, a year on, while there is clearly more choice other concerns that were cited still remain. These include (in order of importance): lack of experience; lack of credibility; lack of independence; varying levels of quality; varying approaches and wide ranging costs.

Consulting on board reviews demands high level experience which may have been gained in a variety of professional fields, but is unlikely to be sufficient if it was not at chairman and

chief executive level. Credibility is considerably enhanced if the provider has direct experience of the overall Companies Acts regime and the FCA Listing Rules and Disclosure and Transparency Rules. In addition, consultants who have sat on boards and committees are naturally able to advise with greater authority.

JWA Governance is clear that, as with any professional service, quality standards are essential and is supportive of the ABI's call for a professional grouping of the main providers of evaluation consultancy to be formed with the purpose of articulating appropriate standards and providing assurance on the management of conflicts of interest.

The most commonly used external board evaluators are now specialist corporate governance consultancies or specialist board evaluators. Where companies have chosen to appoint an evaluator with knowledge of their business (and with whom there tends therefore to be a past business relationship), the type of firm has usually been an executive search firm. JWA Governance believes that FTSE 350 companies are making considerably less use of such firms unless they can demonstrate effectively that the conflict of interest can be managed. The requirement to disclose the identity of the provider and whether there is any existing relationship is ensuring greater transparency. However, even where there is no existing relationship, there must be a question of how appropriate it is for the board evaluator also to provide other board or consulting services. As the market develops it will be interesting to see whether companies use the same provider for the next externally facilitated review or decide they decide it makes better sense to make a fresh appointment

### ***Selection of External Evaluators***

The tender process is the favoured method of appointing a firm to conduct a Board Review and this accords with the most important considerations when selecting an evaluator.

Clients rightly expect the evaluator to be experienced in conducting board evaluations and therefore be better placed to benchmark against peers and best practice. They want experience in dealing at a board level in a company and they want the output to be meaningful and effective. The ability to

provide robust and constructive feedback and the quality of the final report is therefore critical in the decision as to which firm to appoint.

Significantly, in the ABI survey 36% of respondents mentioned gravitas as a quality they sought in their provider. This includes the evaluator's ability to command the respect of the directors; gain the confidence of the chairman and encourage directors to have open and candid discussions. A recent client of JWA Governance started the board review process by agreeing to 'open our cupboards.' No company or organisation is going to do that without having firstly placed a considerable amount of trust in the firm or person they have mandated.

### **Conclusion**

The fact that the market for Board Reviews is in its infancy places a significant burden on practitioners to demonstrate to their clients and potential clients that they are fully equipped to deliver the required evaluation services. JWA Governance believes in value-added Board Reviews. It expects its clients to learn something new from a review and for its recommendations to be a meaningful catalyst for change.

Anthony Archer  
February 2014

*Anthony Archer is a Partner of JWA Governance, an independent governance consultancy. He was a partner of Odgers Berndtson and his earlier career was with S.G. Warburg & Co. Ltd. and County NatWest. He previously qualified as a chartered accountant with Price Waterhouse and holds a law degree from the University of Birmingham.*

*For further information email [anthony.archer@jwagovernance.com](mailto:anthony.archer@jwagovernance.com) or call +44 (0) 7721 504125.*

<sup>1</sup> Financial Reporting Council, *The UK Corporate Governance Code* (September 2012) London: FRC.

<sup>2</sup> Grant Thornton, *Corporate Governance Review 2013: Governance steps up a gear* (November 2013) London: Grant Thornton UK LLP.

<sup>3</sup> Association of British Insurers, *Report on Board Effectiveness: updating progress, promoting best practice* (December 2012) London: ABI.

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