

Achieving Accountability through a Triumvirate Approach: A Way Forward?

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Abstract:

Conventional solution to corporate collapses had tended to gravitate around reforms to corporate governance codes and laws. However, the problem seems to persist. This paper argues that whilst leadership is not a substitute for codes and laws, it should be treated as the ‘driver behind the wheels’ of accountability.

Introduction

In the last few decades many multinational companies have experienced corporate governance failures at a colossal level. Directors have also been fined by courts in many jurisdictions for breaching their legal duties. Continuous reform in the US, UK, Australia and many other countries has not seen the number of corporate collapses abate.

At the heart of the matter is the notion of directors’ accountability. This is a complex construct which overlaps the realms of governance, regulation compliance and leadership. For example, Vincent-Jones described accountability, ‘as a process whereby individuals are required to explain or justify their decisions or acts to another person or body in accordance with certain criteria, and then to make amends for any fault or error.’⁴ Similarly, Du Plessis, McConvill and Bagaric argued that, ‘individuals or groups in a company who make decisions and take actions on specific issues need to be accountable for their decisions and actions. Mechanisms must exist and be effective to allow for accountability. These provide investors

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⁴ Peter Vincent-Jones, *The New Public Contracting: Regulation, Responsiveness, Relationality* (Oxford University Press, 2006) 75.

with the means to query and assess the actions of the board and its committees.’⁵

Accountability is central to what a director does and core to what corporate governance is about.⁶ Therefore, the crux of reforms to corporate governance and laws are directed at achieving greater accountability. However, what appears seemingly obvious and easily attained is complicated by how and in what ways accountability is measured and assessed.

This paper examines approaches towards accountability from three perspectives - corporate governance, legal regulation and leadership accountability. By exploring corporate governance we expose a number of limitations which restrict its effectiveness. We examine regulatory instruments such as, directors’ duty of care and skill and in doing so highlight how these are designed to have impact ‘after the fact’ and therefore do not necessarily address issues of accountability until it is too late. Finally, we attempt to understand the board and its member as leaders, and as such, the means of bridging the gap through the provision of what we define here as *Leadership in Compliance* - ensuring expectations laid out in corporate governance codes and the prescriptions and standards encapsulated in directors’ duty of care and skill are embedded in directors and boards decision making processes.

Corporate Governance and its inherent Limitations

The last twenty years has seen a continued growth of global companies which have revenues, in some cases, larger than the Gross Domestic Product of some small sovereign states. Governing these Leviathans can also mirror the governance of a state. The 2007 global financial crisis and the collapse of large corporations around the globe have raised concerns on how well these corporate entities are governed. This has led many jurisdictions to introduce reform by tightening up regulations on the monitoring role of the board of directors.

The notion of what makes for, and is practiced as, corporate governance draws from a wide number of sources. The Cadbury Report gives a very brief definition of corporate governance as, ‘the system by which companies are directed and controlled.’⁷ Shleifer and Vishny compare ideas of governance to the way in which suppliers of finance assure

⁵ Jean du Plessis, James McConvill, and Mirko Bagaric, *Principles of Contemporary Corporate Governance* (Cambridge University, Press, 2005) 8.

⁶ Jill Solomon and Anis Solomon, *Corporate Governance and Accountability* (John Wiley & Sons, 2004) 14-5.

⁷ The Committee on the Financial Aspects of Corporate Governance, and Gee and Co. Ltd., *Report of the Committee on the Financial Aspects of Corporate Governance* (1992), para 2.5.

themselves a return on their investment.⁸ This, by definition, focuses on the level of accountability to investors and creditors. Perhaps the most widely cited definition is found in the Principles of Corporate Governance issued by the Organization for Economic Co-operation and Development (OECD), which takes a slightly broader view and identifies a number of key stakeholders:

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders, and should facilitate effective monitoring.⁹

The OECD also identified some common elements that underlie good corporate governance embraced under different models in various countries. These principles established the roles and responsibilities of the key members working for the corporation, in particular those related to the board of directors. At the same time, these principles recognise the rights of key stakeholders, including specifically those of shareholders.¹⁰ Identification of the roles and responsibilities of key members in the corporation is important for corporations to set up a system of accountability for two main reasons. First, by making clear their roles and responsibilities, key members can understand what they are held accountable for and know what they are supposed to do. For example, with a clear system of accountability, directors and managers know that they will be rewarded in relation to the profitability of the firm. Secondly, for retail investors the disclosures obligations and other reporting requirements are vital to providing information about the operations and financial position of the firm. Therefore, information empowers the investing community and to some extent the public the ability to hold the board of directors accountable for their decisions and acts. Transparency in this sense enables the investment community and the public at large to develop better understanding of firm and in the process foster trust in the board of directors. Yet, corporate governance suffers from a number of limitations.

