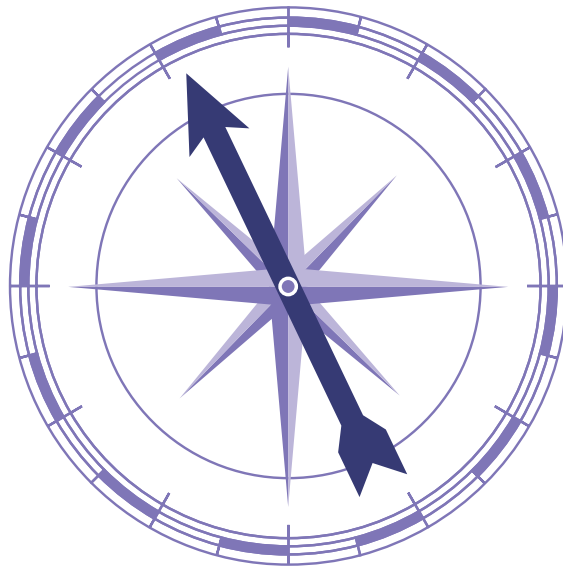


Tomorrow's Corporate Governance

The case for the 'Board Mandate'



About Tomorrow's Good Governance Forum

The Forum was formed in March 2010 in response to questions raised about the effectiveness of corporate governance as a result of the financial crisis and the subsequent reviews by Sir David Walker and the FRC.

The Forum brings together a number of key companies, organisations and individuals to explore what good governance means and to make practical recommendations to company boards and policy makers.

The purpose of the Forum is:

- to develop specific ways forward following the recommendations arising from Tomorrow's Innovation Risk and Governance, in particular those where input may be most valued by the Financial Reporting Council (FRC), the department for Business Innovation and Skills (BIS) and the participating companies, individuals and organisations
- to consider in detail the deeper set of issues which are strategically critical to the well being of companies over the longer-term. These include:
 - risk, innovation and governance, and how best to develop and implement good practice within boards in relation to these linked issues at a strategic level
 - the relationship between companies, their boards, and major shareholders and how that relationship can be strengthened through greater transparency
 - how in practice to define, differentiate and reward effective 'stewardship' by boards of all stakeholder interests.

The key outcomes arise from two distinct forms of engagement:

- engaging with and influencing boards, with a particular focus on the strategic effectiveness of board behaviours and procedures, in part through the membership of the Forum
- engaging with government and other relevant bodies to influence reforms of corporate governance in the light of the Forum's findings and recommendations.

This publication is part of a series of guides and toolkits from the Tomorrow's Good Governance Forum for use by chairmen, boards and advisors, to help achieve practical change.

"Tomorrow's Company is to be congratulated on its timely initiative in creating the Tomorrow's Good Governance Forum. We need a place where the natural leaders from companies and investment can come together and create the stewardship and governance solutions to the problems which my report identified. New rules and codes can only get you so far – what we now need is innovation and leadership and through its work Tomorrow's Company is ideally placed to maintain the momentum."

Sir David Walker

tomorrow's
good governance forum



Sir Malcolm Williamson

Foreword

Over the last couple of decades, we have seen many voluntary codes of corporate governance each improving on its predecessor.

I believe that these have helped British companies become better governed and that working towards self improvement is preferable to having legislation force change.

However the financial crisis and subsequent reviews suggest that further thought and action is urgently required.

This paper recommends the creation of a formal mandate by boards as a powerful instrument for carrying these improvements forward on a number of fronts.

I believe this is a good way to formalise and align the company's ethos for all its stakeholders.

It is intended to be a living document at the forefront of board thinking, which should provide a reference point to test all proposals coming before the board, which the board should ensure remains relevant on a regular basis. It helps to formalise the strategic intent of the board in relation to values, standards, performance outcomes and key issues of risk and forward development.

As a consequence, it should make board review and composition more relevant and effective, and should ensure that the mandate is being implemented throughout the company.

All of this should make company failures, as a result of the misalignment of aims and of misunderstandings, less likely, or where things go wrong make it easier to learn lessons from the mistakes.

A handwritten signature in blue ink that reads "Malcolm Williamson". The signature is fluid and cursive, with the first name "Malcolm" written in a larger, more prominent script than the surname "Williamson".

