Corporate Governance White Paper:

for Business Aviation

Corporate governance white paper:

for Business Aviation

Foreword

There are over 3 billion search hits on Google for the word Governance.

Governance is frequently in the headlines because of corporate scandal rather than business success.

Think Wirecard, Boeing and Enron. But what is governance? What is its purpose? Why is it going to be increasingly important to business aviation?

The best definition we can find is:

"Corporate governance is the system by which companies are directed and controlled."

But while corporate governance is widely used, its purpose is widely misunderstood.

Governance flows through the heart of business; it forms strategy, shapes its leadership, and strengthens relationships with stakeholders.

Good corporate governance is something that benefits us all – whether we are investors, directors, regulators, employees or consumers.

Ultimately, corporate governance (or the lack there of) can mean the success or failure of the enterprise.

At Martyn Fiddler Aviation, we want to start a conversation on governance, as well as start a movement for positive change in governance culture within businesses aviation. Here's why:

- We believe governance is one of the most important topics in both business and society today.
- We believe how a business approaches governance determines its success or failure in the long term.
- We believe it is important for businesses to embrace and uphold good governance not simply from a legal perspective, but as a good corporate citizen.
- In a world of fast media where a corporate reputation can be lost overnight by perceived scandal, there is no reward for the risk of not applying governance standards.

Martyn Fiddler Aviation have carried out extensive research and study on the topic of governance as it applies to business aviation. This whitepaper is the culmination of that research; it explores why governance is important for the success of any business and provides a roadmap that businesses can use to improve and strengthen their governance frameworks.

You can expect to learn how corporate governance can provide the framework for attaining a company's objectives, and how to create action plans, accountability and internal controls. Our goal is to give our industry the best possible chance to address the challenges of governance head on.

Heather Gordon

Director, Martyn Fiddler Aviation

Chapter one:
What is Governance?

The most cited definition of corporate governance is that proffered by the UK Cadbury Report of 1992 as follows:

"Corporate governance is the system by which companies are directed and controlled."

The Chartered Governance Institute UK and Ireland defines it as:

"Governance is the system that provides a framework for managing organisations. It identifies who can make decisions, who has the authority to act on behalf of the organisation and who is accountable for how an organisation and its people behave and perform."

Both definitions speak to the fact that governance enables the board and management team to run organisations legally, ethically, sustainably, and successfully, for the benefit of shareholders, staff, clients and customers and – ideally- for the good of wider society.

While these definitions appear straightforward, they imply governance is concerned with the structure and processes for decision making, accountability, control and behaviour in a business.

In practice, corporate governance involves balancing the interests of all the stakeholders in a business, such as shareholders, senior management executives, customers, suppliers, financiers, government and the community.

Understanding the definition of governance is one thing, but there are two other questions:

1. **What is good governance?**
2. **Who is responsible for governance?**

What is good governance? One description suggests good corporate governance is "about effectively supervising the management of a company to uphold the company's integrity, achieve more open and rigorous procedures, ensure legal compliance, and promote good relations with stakeholders, including shareholders and employees."

Therefore, governance is more than conformance to a set of rules and processes. Governance is not a checklist process that is both bureaucratic and administrative in nature.

Instead, governance is integral to the operations, performance and longevity of a business.

The purpose of corporate governance is to make sure an organisation and its leaders are held accountable in fulfilling their fiduciary duties – i.e., investors know they can trust the business with their funds; customers know they can rely on the business to provide worthwhile services, and internal stakeholders can be confident that funds will be managed fairly and honestly.

Organisations that have good governance use clear decision-making processes, behave openly by reporting on their activities, actively engage with their stakeholders, effectively manage the risks they face, and take responsibility for controlling and protecting their assets.

Governance activity contributes to an organisation's success. Solid governance makes your company more reliable, stable and less prone to liability. All these factors create a sound basis for long-term growth, sets organisational standards and maintains the board's focus and the management team in delivering them.

Who is responsible for governance? The embodiment of governance should be from those persons who lead, control and direct the business – those who are ultimately accountable to its shareholders and other stakeholders. In most cases this will be the board of directors.

As a result, it is easier to consider governance as a set of key ideals which are known and understood by the business, applied throughout its structure, embodied by the board and have the flexibility to evolve with the business over time.

The directors are responsible for the business, how it is run, its successes and failures, and its future. The processes of governance help the board to ensure its decisions flow down throughout the business structure while allowing them to look forward to strategize the business's future.

Chapter 1 takeaways:

- Corporate governance is the system by which companies are directed and controlled.
- The purpose of corporate governance is to make sure an organisation and its leaders are held accountable for their decisions and in fulfilling their duties.
- It is the directors and/or leaders of a business that are responsible for ensuring governance rules and principles have been appropriately implemented and liable should the business be found wanting.
- Good governance contributes to an organisation's long term success.

Chapter two:

3 tenents of governance?