⁸ Shleifer and Vishny, 'A Survey of Corporate Governance' (1997) 52 *Journal of Finance* 737–83.

⁹ OCED, *OECD Principles of Corporate Governance* (2004), p. 11.

¹⁰ *Ibid*

To do or not to do, that is the question

The first of these limitations is that companies are *given choices to adhere to or ignore* governance benchmarks.¹¹ Often many jurisdictions opt for a “comply-or-explain” approach to corporate governance obligations as oppose to mandatory legally binding rules.¹² This allows firms who do not comply with certain provisions of corporate governance codes to explain why they chose to depart from those standards. For non-compliers the burden of explaining why be quite onerous. The ratio of listed companies in the UK, Australia and Hong Kong is inclined towards compliance.¹³ A key limitation is that whilst there is certainty in ensuring companies comply with the benchmarks, in absence of active scrutiny and an independent compliance audit it is likely that firms will carry out superficial compliance at best, in short, form over substance.

Questionable Measurement Indices

A second limitation comes in the form of measuring indices. To measure the quality of corporate governance firm rating agencies developed indices to benchmark a firm’s governance features against a defined index of characteristics.¹⁴ A major shortfall with this approach is the reduction or oversimplification of the complexities and dynamics of governance into numerical value. Nevertheless, these indices can be used to allow the firm to consider whether they should invest in improving their governance.¹⁵ For listed entities, indices have greater impact in terms of using their rating to benchmark their governance practices with peers in order to attract investors, particularly institutional investors.¹⁶ As such, listed entities with good governance ratings may be able to lower their capital costs, increase the chance of attracting quality directors and executives, and reduce insurance premiums, in

¹¹ Alastair Hudson, *Understanding Company Law* (Taylor and Francis 2017) 172.

¹² The comply-or-explain approach was first introduced by the Cadbury Report.

¹³ MacNeil, I. and Li, X. “Comply or explain”: Market discipline and non-compliance with the combined code’ (2006) 14 *Corporate Governance: An International Review* 486–96.

¹⁴ Bhagat, S., & Bolton, B. ‘Corporate governance and firm performance’ (2008) 14 *Journal of Corporate Finance* 257-273.

¹⁵ Bebchuk, L. A., & Hamdani, A. ‘The elusive quest for global governance standards’ (2009) 157(5) *University of Pennsylvania Law Review* 1263-1317.

¹⁶ Vo, T.-N. T., ‘Rating management behavior and ethics: A proposal to upgrade the corporate governance rating criteria’ (2008) 34(1) *Journal of Corporate Law* 1-41.

particular, directors' and officers' liability insurance.¹⁷ However, empirical studies have shown mixed results on the linkage between governance ratings and various measures of corporate performance.¹⁸

Ensuring the independence of those who govern

In many parts of the world countries have put considerable efforts into introducing corporate governance reforms targeted at improvement of the board's ability to effectively carry out its monitoring responsibilities and accountability. These include an increase in the number and the proportion of independent non-executive directors in corporate boards, separating chairman and CEO roles, and establishing dedicated board-level committees on nominations, compensation, and audit in jurisdictions such as, the UK, Hong Kong and Australia.¹⁹ These measures are aimed at listed entities in the form of either list rules or codes because it is presumed that failure of publicly listed companies creates considerable harm to market integrity and investors' trust in equity markets.

Independent non-executive directors are supposedly meant to be impartial when making corporate decisions and evaluating the performance of senior executives of the firm. In practice they are outsiders who serve part-time on boards. As a result, their exposure to, and understanding of, the operations of the company will be inherently limited, and rely on executive management for information and recommendations.²⁰ The tightening requirement for "independence" of the board in recent years has driven companies to appoint many independent non-executive directors with little industry expertise relevant to the firm.²¹ However, this trend has not led to better board performance or enhanced accountability.

¹⁷ Ibid.