Sir Malcolm Williamson

Chairman of Friends Provident Holdings (UK) plc, National Australia Group Europe Limited, Clydesdale Bank PLC, Signet Jewelers Limited and SAV Credit Limited

Introduction

Boards are operating in ever more complex and challenging business environments. At the same time, their behaviour and standards are coming under increasing external scrutiny, for example through the Financial Reporting Council (FRC) and Walker Reviews in the UK.

This scrutiny is driven by broader concerns about a range of issues including trust, the environment, the increasing volatility of capital markets, and the capability of boards as custodians of the company ensuring its resilience for the longer term.

This publication champions the concept of a ‘mandate’ which sets out the ‘essence’ of the ‘character’ and distinctiveness of the company. We believe that this ‘working charter’ can help boards navigate their way through increasingly choppy waters by facilitating more effective strategic engagement: primarily between executive directors and NEDs to improve board effectiveness, but with the associated benefit that it drives communication externally with the key stakeholders, including investors, government and regulators, and society at large.

It is, we believe, one of the most effective ways in which boards can rise to the challenge, from the FRC and Walker Reviews, that there is room for improvement in boardroom behaviours. It provides particular emphasis on the roles of NEDs and the board as a whole in setting strategic direction, controlling strategic risk and ensuring alignment of key stakeholders in relation to critical decisions about the company, and in particular to ‘business transforming’ judgements made by the board (such as acquisitions). We also believe that this could be the bridge between the UK Corporate Governance Code and the Stewardship Code.

Though a carefully shaped mandate alone is not the answer to good corporate governance, it is a key part of the evolving journey requiring as it does a deep discussion by the board about the core direction of the business, its attitude to risk, development and reward, and the commitment to the sound custody of the company on behalf of all stakeholders.

This publication explains what a mandate is, its purpose and how to create and use one. It concludes with some questions of the type that a board might discuss when thinking about a mandate for their organisation. These are provided in the ‘tool-kit’ enclosed in this document.

A mandate captures the ‘essence’ of the ‘character’ and distinctiveness of the company, in terms of: its essential purpose; its aspirations; the values by which it intends to operate; its attitude to integrity, risk, safety and the environment; its culture; its value proposition to investors; and plans for development.

It is a living statement about what the company stands for and how it wishes to be known to all of its stakeholders.

How does a mandate fit with the role of a board?

Beyond its legal and fiduciary duties, the purpose of a unitary board – comprising both part-time non-executives and full-time executives – is to create value more effectively over time than the executive of the company could do on its own. In using the term ‘value’ we refer to the company as an engine of long-term value creation, acknowledging the importance of the relationships between the business and all its stakeholders for this purpose.

It is precisely the interaction between the executive and the NEDs, with their different experience, perspectives and knowledge bases, which should create a better stream of value and understanding of risk and opportunity for the benefit of investors and all stakeholders.

In charting the way forward, the board is constantly looking to ensure coherence between the purpose and identity of the business as it has evolved to date, its current condition, strengths and weaknesses and the discontinuities it will experience in the future from changing markets, technologies, political regulation and evolving societal expectations and values.

In practice this means making continual judgements about the direction of the business, in particular assessing recommendations for transformational actions, to ensure the good custody of its assets despite the inevitable pressures and cycles of disruption the business will encounter.

A mandate assists in this process by capturing the ‘essence’ of the ‘character’ and distinctiveness of the company, in terms of: its essential purpose; its aspirations; the values by which it intends to operate; its attitude to integrity, risk, safety and the environment; its culture; its value proposition to investors; and plans for development. It is a living statement about what the company stands for and how it wishes to be known to all of its stakeholders.

“The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company.”

The UK Corporate Governance Code, Financial Reporting Council
June 2010

What is a mandate?

The process of creating a mandate requires deep and comprehensive discussion by the board, and is a prerequisite to encapsulating the board's fundamental sense of future direction. It provides a source of understanding from which to draw to inform critical conversations with key interests, internally and externally.

The mandate therefore provides a lens through which the board as a whole can probe the route for creating value, sustaining performance, and making tomorrow's company emerge coherently and consistently out of today's business.

All or some of the information included in a mandate may already exist in other forms. For example, a mandate may pull together information from mission and vision statements, long-term strategy, governing principles, codes of conduct etc. These different elements are important but they have a different focus, priority and interpretation.