The success of a business will be largely determined by how the board incorporates governance into their decision making, their corporate structure, and how they use governance to represent themselves both internally and externally.

However, this is easier said than done. Underpinning the processes of governance are three tenets:

Accountability **Integrity** **Transparency**

Each of these topics are relatively easy to define, but are frequently difficult to put into practice. How a business grasps each tenant will result in whether or not their governance culture will result in positive or negative outcomes for the business.

Accountability

"The buck stops here" (U.S. President Harry S. Truman)

Accountability ensures those who make decisions, or manage others who make decisions are held to account for them.

There is a further distinction: responsibility is not the same as accountability. While an individual employee may have responsibility to perform an action or take a decision, it is the manager (and ultimately the board) who should be accountable for the outcome.

In a business, the board of directors are held to be collectively accountable for all decisions made within the business – even if they did not take the decision themselves. Most legal systems have rules in place to create civil and criminal penalties against the board where an organisation commits a wrong or fails in its fiduciary duty.

Over the last 30 years, the rules on corporate governance have expanded beyond the basic duties seen in older company law and moved to more detailed regulations setting out mandatory levels of governance. Penalties for those breaching such rules can be directed at both board members individually and the company as a whole. Penalties include fines, prohibition on serving as a director and even prison.

A textbook example of whole board penalties are when an accounting fraud occurs: while the financial director is responsible for the financial books, the whole board is accountable for their deficiencies and will suffer the penalties.

From a cynical perspective, the timing of periodic government reviews into the sufficiency of governance rules appears to follow an international corporate scandal whereby board accountability is lacking and the suffering is experienced by the business's stakeholders. For example, the Cadbury Report that led to the first code of best practices for corporate governance in the UK followed the Maxwell Corporation and Polly Peck scandals in the early 1990's.

In the US, the Sarbanes-Oxley Act 2002 was a reaction to the Enron, WorldCom and Parmalat scandals. And most recently the in the UK, the UK Corporate Governance Code following the 2008 financial crisis and Carillion collapse.

Despite the increased regulation and strongly recommended adherence to codes of best practice, 2021 witnessed (amongst others) the WireCard and Greensill Bank scandals in which the strict separation between banking and commerce elements of the organisations became blurred. The investigations into each scandal remain ongoing at the time of writing and it is likely that more negative information will be forthcoming in the future.

In each scandal the media highlighted the insufficiency of the decision makers in each business being held to account. While it would be naive to think that laws and codes of best practice will eliminate scandals such as these in the future, the stories may have been different if the boards of those companies had embraced a culture of accountability into their governance structures from top to bottom.

Intergrity

"With great power comes great responsibility" (Uncle Ben, Spiderman)

It is a basic expectation that members of the board should act with integrity. To expect anything less than telling the truth, acting honestly and holding strong moral principles from those leading a business would destroy trust and devalue it in the eyes of stakeholders. The same level of integrity is expected in decisions made by the board, documents they produce and statements they make. Yet it is almost impossible to read the news without one story appearing to show a prominent business leader having acted inappropriately.

While it is true that integrity can be subjective, numerous employee surveys show the ethics and values of an organisation are more important than salary levels, and are a key factor in deciding whether or not to join or leave a business. Lack of integrity from the board can create a toxic culture as it flows into different levels of the organisation.

In 2021, an open letter from former employees of UK company BrewDog described a "rotten culture of lies" and a business in which "growth, speed and action" were valued above all else by the board. The primary claims were pointed at the founding directors of the business leading to negative press, further employee departures and many investors reconsidering their ties.

In some cases, lack of integrity leads to what is known as whistle blowing. Special legal protections have been put in place for 'whistle-blowers' in many jurisdictions to allow employees to speak to authorities regarding breaches of law and governance without fear of persecution.

In 2021, former Facebook Product Manager, Frances Haugen revealed her identify as the whistle-blower who had disclosed over 10,000 pages of internal Facebook documents to the US Securities and Exchange Commission (SEC). The disclosure led to a reckoning over what Facebook's executives knew about its contribution to teen mental health issues and to human traffickers' open use of its services. The documents paint a picture of a business which is often aware of the harms to which it contributes to its users and places profit over ethics.

Ethical scandals in business can hurt the look and reputation of a corporation. Employees and consumers get a negative view about its leader's integrity.

Case study: reacting to an ethics scandal

How a business reacts to ethical scandals and dilemmas that happen (big or small) speaks volumes about their core practices and values. For example, in 1997, numerous protests were held over Nike's use of low-cost, maltreated labour at its overseas factories. The following year, the CEO acknowledged that "the Nike product has become synonymous with slave wages, forced overtime, and arbitrary abuse."

Following this statement Nike adopted a code of conduct for its plants and implemented a factory auditing system - Nike is now a leader in social sustainability through good governance culture. The company produces detailed reports on its efforts to improve working conditions and protect worker rights in its supply chain, and in 2005, it became the first company in its industry to publicly disclose its factory base. While other retailers suffer with revelations about unsafe conditions overseas, Nike is able to keep its brand focused on what matters to its customers.