¹⁸ For example, Bebchuk, L. A., Cohen, A., & Wang, C. C. Y., 'Learning and the disappearing association between governance and returns' (2010) 108 *Journal of Financial Economics* 323-348. Bhagat, S., & Bolton, B. 'Corporate governance and firm performance' (2008) 14 *Journal of Corporate Finance* 257-273. Chi, J. D., & Lee, D. S. 'The conditional nature of the value of corporate governance' (2010) 34(2) *Journal of Banking & Finance* 350-361. Johnson, S. A., Moorman, T. C., & Sorescu, S. 'A reexamination of corporate governance and equity prices' (2009) 22(11) *Review of Financial Studies* 4753-4786. Newel, R., & Wilson, G. 'A premium for good governance' (2002) 3 *McKinsey Quarterly* 20-23.

¹⁹ Wong, S. C. Y. 'Uses and limits of conventional corporate governance instruments: Analysis and guidance for reform-part one' (2009) *Private Sector Opinion, Issue 14: A Global Corporate Governance Forum Publication*, International Finance Corporation.

²⁰ Ibid.

²¹ Ibid.

There is still little consensus on whether an independent board will result in better monitoring of management conduct.²²

Getting the Director Mix right

A final limitation comes in the form of generalization over tailoring. Most stock exchanges simply impose a minimum number and/or a minimum ratio of independent directors on the boards of their member organizations. This tends to ignore the fact that different companies may need a different mix of various types of directors. It is therefore important for stock exchanges, securities regulators and governments to reassess the optimal mix between different types of directors in a corporate board so that the resulting board will feature a diversity of perspectives, substantial formal independence, and strong company and industry knowledge.²³ In fact, board roles and contributions will vary by company and over time, depending on firm maturity, ownership structure, performance and management depth.²⁴ Optimal mix of the various types of directors in the board of a corporation will vary as well.

Although reforms can introduce structural changes such as, the establishment of committees within the board, independent directors to reduce executive directors decision making powers, and mandate a set of procedures or best practices in decision making at the board level, they are not a panacea. Governance reforms by themselves cannot ensure directors ‘do the right thing’ and ‘do things right’. There are clear limitations to what reform of directors in listed entities could achieve to bring about accountability as they cannot ensure directors adhere to good corporate governance norms. At best corporate governance listing requirements or codes should be understood as best practices, benchmarks or standards.

Directors’ Duties as a Regulatory Instrument

Laws or prescriptive and proscriptive legal requirements are said to be more potent than corporate governance codes in compelling conformity to the stipulated duties. If this

²² Vo, T.-N. T., ‘Rating management behavior and ethics: A proposal to upgrade the corporate governance rating criteria’ (2008) 34(1) *Journal of Corporate Law* 1-41.

²³ Wong, S. C. Y. ‘Uses and limits of conventional corporate governance instruments: Analysis and guidance for reform-part one’ (2009) *Private Sector Opinion, Issue 14: A Global Corporate Governance Forum Publication*, International Finance Corporation.

²⁴ *Ibid.*

assumption holds true then the imposition of such legal duties would mean directors would be obliged to ‘do their job’ or act in such a manner that would ensure they are accountable to the company. In an Australian case Middleton J describes a director’s responsibilities in the following:

Each director is placed at the apex of the structure of direction and management of a company. The higher the office that is held by a person, the greater the responsibility that falls upon him or her. The role of a director is significant as their actions may have a profound effect on the community, and not just shareholders, employees and creditors.... Directors are generally well remunerated and hold positions of prestige, and the office of director will continue to attract competent, diligence and intelligent people...A board should be established which enjoys the varied wisdom, experience and expertise of persons drawn from different commercial backgrounds...What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her.²⁵

Interestingly his honour was referring to the directors’ duty of care and skill to illuminate the expectations of the role of directors from a legal perspective.

Critics might point out that it should statutory provisions such as, section 172 of the UK Companies Act 2006 should ensure directors ‘do their job’ as this provision creates a statutory duty to promote the success of the company. Even though the text in section 172 appeared to depart from common law standards,²⁶ *Cobden Investments Ltd v RWM Langport Ltd*²⁷ reinforces the fact that the test remains subjective. Thus, status quo is the standard applied. The major departure from the historical formulation is a non-exhaustive list of matters to which the directors must have regards when deciding on the appropriate course of actions.²⁸ In its place the statutory duty of care and skill in section 174 could be more effective regulatory instrument to ensure directors fulfil their obligations diligently.

²⁵ *Australian Securities and Investment Commission v Healey* [2011] FCA 717, paras 14, 15, 18, 20.

²⁶ Nicholas Bourne, *Bourne on Company Law* (7th edn, Routledge 2017) 179.