To be clear: a mandate is not a mission statement, or any of the aforementioned. It is a living statement for and by the board, continually refreshed and reinforced through the leadership of the chairman, actively engaging with all of the members of the board. If each member of the board can describe what is distinctive about the company in broadly the same way, the mandate has been successfully embedded.

There is no prescribed format and length for a mandate. It should be created by the board in sufficient detail to be a useful framework for internal strategic decision-making and subsequent communication.

A mandate is not a mission statement – it is a living statement for and by the board.

A number of case studies, along with some useful reference documents, are available on the website:

www.tomorrowscorporategovernance.com

The case studies demonstrate how, in practice, a mandate can be created, used, embedded and refreshed. They draw on current practice of leading companies as well as setting out new innovations in practice that companies might follow.

How does a mandate add value?

The value of a mandate derives from the deep and comprehensive thinking by the board. Its primary purpose is its use as a framework against which the current condition of the business, and its capacity to meet the requirements of organic development, can be assessed. Once this is achieved it can be used as a framework against which to judge ‘transformational’ business decisions.

The board may together decide – once this primary objective has been achieved, and as a secondary benefit – to draw on the mandate in communicating beyond the board to ensure everybody with interests in the company has consistent expectations and acts and responds accordingly. It can provide a clear line of sight and alignment of expectations within the business and between the business and its stakeholders.

Additionally, the mandate can also inform internal dialogue and conversation within the company at every level. This is not however a simple tool of internal communication; rather it recognises the importance of ‘the tone from the top’ and ensures a coherence and consistency of approach, seeping through the culture of the business.

A functioning mandate therefore adds the greatest value if it underpins all boardroom conversations, strategic choices, operational and execution processes, systems and people development, and frames all external communications to shareholders and stakeholders, as well as also being a baseline for internal communications.

Because it defines the broad principles and parameters of future direction within which the board seeks to operate, potential misalignment should automatically trigger a requirement for close inspection and constructive but critical challenge. The aim is to create and shape appropriate dialogue both within boards and between boards and stakeholders as soon as possible, without cramping the executive by stifling innovation or inviting micro-management by the NEDs, the institutions or the regulators.

“All boards by definition have the ‘mandate’ to govern; the key issue is HOW they collectively approach their responsibility.”

John Griffith-Jones
Joint Chairman, KPMG Europe LLP

Helping the board work together more effectively

A mandate helps create alignment and clarity by:

- **ensuring that the board as a whole:**
 - has a reference base for engagement in strategy, risk and oversight of executive policies
 - has a primary focus on ‘what really matters’ in the context of profound changes in the business environment and the nature of risk
 - has an active reminder of the reality that changing external circumstances will constantly challenge the underlying assumptions of the business model and leadership style and therefore of its own need to evolve
 - ensures that key transactions and policies are stimulated by, and decided in line with, the company’s fundamental purpose, values, capabilities and risk profile
- **providing a continual thread and framework for executive managers**
 - guiding their activities, actions and standards within the mandate without stifling their initiative and independence
- **helping equip NEDs to have better strategic conversations in the board**
 - giving them a context from which to engage in the development of strategy and the ongoing inspection of risk and behaviours; providing a common basis for both non-executives and executives in reaching critical judgements
- **providing a selection ‘screen’ for the attraction and recruitment of people at all levels**
 - including refreshing the skills and competencies of, induction to, and subsequent evaluation of the board and executive leadership.

A mandate cannot guarantee success. 'Good' or 'bad' boards are dependent on the quality of judgement that is used and the preparedness for unforeseen events. What it does do is:

- provide 'tramlines' and reference points so that the board understands when they are going outside these tracks in dealing with a challenging decision
- provide a framework against which to test the validity and suitability of different business scenarios
- secure sufficient elevation from the operations to enable the board to see the patterns as early as possible that suggest pathways and pitfalls to a successful and sustainable future.

The presence of a mandate will not prevent bad judgement occurring, or reversals happening, or recurrence of 'irrational exuberance' and 'momentum thinking' which underpin most corporate failures, but it should represent some kind of 'pause' button around which boards can take stock, without being hostile to innovation.

A mandate could be the bridge between the UK Corporate Governance Code and the Stewardship Code.