Transparency

"The currency of leadership is transparency" (Howard Schultz)

In the landscape of governance, transparency is the practice of openly and honestly disclosing information to stakeholders in a business – such as shareholders, investors, employees and customers. For example, financial transparency refers to the openness and willingness to disclose financial performance figures of a business which are truthful and accurate. Transparency helps build trust with business partners and to the public at large. It is also evidenced that a well governed business with a high standard of transparency reap the benefits with reduced costs of capital through higher demand for its stock and lower transaction costs.

It is easy to demand transparency – when Volkswagen's diesel emissions scandal came to light, German chancellor Angela Merkel demanded complete transparency in response. When contaminated meat or vegetables are recalled, consumer advocates demand more transparency from food supply chains. When obscure financial instruments threaten the global economy, transparency is the proposed solution and so on. Equally there is no doubt that transparency is required to know what is happening in a business, and that information can be used in constructive ways to reduce wrongdoing. However, it is wrong to assume that complete transparency will entirely rule out bad behaviour or is in fact positive for business in general.

Studies show complete transparency in a business may actually decrease constructive, reciprocal behaviour between employees and senior team members. It can create a blame culture too focused on what happened rather than why it happened. It can also lead to employees believing the business does not have faith in their abilities, reduce innovation and create low morale. Boards must also have the ability to work privately on certain projects and human resource matters are generally considered to be confidential to the individuals involved.

Therefore, transparency alone does not create a healthy governance culture and must work in tandem with the other principles. The board should understand the importance of transparency and ensure that transparency is a means to an end rather than an end in itself. It is for the board to understand what levels of transparency are required for its business and to ensure this is communicated throughout its structure.

Combined approach

Even the most aware CEO's sometimes fall afoul of the need for governance, somehow separating it from accountability, integrity and transparency. Ray Dalio, American billionaire investor and hedge fund manager, believes that 'governance is the oversight system that removes the people and the processes if they aren't working well. It is the process that checks and balances power to assure that the principles and interests of the community as a whole are always placed above the interests and power of any individual or faction.'

Dalio's view on governance is that because power will rule, power must be put in the hands of capable people in key roles who have the right values, do their jobs well, and will check and balance the power of others.

However, Dalio admits that he did not realise the importance of this sort of governance until after he transitioned out of the CEO role, because he was an entrepreneur and company builder (as well as an investment manager) who largely did what he thought was best. In a rare act of self-awareness for a Founder CEO, Dalio now believes that he certainly did not create the sort of governance system appropriate for Bridgewater, given its scale.

Dalio points out, that despite its mammoth scale, Bridgewater did not have a board of directors overseeing the CEOs, there were no internal regulations, no judicial system for people to appeal to, and no enforcement system. Dalio simply created the rules and enforced them, though everyone had the right to appeal and overturn his and others' judgments.

As a result, when Dalio stepped out of his CEO role and passed the power to others, confusion about decision rights rose immediately. After conferring with some of the world's greatest experts on governance, Dalio put a new system in place.

Dalio is now a proselytiser for governance. He points out in his book 'Principles':

- To be successful, all organisations must have checks and balances.

- Remember that in an ideal meritocracy a single CEO is not as good as a great group of leaders.
- No governance system of principles, rules, and checks and balances can substitute for a great partnership.

Chapter 2 takeaways:

- All governance systems should be underpinned by the tenants of accountability, integrity and transparency.
- For stakeholders to have faith in a business, its leaders should be able to stand up and be accountable for the decisions of the business.
- Many of the major business scandals which have occurred over the past 40 years have arisen because of insufficient oversight and accountability from corporate boards.
- The ethics and values of an organisation are more important to its workforce than salary levels.
- The requirement for appropriate transparency of a business to its stakeholders build trust and creates may business benefits. However, transparency should not be in place simply for transparencies sake – it must be considered, understood by the board and communicated to the business clearly.
- The 3 tenants should not be considered in isolation; the board should consider all tenants in a combined approach when building their governance framework.

Chapter three:

Good, bad & ugly reasons for poor governance

The outcomes of poor corporate governance can result in extremes such as corruption, negligence, and fraud, or more mainstream outcomes such as stunted business growth, repetitive complaints, and high levels of waste.

All of these outcomes are undesirable to any business. So why are so many businesses bad at governance?

Education

It is well known that leadership and governance go hand-in-hand in any successful company. However, many leaders and directors did not start their careers studying or understanding business and governance, and they are now too busy 'running the business' to learn about it. As a result, there are many in leadership positions who are not aware of what governance really is and what they need to do.

The quarterly agenda

There is an unfortunate- and common- belief by many business leaders that if governance is included as an agenda item for board meetings, then it is effectively dealt with. This could not be further from the truth.