²⁷ [2008] EWHC 2810 (Ch)

²⁸ Paul Davis and Sarah Worthington, *Gower Principles of Modern Company Law* (10th edn, Sweet & Maxwell 2016) 501.

The Duty of Care and Skill

The classic formulation of the common law duty of care can be found in *Re City Equitable Fire Insurance Co.*²⁹ Davis and Worthington note that, ‘The proposition was famously formulated by Romer J in the *City Equitable* case that “a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of *his* knowledge and experience.”’³⁰ The standards were clearly subjective. More importantly, Davis and Worthington make the following observation, ‘The courts were also influenced by a model of corporate decision-making which gave the shareholders effective control over the choice of directors. If the shareholders chose incompetent directors, that was their fault and the remedy lay in their hands.’³¹ Therefore, the standards were a product of the times. Even though the beginning of the modern approach can be found in *Dorchester Finance Co v Stebbing*³², the new statutory provision in the UK under section 172 of the Companies Act 2006 created a two-folds or mixed test regarding the standards of directors.

There are two limbs in this statutory provision with the first found in section 172(2)(a) where directors are expected to carry out their duties in keeping with their peers. This would mean that directors cannot avoid liability by relying on his or her lack of knowledge, experience or skill.³³ The second in section 172(2)(b) is more peculiar where directors will also be assessed according to the knowledge, skill and experience of that particular person.

Another interesting dimension is that the statutory duties, ‘[h]ave brought the standard of care, skill and diligence required of directors into line with that required generally in other areas of social life by the law of negligence.’³⁴ Directors would thus be expected, if not required, to reasonably foresee harm to the company. If so, directors should demonstrate that they have internal controls in place to identify possible adverse risk to the company and means with which to actively deal with them.³⁵

²⁹ [1925] Ch. 407.

³⁰ Paul Davis and Sarah Worthington, *Gower Principles of Modern Company Law* (10th edn, Sweet & Maxwell 2016) 478.

³¹ *Ibid* 478-479.

³² [1989] EWHC 2289 (Ch); [2015] Bcc 661.

³³ Tamo Zwinge, ‘An Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care’ (2011) 22 *International Company and Commercial Law Review*, 31, 39.

³⁴ Davies and Worthington (n 25) 483.

³⁵ *Ibid* 481

An Australian Perspective

The Australian formulation of the statutory duty of care is said to reflect the ideas of a case in 1992 by Rogers J in *AWA Ltd v Daniels t/as Deloitte Haskins & Sells*³⁶. The wordings of section 180(1) of the Corporations Act 2001 (Cth) are somewhat different from the UK, but in effect are similar. Drawing from recent Australian case laws Austin, Ford and Ramsay cited examples of breaches of the Australian statutory provision by failing to;³⁷

- monitor management;
- take reasonable steps to assess the company's financial position and performance;
- take reasonable step to assess properly material adverse developments;
- put the board of directors into a position to assess these matters and take appropriate steps;
- ensure the establishment of appropriate systems to produce financial information which was accurate and reliable;
- maintain cash reserves at a level which ensured liquidity; and
- take reasonable steps to employ appropriately qualified finance director.

The analysis paints a progressive picture and invokes higher expectations compared to the low standards of the *City Equitable* case.

An important element of the directors' duty of care and skill is risk management. Young and Huo argue that;³⁸

The links between risk management and directors' duty of care are complex. It is not sufficient to rely on experts as well as the accuracy of the information provided. The first is an *ex ante* preventive measure, and the second is an *ex post* obligation to hold directors accountable...Whilst due diligence is applicable to a wide range of transactions and obligations, risk management is often associated with tortious liability where duty of care is central to establish whether due diligence was performed...To achieve this, the identification, analysis and

³⁶ (1992) 7 ACSR 759; 10 ACLC 450.

³⁷ Robert Austin, Harold Ford and Ian Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis 2005) 232

³⁸ Angus Young and Coral Huo, 'New Risk Management Requirements in Hong Kong's Corporate Governance Code: "More than Just a Box to Tick"' in J. Hu, M. Vanhullebusch and A. Harding (ed.), *Finance, Rule of Law and Development in Asia: Perspectives from Singapore, Hong Kong and Mainland China* (Brill, 2016) 261, 278.

minimisation of risk because ignoring them may lead to losses. Hence, directors as officers charged with the responsibility of governing and managing a company might be liable for failure to monitor and manage the organizations risks. Such obligations are encapsulated in the duty of care that involves taking steps to avoid risk and reduce the probability of incurring losses, or if it did occur to reduce the magnitude of loss.