Helping boards communicate with stakeholders

Outside the boardroom, a mandate helps to frame the relationship the company wishes to have with:

- **investors** – a mandate will provide a clear investment proposition with identified parameters of success and risk and will help manage expectations in terms of growth, timeframes and risk or where changes in the value frame are contemplated. It will assist them in the determination of their investment allocations and as the spur for their intervention in major transactions and appointments. It can therefore act as a trigger for flagging the need for ‘stewardship’ discussions at all levels and could be the bridge between the UK Corporate Governance Code and the Stewardship Code
- **customers** – a mandate will distinguish what the company wishes to deliver to them in comparison with competitors
- **suppliers** – a mandate will be an invitation to partner with a client which has similar goals to their own
- **employees** – a mandate captures the core identity of the business as a place to work, as a vehicle for personal growth and as a framework of values and operational style; and provides a benchmark by which employees are attracted to join and stay with a company and around which values and behaviours are embedded in daily activity.

The board would need to ensure that in discussing and communicating its mandate, confidential commercial information and price sensitive detail is protected, and that putting shareholders in the position of shadow directors is avoided. Such conversations are the norm for mature companies with long-standing relationships.

In the same way that accounts are made public but the management information creating those accounts is not, the broad frame of a mandate could be made public although much of the information used in its construction should remain private.

How is a mandate created?

A mandate is the board's working charter and it must therefore be created and owned by the board as a whole.

The chairman must be the ultimate custodian of the process of creating the mandate, in terms of the tone and style of the boardroom process.

The chief executive in particular is vital to its creation as well as implementation. It will be for the chairman and chief executive to agree their specific roles in this process.

A mandate for a new company is naturally created through conversations between the entrepreneur founders, their financial backers, customers and key employees, and refashioned over time to ensure resilience in the face of changing markets, technologies and other factors.

To create a mandate in an established company, the board should ensure that it goes through a comparable entrepreneurial process by redistilling the essence of their business and taking into account the thoughts of investors and key employees as they do so. Significant new directions of products/services or geography or transformational acquisitions would merit new and intensive discussion to ensure their fit with the mandate and core capacity of the business, and may require a fundamental revision of the mandate to give full recognition and communication of that change.

The chairman must be the ultimate custodian of the process of creating the mandate, in terms of the tone and style of the boardroom process.

Managed internal debate, however radical or uncomfortable, is a better outcome than uncontrolled market reaction to perceived loss of strategic control and direction.

The creation of a mandate is unlikely to be a straightforward process and will demand challenging and hard fought conversations within the board¹, in private, over several iterations. That should not detract from the fact that managed internal debate, however radical or uncomfortable, is a better outcome than uncontrolled market reaction to perceived loss of strategic control and direction.

Everyone on the board should take individual responsibility for the mandate (as opposed to a mandate committee or lukewarm individual sign-up) otherwise it becomes someone else's document/problem and the fundamental collective responsibility of the board is jeopardised. Key to the success of the mandate is how board members collectively approach their responsibility.

The 'tool-kit' enclosed with this document offers questions of the type that a board might discuss when thinking about a mandate for their organisation.

¹ The quality of the debate that creates a mandate and subsequent conversations using the mandate will have a significant impact on its success. Whilst the board mandate focuses on what should be discussed, a further publication from the Tomorrow's Good Governance Forum will focus on how to improve boardroom conversation.

How is a mandate embedded?

The development of a sound mandate is rooted in the process of commitment and shared understanding of the board as a whole, guided by the chairman and supported by the chief executive.

A mandate cannot add true value until it becomes a living document that is constantly reviewed and confirmed – in light of the strategic condition and life stage of the business in relationship to its external markets and the changing business and social environment and circumstances.

It becomes alive when it is automatically used as the reference base in the first instance for all strategic decision-making. Whereas discussion about the mandate should be regular, significant change to the substance of a mandate is likely to be rare and the result of a widely developed new consensus.

A mandate should feature prominently in the board pack and act as a key point of reference for subsequent discussion and decisions.

Arguably everyone should be able to sum up in a sentence or two what the company stands for. Therefore it is important that the contents of a mandate are reinforced at all levels of the organisation. For example, individual units of the company may devise their own interpretation of the mandate to ensure their particular strategies, standards and behaviours are consistent with it – which can then be backed up by supporting material at different levels of detail for different audiences.