Good governance does not happen by chance. Good governance practices need to start with the board, and be cascaded throughout the business together with systems and processes to effectively communicate with all teams' members.

The governance department

Some businesses see governance as a separate activity or the role of a certain department – for example compliance or legal. Good governance, however, is made by design and is certainly not a bolt-on activity. If governance is viewed as separate it is almost always seen as a chore by the board and, as a result, by the business as a whole.

Delegation

While many businesses delegate governance processes and controls to managers and/or board committees, it is not possible to delegate all governance matters away from the board. Ultimately governance remains the responsibility of the board and they are accountable where it fails.

Failure to look at the bigger picture

In many businesses, the board is made up of directors who have risen from management positions and have failed to delegate their operational tasks sufficiently. This often leads to board members being unable to dedicate portions of their time to the business as a whole, its future and what strategies are needed to create positive, long-term change.

Friends and family

It is established by law that directors should make decisions independently and without the influence of others. Unfortunately, the make-up of many boards, especially in smaller and older businesses, involve multiple family members and/or close friends, often with one or more dominating personalities.

This can have multiple negative consequences: directors may feel pressurised to make decisions to retain their employment, views are not challenged, confirmation bias and group think can occur, and new strategies can be ignored in preference to the 'traditional way'.

These six explanations for why poor governance can occur are not exhaustive or exclusive to one another. In most cases a combination of these factors will lead to poor governance overtime if they are not recognised by the board and steps put in place to remedy them.

Chapter 3 takeaways:

- Poor corporate governance often occurs for a combination of reasons.
- Lack of understanding of governance has a trickledown effect throughout the business – if the board do not embrace governance, it is unlikely the business as a whole will.
- Governance is the responsibility of the board collectively and cannot be delegated away; its requires time, attention and dedication at board level.
- All board members should be able to debate, discuss and challenge ideas openly and independently to avoid group think and confirmation bias.

Chapter four:
Case studies in poor governance

Chapter 3 reviewed several reasons why boards can be lacking when it comes to corporate governance: lack of challenge, group thinking, dominant leader for example. In this chapter week we will review two case studies where poor board governance has led to dramatic and disastrous outcomes.

Case Study # 1: Boeing, accountability and risk

In February 2021, Boeing shareholders filed a lawsuit against the company's board of directors. They argued the board had neglected their oversight duty, failing to hold Boeing accountable for safety before and after the crashes of two 737 MAX airplanes that killed 346 people in 2018 and 2019.

"Safety was no longer a subject of Board discussion, and there was no mechanism within Boeing by which safety concerns respecting the 737 MAX were elevated to the Board or to any Board committee," they wrote in the 120-page filing.

Boeing's strategy was to minimize training costs in order to keep the overall cost of the aeroplane low. The real world cost was several hundred lives, billions of dollars in losses, and reputational damage that Boeing is still trying to recover. The shareholders suing Boeing argue the board could have prevented it.

Boeing's fall from grace didn't happen overnight. Rather, it occurred over time as the processes that made Boeing a trusted engineering company were eroded.

By the time of the crashes, the Boeing board was light on safety and engineering experts and heavy on former government officials. Four of the Boeing board members named in the suit were former government officials in positions unrelated to the aviation industry, including a former ambassador to the U.N. and a former White House chief of staff.

Moreover, out of its 13 members, three sat on the board of Caterpillar, and two on the board of Marriott. These inter-relationships increase the difficulty of getting an objective opinion and can foster sectionalism.

"Any cross relationship is a problem because it interferes with objectivity," noted Charles Elson, professor of finance and former director of the Weinberg Centre for Corporate Governance at the University of Delaware.

The Boeing board had five committees (audit; finance; compensation; special programs; and governance, organization, and nominating). Audit oversaw risk, but its charter focused on financial risk, and it had no mandate to discuss safety.

Moreover, the committee had no mechanism for receiving alerts from whistle-blowers. According to the lawsuit, this is at odds with the industry where several different airlines, including Southwest, JetBlue, and Delta have board committees specifically established to address safety.

Boeing didn't establish a board committee to address safety until April 4, 2019, which was six months after the first crash in Indonesia, and nearly a month after the second crash in Ethiopia.

Instead, safety issues were reviewed by a "Safety Review Board" run by employees, which had neither a mandate nor a mechanism for reporting to the board. Meanwhile, the Boeing board was not even aware the Safety Review Board existed until after the 737 Max Jet had been grounded in 2019.

Despite CEO Muilenburg's several missteps, from failing to ground the 737 Max jet immediately to insisting that the issue would be fixed with better training and a software upgrade, the board continued to back him up.

On November 5, 2019, Board Chairman David Calhoun told CNBC that the board believed Muilenburg had done "everything right." Muilenburg wasn't let go until December 22, 2019, and he left with an $80 million exit package even without severance. He was succeeded by Calhoun.