This notion was put to the test in *ASIC v Healey*.³⁹ Directors were held liable for failing to adequately manage the company's finance risk. The failure of directors to scrutinize the financial information provided, combined with reliance on the board advisors' knowledge where each director was sufficiently financially literate was deemed by the court as a breach of directors' duty of care and skill.⁴⁰

The scope of this duty is therefore non-exhaustive. For example in *ASIC v Macdonald*⁴¹ the court held that directors have to be diligent in the delegation of duties and their reliance on experts as well as the accuracy of the information provided by others.⁴² This case also demonstrated that the courts have higher expectations placed upon executives.⁴³ Whereas in *ASIC v Flugge and Geary*⁴⁴ directors failed to make adequate enquiries about the propriety of the certain suspicious payments, as a result did not stop the company from engaging in improper conduct in paying bribes.

The Achilles Heel

In spite of the fact that this statutory provision is not only versatile in its application, proven capable of dealing with prospective governance failures, it is not without limitation. The overarching drawback is that the duty is enforced in the aftermath of some corporate scandal or severe financial distress. As such, this regulatory instrument is applied 'after the fact'. Therefore, the role of the law, though important in policing standards has limited reach. The law or legal instrument was not meant to inspire directors. They are instruments to provide remedies for the aggrieved parties. Further, it is meant to provide compensation for the damages inflicted on the innocent who had suffered losses. A possible solution is to

³⁹ (No. 11) (2009) 71 ACSR 368.

⁴⁰ Young and Huo (n 38) 281.

⁴¹ (No. 11) (2009) 71 ACSR 368

⁴² Austin, Ford and Ramsay (n 32) 493-495

⁴³ *ibid*

⁴⁴ (2016) VSC 779.

rethink the statutory duty as a preventive measure where the obligations are diligently sought and attained. As such, compliance is relevant to overcome the limits of legal rules and CG Codes.

How can Leadership Bridge the Gap?

It is important to note that compliance will not overcome the limitations in corporate governance and directors' duty of care. Critics have argued that having compliance systems in place as part of risk management procedures will not, of itself, prevent directors from breaching the law.⁴⁵ This is why leadership is integral to achieving accountability.

At a broader level, the board's role is to provide entrepreneurial leadership of the company with prudent and effective controls which enable risk to be assessed and managed.⁴⁶ To this end, it should set strategic aims, ensure financial resources are in place and review executive management performance. Similarly, non-executive directors should satisfy themselves that financial information is accurate and that controls and systems of risk management are robust and defensible within the company. The seminal work on the role of directors is the 2003 Higgs Report which argued that the board is faced with an inherent dilemma:

1. The board must simultaneously be entrepreneurial and drive the business forward while keeping it under prudent control.
2. The board is required to be sufficiently knowledgeable about the workings of a company to be answerable for its actions, yet to be able to stand back from the day-to-day management of the company and retain an objective, long-term view.
3. The board must be sensitive to the pressures of short-term issues and yet be informed about broader, long-term trends.⁴⁷

⁴⁵ Jason Harris, Anil Hargovan, and Michael Adams, *Australian Corporate Law* (4th edn, LexisNexis, 2013) 411.

⁴⁶ Higgs, D., 2003. Review of the role and effectiveness of nonexecutive directors www.dti.gov.uk/cld/non_execs_review

⁴⁷ Higgs, D., 2003. Review of the role and effectiveness of nonexecutive directors, <http://webarchive.nationalarchives.gov.uk/20091204141310/http://www.berr.gov.uk/whatwedo/businesslaw/corp-governance/higgs-tyson/page23342.html>

Higgs was in fact referring to the duty of care and skill as well as the expectations of boards to focus on the commercial needs of its business while acting responsibly towards its employees, business partners and society as a whole. To do so and deal with conflicting issues directors need to use a framework such as, the learning cycle.