If it is to achieve its aim of guiding decisions and behaviours it needs to become embedded within the activities of the organisation e.g. in the workings of audit and risk committees, ensuring that the necessary monitoring tools and processes are in place. For example, if the company decides that it has a low appetite for risk – does the risk committee review all new and amended products or services to ensure that they are compliant with this statement?

Through its active use in this way, feedback is provided to ensure that it is amended in the light of experience and changing circumstances so that it remains a relevant, credible and useful tool.

A mandate comes alive when it is automatically used as the reference base in the first instance for all strategic decision-making.

How does a mandate help evaluation and renewal?

As a tool for NEDs and new executive directors, it facilitates open discussion at the time of accepting the directorship, around the purpose, value and culture of the company and their 'fit' with it – i.e. “This is who we are... does that attract you?” It helps achieve clarity from the outset.

An incoming CEO may set out a case for adapting or altering a mandate if prompted by a belief that, for example, the business model needs to be changed. A conversation about changing the mandate will be a crucial pre-cursor of any appointment and the chairman should therefore ensure a close alignment between the mandate and the CEO's terms of reference.

When a mandate is created or substantially amended, this is a useful prompt for the chair to review the competencies of a board to ensure that it is able to effectively deliver on the mandate.



“A board mandate can only be established when a board has collectively made common cause on the purpose of the business of the company, the values that drive the business, the stakeholder groups linked to the company, their needs, interests and expectations, the sustainability issues pertinent to the business and the long-term strategic direction of the business. In short, it demonstrates that all board members are facing in the same direction which should lead to more rational business judgment calls in the best interests of the company and the maximisation of its total economic value.”

Prof Mervyn King SC, Chairman, King Report on Corporate Governance in South Africa; Deputy Chairman, IIRC; Chairman, Strate (Settlement arm of the JSE SA); Chairman, Integrated Reporting Council of SA and Chairman of the Global Reporting Initiative.

Q&A

Possible concerns:		Response:
Our board members already know this	Maybe	If each of the board members can consistently articulate all that a mandate would contain without thinking about it, and if it is an active part of the decision-making process, and shared with external parties, then you already have a mandate.
Could this conflict with directors' legal duties?	No	The legal requirement to promote the interests of the company is entirely consistent with enhancing the value stream, understanding risk and the legal responsibilities of stewardship.
Does this fit with the UK Corporate Governance Code and Walker's recommendations?	Yes	It is designed as one of the instruments to improve boardroom conversation and risk evaluation, to fill the gaps identified by Walker in his board performance recommendations.
Can this come back to bite us?	Maybe	If the actions and performance of the company are in line with its mandate, the expectations of investors and company would be consistent. However, unexplained deviations would rightly generate challenge and the need for critical debate.

Enclosed in this document is a ‘tool-kit’ which provides an agenda for board discussions.

These are not questions to create a mandate – they are questions of the type that the board should consider and discuss, from which a mandate might be created.

It is suggested that a mandate should be a formal synthesis of board conversations considering questions such as:

Who are we and what do we stand for?

What values, reputation and culture do we want?

How do we create a successful and sustainable organisation?

What relationships do we have with our stakeholders?

How do we develop our business?

What is our appetite for risk?

We as Forum members welcome this document as an important contribution to improving the effectiveness of corporate governance. It is the first in a series of publications, proposing instruments and practical tools for consideration by chairs, chief executives, company secretaries and other key figures responsible for the quality of corporate governance. Together these publications will provide an essential guide to good governance.

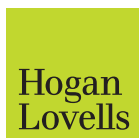
Tomorrow's Company thanks and acknowledges the support and expertise of members of the Good Governance Forum. As well as the corporate members shown, we are immensely grateful to a number of individuals: Leslie Dighton (whose generous idea is at the heart of the Mandate); Patrick Houghton (PHI Associates); Patricia Hewitt (Senior Independent Director, BT); and Keith Mackrell.

We also want to express our deep appreciation to BIS (The UK Department for Business, Innovation and Skills) and the FRC (Financial Reporting Council) for their support and active engagement with the work of the Forum; and to the Lord Mayor's Office in the City of London for their collaboration.



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