To add fuel to the fire, the shareholder lawsuit alleged the CEO exit package was allowed by the board to protect any exposure of the board.

By continuing to back the CEO and letting him walk away with nearly $80 million, the board sent the message that it condones his missteps, which inspires very little trust in them and their ability to right Boeing's wrongs. It's no surprise that the board is being sued.

Boeing's board failed in many ways but buried in its failures are lessons other boards can learn.

As Professor Sandra Sucher and Shalene Guptat of Harvard Business School write ***"You can set yourselves up for success by ensuring you have the right members, are structured correctly, and are able to have intentional, open, honest, and timely conversations where issues of accountability can be fully addressed."***

Case Study #2: Wirecard and fraud

Wirecard filed for insolvency in 2020. The former CEO, COO, two board members, and other executives have been arrested or otherwise implicated in criminal proceedings. In June 2020, the company announced that €1.9 billion in cash was missing. It owed €3.2 billion in debt.

Wirecard is one of Germany's biggest postwar accounting frauds. The spectacular accounting scandal disgraced the country's banks, investment funds, regulators, auditors and police.

Wirecard was worth €24bn at its peak. It turned out the CEO, Markus Braun and COO, Jan Marsalek, had hoodwinked auditors with forged documents, hounded critical journalists and investors, stifled internal investigations and fired whistle-blowers for years.

The cause of Wirecard's collapse was clear cut — half the group's sales and €1.9bn of the cash on its balance sheet were fictional. In Munich, a team of more than 20 prosecutors and 100's police officers spent 21 months grinding through the complex scandal, which involves dozens of suspects and companies in about 25 countries, including Singapore, the Philippines, Mauritius, Belarus and Russia.

German law enforcement held 450 interviews with witnesses and suspects, raided 40 properties and sent out 90 requests for co-operation to foreign colleagues. The indictment against CEO, Markus Braun, stretches to 474 pages.

The court documents and testimony reveal a company shaped by persistent mismanagement. Wirecard had presented itself as one of Germany's rare technological success stories; but on the inside, it was a byzantine and ineffective organisation.

In subsequent investigations by the Financial Times, it was found that CEO Braun, had little, if any, tolerance for dissenting views and scolded fellow management board members raising them.

According to Robert Peres, the Head of the Minority Shareholders Initiative, the chief problem of German corporate governance is that shareholders lack the power to hold management accountable.

Wirecard shareholders tried to question CEO Markus Braun at annual general meetings, but they did not have a chance to grill him as German law makes it easy for a company's board members to evade awkward questions by talking in platitudes.

A related problem is that Germany's two-tier system of a management board and a supervisory board does not produce the necessary stringent controls. Wirecard's supervisory board say they did not have a clue about how executives were cooking the books.

the necessary stringent controls. Wirecard's supervisory board say they did not have a clue about how executives were cooking the books.

Shareholders and other stakeholders suffered as legislation and the federal high court reduced their influence — already small by international comparison — to allow for rapid approval of mergers or capital increases.

The silencing of investors reflects the determination of German corporations to thwart active shareholders who like to ask questions. Lack of accountability created a breeding ground for large scale misconduct and the most skilled fraudsters take advantage of lax legislation.

Much work lies ahead in Germany to fix governance system and the laws that protect it. In the meantime, the Wirecard scandal offers a cautionary tale for outsiders willing to learn from Germany's mistakes

Robert Peres recommends overhauling the corporate governance system and provide transparent accounting mechanisms. Good corporate governance requires effective means of private enforcement. Peres points out that class action lawsuits and UK-style disclosures to investors are long overdue in Germany. Those who seek compensation from German companies are also hampered by its 1879 civil procedure code, which forces claimants to litigate individually- with clogs the justice system.

Ultimately, Robert Peres believes that protecting and strengthening the rights of investors is the surest way to promote corporate accountability.

Chapter 4 takeaways:

- The processes of governance should always be tailored to a board and its business.
- Risk assessment is not just about the financial state of a business; risk should consider any event which could impact the business including regulatory, financially, and reputationally.
- All board members should act independently and challenge actions they feel are wrong both ethically and for the business.
- Board should be mindful of their stakeholders when making decisions including shareholders, employee, consumers and investors.
- Dominant personalities on boards should be challenged to understand rationale for decisions, boards should use voting power where the majority disagree with a dominant member.
- If a director is uncomfortable with decisions being made by the board they must declare this and, in some cases walk away. Directors must remember the jointly and severally liable for decisions made by the board.

Chapter five:
Fact & fiction: the age of digital transformation

The accelerated rate of change in markets, technology development and associated consumer behaviour – much of which was driven by the pandemic- has challenged businesses to reinvent how they originate, commercialise and scale ideas.

However, there is an inherent potential conflict between 'going digital' and 'traditional board governance'.