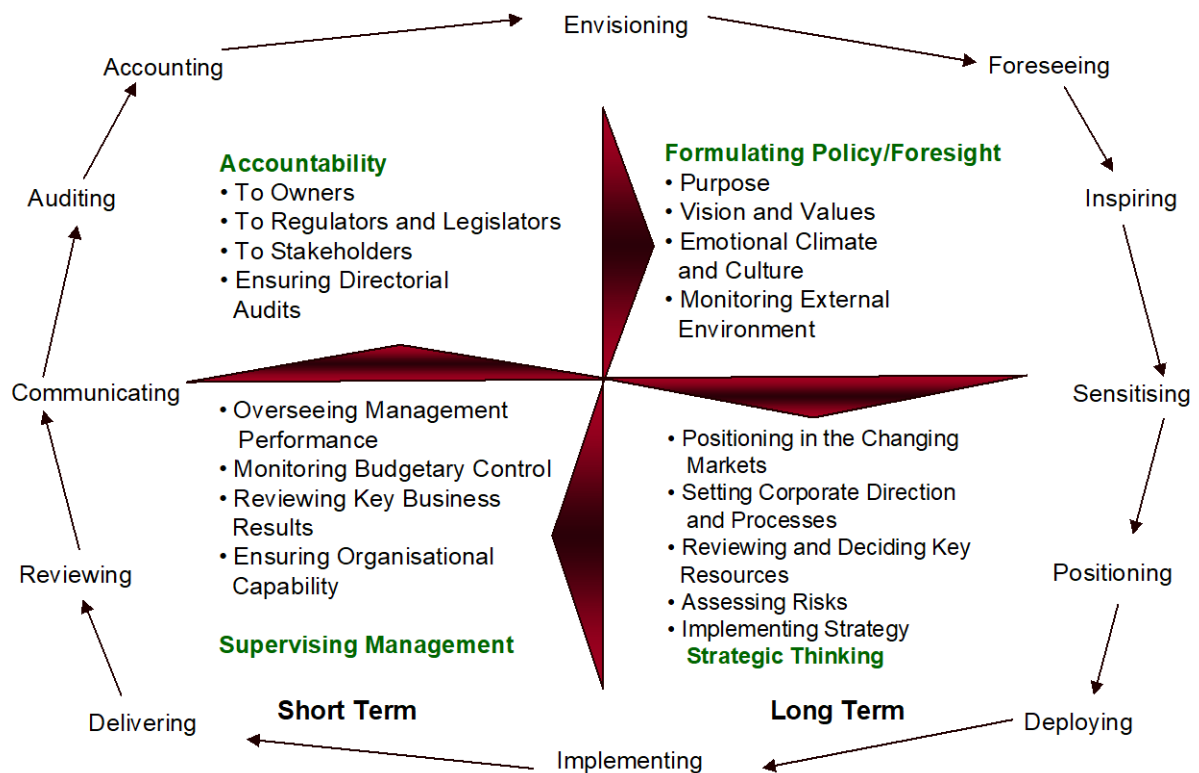


Figure 1.1 The learning cycle of the board⁴⁸

Higgs also suggests that, “Corporate failure, of course, will always be with us. Enterprise creates prosperity but involves risk. No system of governance can or should fully protect companies and investors from their own mistakes. We can, however, reasonably hope that boardroom sins of commission or omission – whether strategy, performance or oversight – are minimised.”⁴⁹ Even more reason for directors to comply with the spirit of the duty of care and skill and demonstrate proactive performance of their duties.

⁴⁸ Garratt, B., 2010, *The Fish Rots From The Head: The Crisis in our Boardrooms: Developing the Crucial Skills of the Competent Director*, Profile Books, London.

⁴⁹ Higgs, D., 2003. Review of the role and effectiveness of nonexecutive directors, p.12, <http://webarchive.nationalarchives.gov.uk/20091204141310/http://www.berr.gov.uk/whatwedo/businesslaw/corp-governance/higgs-tyson/page23342.html>

Bridging the gap comes from the correct leadership skills mix applied less as compliance and more as *Leadership in Compliance*. Leaders of financial institutions would be best served embedding compliance within their organizational culture rather than attempting to apply rules and regulations imposed on them. Even though the International Standards Organization's manual on Compliance Management Systems Guidelines offer some explanations on leadership, it focuses on structural, procedural, policy and commitment issues.⁵⁰ We would argue that leadership in compliance can be achieved in three ways; showing the way, ensuring independence and diversity at the top and developing the skillsets of leaders towards establishing compliance cultures.