The typical governance framework (& many board members) often view digital and digital technologies as conflicting with their foundations. Historically governance had desired certainty, risk aversion and visibility. Traditionally board members are older with years of experiences aligned to analogue corporate ways of working; they are not ready made (or ready to accept) for digital.

In the Age of Digital Transformation, business leaders now have a set of new questions

- What are the synergies between what digital can do and the role of governance in the boardroom?
- What are the board missing due to their lack of understanding of digital?
- Has the reliance on board members (in particular NED's) whose experience is built on multiple historical board positions, become less relevant?

Digital thrives on fast-moving, test & learn and fail-fast methods. Often digital is combined with thoughts about new technology companies which thrive on disruption, change and innovation more broadly. These rubs up against the traditionally perceived role of governance the as a checks and balances mechanism, with leaders wanting control, predictability, assurances and known outcomes.

Many boards are less well versed in digital approaches and parlance: they face what the former US Secretary of Defence, Donald Rumsfeld called 'unknown unknowns'. In plain English, they don't know what they don't know.

The reality is the digital curve is evolving in months as opposed to decades, so today's young digital natives are already ahead of experienced board members (even those who state they are 'digital experts'). For this reason, any tension or conflict between digital and governance must be resolved quickly.

Synergies between digital and governance

- Increased efficiencies with more efficient processes and relevant data, enabling faster decision making and taking advantage of new opportunities
- Evolving business strategy to take advantages of new revenue streams in customer behaviour
- Driving operating leverage and scale driving increased profitability and shareholder return
- Digital can deliver on the more-for-less agenda that boards have- digital is a way to save money (customers self-serve so we need fewer staff, for example).

Frictions between digital and governance

- Perceived conflict with governance role
- Board willingness to understand and adopt technology / new ways of working / risk taking
- The 'knowledge + experience + talent gap'. Many business leaders simply haven't grown up with digital, and, therefore, do not have a frame of reference. Similarly, boards are unwilling to hire people without board experience even though they have digital experience
- Technology and digital in general are 'abstractions' and 'soft' assets compared to the world of balance sheets, P+Ls and audit committees.
- Data protection / security
- Too many board executives still believe digital = cheap. As a result, governance, budget approval, project approval, becomes death by a thousand cuts until nothing of consequence is left.

Currently many boards are focused on the friction with digital rather than the positives it could bring their business. The fear of embracing digital often results in digital having no voice at the table.

Just about every board wants to be more agile and more innovative. The accelerated rate of change in markets, technology development and associated consumer behaviours is challenging every business to reinvent how they originate, commercialise and scale ideas. Boards need to accept digital as inevitable. Moreover, boards need to use their corporate governance tools not just to embrace digital, but to be a better business because of it.

Chapter 5 takeaways:

- Businesses will have to adapt and embrace digital.
- Many boards members struggle to accept or embrace digital because they do not understand it.
- There is a perception that governance processes conflict with digital transformation.
- Many true digital experts do not have sufficient corporate experience to be accepted as board members; this results in digital not having a voice at the board table.
- Digital and innovation companies are not going anywhere; to be successful, businesses must adapt their governance to incorporate digital.

Chapter six: A guiding framework for governance

Today, we expect more from governance. We increasingly expect organisations to uphold high ethical standards, be good employers and be mindful of their environmental impact. However, governance is fluid. Many businesses may have great governance at one point, but then fail to evolve governance in step with internal changes and external events - this can create bad outcomes despite good intentions.

A lack of governance (or the lack of understanding of governance) will have long term negative outcomes for a business. Similarly, good governance can turn bad over time if it does not evolve as a business grows.

So how can a business employ governance positively for the long-term success of the business?

This chapter will set out a guiding philosophy for corporate governance and how all businesses can use these principles to create a flexible, appropriate and strong governance culture to create long term success.

The starting point to note is that setting up a governance framework is a marathon, not a sprint.

There is virtually no business that starts off with a full governance framework in place. It is idealistic to expect a business to establish a full governance framework during the start-up phase- unless of course this is not the founders' first business. It will also be in the minority of businesses that the founders understand the importance of governance to create a culture of governance from the very beginning.

While it is a generalisation, in most cases businesses will recognise they require some form of governance as they start to submit accounts or make other regulatory filings. Governance may also be thought of when the first employees are taken on. The results of this are that most businesses develop governance by default rather than by design. This leads to governance evolving only to satisfy external requirements during the early stages.

As a business starts to establish itself as a viable profit-making entity, governance will become more important to the structure and future success of the business. It is at this stage the board would (ideally) understand that governance is a tool to support good decision making, future strategies and compliance with the law.

This stage of corporate development is ideal for the board to create a framework for governance that matches their business and creates a positive culture in which it can grow.

Any framework for a positive governance culture should incorporate these three principles:

Understanding: leaders need to understand the underlying principles of what governance is and why it is important to the success of a business. There are specialised training courses, however, many governance resources are available online for self-education.

Honest discussion of the purposes and principles of governance by the whole board are paramount to understanding and embracing governance for the needs of a particular business. For example, some directors may need assistance to fully understand the financial elements of the business, or to understand the risk elements of making certain strategic decisions. Governance is a continual process and changes over time, therefore education and understanding of governance must always be on the mind of the board.

Implementing: A knowledge of governance is pointless unless it is used within and in the best interest of the business. Once governance is understood it can be incorporated with the flexibility required for specific business needs – this contrasts with the checkbox mentality of many corporates. Understanding why a certain process is required - as well as educating those following or in charge of the process- will help avoid resistance to change and encourage adherence.

Reviewing and Updating: As a business grows and its external environment changes, there is a need for continual review and adaption of governance. Governance is fluid not static, and as such a process or risk item which may have been put in place for a very good reason may no longer be relevant. The best examples of this are often seen in risks facing the business – risks change over time and the board needs to be aware not only of its current risks, but those which will increase or appear in the future.

Chapter 6 takeaways:

- There is an underlying expectation from the layperson that businesses should automatically apply the tenets of governance (ethics, transparency and integrity) in all their dealings – scandals hit the headlines and erode public trust when they are not.
- Many businesses do not start out with a governance framework; rather this develops over time and as a result of business regulatory requirements.
- Boards need to consciously create a governance framework for their business as it evolves into a profit-making entity.
- A successful governance framework will only work if the board understands why it is needed, implement it into their business thinking and decision making, and evolve the framework as the business grows.

Chapter seven: Maintaining a governance framework

Whether the board is drafting its first governance framework, or re-evaluating its governance processes as the business evolves- five important questions should be considered to establish good governance:

1. **What is or was the purpose of the process?**
2. **Why is it required?**
3. **How should it be implemented, improved or amended to make it appropriate for this business?**
4. **How frequently should it be reviewed?**

By asking these questions, the board will not just examine the governance process itself, but also how it will fit into the business as a whole and its relevance for the future.

Taking this approach to each element of governance ensures the present and future strategy of the business is taken into consideration rather than making isolated decisions which could disrupt client operations unnecessarily. Further it creates responsibility and accountability for process to ensure relevance and future review.

As a positive culture of governance develops within a business, the questions above will become automatic. The board will not only look forward to potential matters they may need to incorporate into their framework but will also consider which processes are now redundant and can be removed. This will lead to more efficiencies, agile forms of work and greater understanding of flexibilities in the business. It will also highlight weak points which need improvement or areas which have developed increased risk. As a board gets a greater understanding of the value of governance it moves away from being an agenda item towards being fully embedded in the way the board thinks, operates and makes decisions.

Governance in the Goldilocks zone

No governance is bad governance. Too much governance is bad governance!

'Appropriate' is a key principle for good governance. Some of the worst examples of governance come from the whole-sale import of another businesses governance framework which is completely inappropriate for the size and type of business to use it.

For example, if a fifteen-person business were to use the governance framework for a NYSE listed company, it would not only cripple their productivity, but it would also demonstrate an absolute failing of the board to understand appropriate governance for their business.

While this example may seem extreme it is commonplace for businesses who do not understand governance to use this approach – it is the danger of a quick find on a Google search.

Rather than being a slave to an abstract set of processes which do not suit the business, the board should take time and care to understand what the governance framework for their business will look like. It does not have to be a long and laborious process. However, it does take dedicated time and effort to achieve.

Build on the three tenets of governance

In Chapter 2, we described the three tenets of governance: accountability, integrity and transparency. The board should embrace and demonstrate these tenets not just to one another but to the business as a whole and onward to its stakeholders. Further, the board should encourage and hire staff on the basis of the tenets to ensure the business works together as a whole and for the same aims.

It is easier said than done to fully incorporate each tenet all of the time, especially for new board members where it could be overwhelming. Often in the case of accountability, the full responsibility of being a director of a company can cripple decision making through fear of mistake. Equally, the subjective nature of each tenet has the potential to stifle dynamic business strategies, honesty around the board table or (in extreme cases) create cover-up's where something has gone wrong.

Therefore, it is the task of the board to embrace the 3 tenets with a common sense and human approach – everyone is fallible and mistakes will be made. Where a risk, error or issue is found it is for the board to work together using the 3 tenets to find a solution in the best interests of the business and its stakeholders. By doing this, the 3 tenets will flow down into the operations of the business and form the base of future strategies.

Positive deviation

The creation and establishment of a governance framework does not mean the board may never deviate from it. There are many reasons the board may choose to ignore a specific process or take on an additional risk, for example:

- There is an immediate threat to the business which requires a process to be ignored
- The process has become redundant and needs to be changed, replaced or repealed
- An opportunity has presented itself which requires a higher risk appetite
- An external environmental change requires the deviation

Where a deviation from the governance framework is required, those decision makers should try to understand why they need to deviate on this occasion, record the reason, and seek authority from those who are ultimately accountable. By following this process, the decision will be transparent, the decision maker will consider why the deviation was required (and potentially whether the overall process needs revision), and responsibility and accountability will be recorded and understood.