Showing the Way

Leaders themselves are crucial in assuring that their organizations behave ethically – they model behaviour.⁵¹ Leaders who are mindful of the messages they send can have a great impact on organizational culture, which has the greatest influence in determining greater compliance outcomes. To this end, they are best positioned to influence culture and act as role models.⁵² Leaders must be ethical role models who make visible that compliance is not a way of applying the rules and regulations but is endemic to corporate behaviour.⁵³

A lack of alignment of among directors and executive management can also result in mixed messages which may have a negative effect.⁵⁴ However, in financial leadership terms this creates a dilemma of attempting to temper risk culture. Leaders who permit less compliant conduct to continue or re-occur for short-term financial success, cannot reasonably expect that a newer compliant conduct will become embedded.⁵⁵

⁵⁰ International Standards, 'Compliance Management Systems: Guidelines – ISO 19600' (International Standards Organization, 2014) 8-9.

⁵¹ Carlson D.S. and Perrew P.L. 1995, 'Institutionalization of organizational ethics through transformational Leadership', *Journal of Business Ethics* 14(10): 829–838.

⁵² Grojean M, Resick C, Dickson M, Smith D., 2004, 'Leaders, values, and organizational climate: examining leadership strategies for establishing an organizational climate regarding ethics', *Journal of Business Ethics* 55(3): 223–241.

⁵³ Heminway JM. 2008. 'Does Sarbanes-Oxley foster the existence of ethical executive role models in the corporation?' *Journal of Business and Technology Law* 3: 221–242

⁵⁴ Lankau MJ, Ward A, Amason A, Ng T, Sonnenfeld JA, Agle BA. 2007, 'Examining the impact of organizational value dissimilarity in top management teams' *Journal of Managerial Issues* 19 (1): 11–34.

⁵⁵ Vance N, Trani B. 2008, 'Situational prevention and the reduction of white collar crime', *Journal of Leadership, Accountability and Ethics* 6(4): 9–18.

Ensuring Independence and Diversity

This harks back to our review of some of the limitations of corporate governance. Boards need to be truly independent of their executive management function. To be able to provide strategic direction and guidance effective boards need a balance of well-chosen, competent directors, who, with the chairman's leadership, provide a cohesive working group to shape the destiny of the company, safeguard its interests and ensure its profitable performance. Requiring a greater degree of independence on boards has been a central theme in US corporate governance reform. The Sarbanes-Oxley Act requires all members of the audit committee to be independent. Under the NASDAQ and NYSE listing rules, a majority of the board must be independent. The Bouton report on corporate governance in France also recommended that half the board should be independent.⁵⁶

Achieving balance and choosing the right directors is not easy. However, *Standards for the Board* (IoD, 1999) identifies a number of personal attributes - abilities, skills, motivations and values - and some key areas of knowledge exhibited by company directors.⁵⁷ This may help in specifying what to look for when recruiting a new director and the areas where existing directors could be developed. The criteria for assessing an individual's specific personal attributes must be clearly established in relation to the board's particular requirements. The personal attributes were classified into six groups:

1. Strategic perception including change orientation, creativity, foresight, organisational awareness, perspective and strategic awareness
2. Decision making including critical faculty, decisiveness and judgement
3. Analysis and use of information including consciousness of detail, eclecticism, numeracy and problem recognition
4. Communication including listening skills, openness, verbal fluency, presentation skills, written communication skills and responsiveness
5. Interaction with others including confidence, co-ordination skills, flexibility, presence, integrity, learning ability, motivation, persuasiveness and sensitivity

⁵⁶ Higgs, D., 2003, p.35

⁵⁷ *Standards for the Board: Improving the Effectiveness of Your Board* (Good practice for directors), 19 Apr 2002, Institute of Directors.

6. Achieving results including business acumen, delegation skills, exemplar, drive, resilience, risk acceptance, tenacity.

Developing Leader Skillsets

Ultimately directors need to know - or know how to find out - everything that is relevant to their responsibilities. To do so, directors need to be developed. As Higgs points out,⁵⁸

Companies should acknowledge that to run an effective board they need to provide resources for developing and refreshing the knowledge and skills of their directors, including the non-executive directors. The chairman should address the developmental needs of the board as a whole with a view to enhancing its effectiveness as a team. It is my belief that there should be a step change in training and development provision so that it is suited to the needs of boards... More could also be done to ensure that the non-executive directors of the future are prepared for what is an increasingly complex and demanding role. Providers of MBA courses might consider the benefits of including elements on the behaviours and skills needed in the boardroom, as well as corporate governance and the role of the board, to prepare prospective board members at an earlier stage in their career.

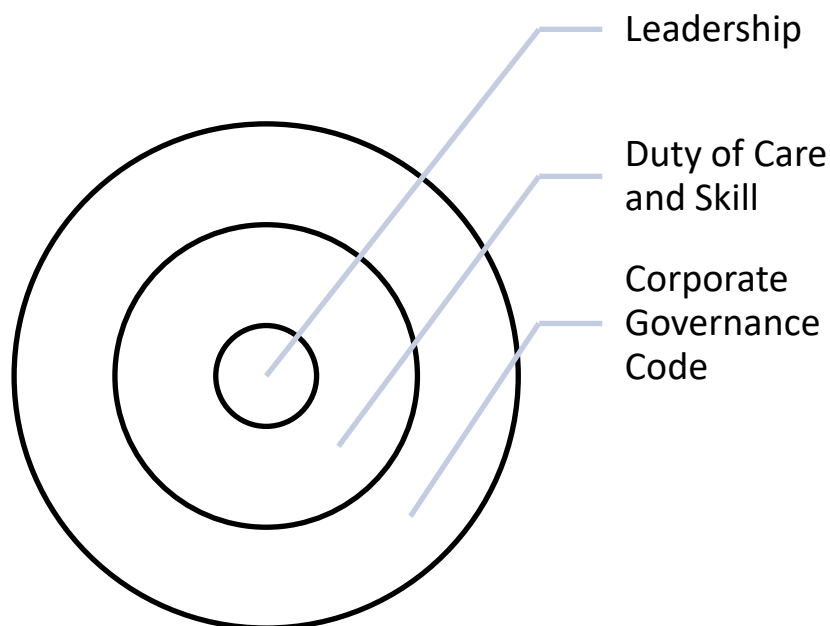
Therefore, directors need to be developed as strategic leaders and thinkers. They are currently rarely trained to do so.⁵⁹ A board should openly accept its weaknesses and development needs. These might involve professionalising the role or at least entail continuous development. Leadership in the context of compliance is thus to ensure the expectations laid out in the corporate governance code and the prescriptions and standards encapsulated in the duty of care and skill are embedded into decision making. Leadership should be treated as the driver behind the wheels of accountability.

Conclusions and Recommendations

⁵⁸ Ibid, p.49.

⁵⁹ Garratt, B., 2010, *The Fish Rots From The Head: The Crisis in our Boardrooms: Developing the Crucial Skills of the Competent Director*, Profile Books, London.

Successive reforms had repeatedly tightened CG Codes and raised legal standards. However, the number of corporate collapses does not seem to abate. The latest example in the UK is Carillion Group. Whilst the cause of this collapse is yet to be determined, the repeated theme is directors failing in carrying out their duties or being accused of ‘sleeping at the wheel’. Even if more refinements to CG Codes were added and legal requirements further strengthened to hold directors accountable in the hope of reducing the number of corporate governance failures, the problem will persist. The explanation, as noted in this paper, is that there are limitations to what corporate governance and codes can achieve. Furthermore, the law, whilst vigorous and demanding in providing remedies for aggrieved parties cannot effectively police the acts and decisions of directors. The solution to the conundrum of corporate failures might not rest with more reforms, rather to invest in enhancing the leadership skills and training of boards. To achieve accountability, leadership should be at the core, legal duties as the default rules to remedy failure and CG Codes providing and infrastructure and support.



*Figure 1.2 Achieving Accountability*⁶⁰

This paper has argued that instead of more laws and CG Code reforms, companies should be looking at strengthening the role of their directors that is ensuring they behave as

⁶⁰ Adapted from Farrar, see John Farrar, *Corporate Governance: Theories, Principles and Practice* (3rd edn, Oxford University Press, 2008) 4.

leaders, and as such should provide *Leadership in Compliance* to ensure accountability is achieved. Leadership as argued is showing the way, ensuring independence and diversity at the top and developing the skillsets of leaders towards establishing compliance cultures. Whilst there have been advocates supporting the professionalization of directorship,⁶¹ given the diversity of businesses and the diverse scale of organizations turning leadership into a profession might not be the most feasible way forward. However, providing directors with continuous formal training and mentorship is indispensable, especially in the digital age where technological innovation and intense competition mean that no amount of traditional or technical experience can equip directors to deal with the dynamic challenges of a new business environment.

To this end, we would suggest that not that leadership is not a replacement nor a substitute for the laws and for governance codes. They are complementary; if directors cannot lead, they should not be appointed to leadership positions of companies. The means of bridging the gap of CG Code and the law is *Leadership in Compliance*. This will be crucial to addressing the ongoing debate about directors' responsibilities in achieving accountability.

⁶¹ For example see Bob Garratt (n 59).