A business with good governance will have a deep understanding of why its rules and procedures are in place – and therefore understand how and why a deviation may be required, and how quickly this can be escalated to the board if necessary.

An ideal progression of this is that, as the governance framework matures, it will extend throughout the authority framework of the business. Managers will understand why processes or mechanisms under their remit are in place, they will understand the risks of deviation and associated implications of accountability – and they can be empowered either to take a decision or escalate it to the board.

As a business grows, the need for education on why a governance framework exists is increasingly important. Knowledge of governance mechanisms will be required in different degrees of detail – and linked with this is the responsibility and accountability for the integrity of the framework.

In a large business, the board will not have detailed familiarity with all individual processes within its operating teams – this is for the managers and team leaders to have responsibility. However, the managers are responsible for understanding why and how deviation can impact their business areas and to report these to the board which is ultimately accountable for the overall framework.

The lines of communication between operational managers and the board are essential for discussion on changes and deviations as the framework develops with the business (micro-operations view v macro board view).

There is no perfect governance framework

Each framework is different as each business is different. As a business evolves some parts of its framework will become dated and require improvement, or in some cases, wholescale change.

New board members will provide insights to their governance experiences – good and bad – which the board may wish to adapt. New business and strategy theories will highlight areas of weakness or vulnerability within an existing framework. New laws and rules will require higher standards and processes. Entering new markets and jurisdiction will require framework adaption and changes. It never ends and therefore will never be perfect.

Rather than seek perfection, good governance stems from continual improvement and development as the business evolves and the external environment changes. It incorporates the 3 principles and the rational of why we are doing this, how will it affect the business and who will it impact.

Chapter 7 takeaways:

- Governance is fluid – it should evolve not just with a business, but also with environmental changes outside of the business
- Governance should be appropriate for the size and life stage of a business
- Educating team members and team leaders about the governance framework and discussing improvements or problems allows the board to get better feedback
- Deviations from the framework happen and they should be recorded and understood to ensure analysis can take place
- There is no such thing as a perfect governance framework!

Chapter eight:

Risk & predicting the future

Governance does not sit in isolation with business. The external environment in which a business sits changes over time, sometimes rapidly, and it must adapt to survive. Businesses may succeed or fail for a multitude of reasons but governance helps the board navigate problems and provide proper direction and control.

The current pressures on businesses did not exist when the governance movement started over 30 years ago. Examples of additional governance requirements are:

- Accountability to multiple stakeholders (both direct and indirect)
- Delivering public disclosures regarding finance and operations
- Maintaining good public relations and reputation

The expectations on business to have good governance systems is exponentially increasing and this is difficult for all businesses- not just family run companies.

This chapter will examine how modern governance requires businesses to look beyond themselves to the wider world, and how good governance will provide the opportunities to take on these challenges.

Predicting the future

After the occurrence of the latest corporate scandal (whatever and whenever that may be), the impact on business will often be public comparison, consumer distrust and potential new regulations. Global events can also have a knock-on impact on businesses across the world, in a variety of different industries and can often appear as a complete surprise. How a business reacts in such circumstances is critical and governance plays a vital role in this.

Modern governance is more than looking inward and only to the future of the business; it requires a broader look at the international environment. Modern governance requires a view across a spectrum of world and geopolitical events.

To do this many businesses use analysis techniques such as SWOT or PESTLE. Unfortunately, most analysis is an internal project for small team (or individual) and the results have cursory review and filed forevermore. For businesses with a governance framework, the risk matrix is generally a standard agenda item for quarterly review and therefore the most likely opportunity to consider the future.

Analysing risk is an essential part of good governance; it allows the board to project risks that may impact the business (whether negatively or positively) in the near or further future. Businesses that do not identify the likelihood of future events will have a greater exposure to potential failure than their competitors who do. The following are just some examples of using governance risk planning in the current world environment.

Politics and War

There have been very few times in history whereby military action or significant political change has been a complete surprise. The 2022 invasion of Ukraine was foreseeable at least months in advance, with many businesses closer to the region sensing tensions far before the rest of the world. Despite this the reaction of many businesses was shock and alarm with a sudden realisation that this could have an impact on their business, their consumers and their suppliers.

Similarly political changes can impact businesses both nationally and internationally – export controls and levies, domestic business opportunities, tax boosts – to the benefit or detriment of both a business and its stakeholders.

The departure of the United Kingdom from the European Union in 2020 is one example of a well-known political event with wide ranging consequences that despite being known four years in advance still caused significant disruption and confusion when it came into effect. Businesses who successfully managed to plan, prepare and create opportunities arising from 'Brexit' placed themselves at a significant advantage to profit from those that did not.

ESG

Environment, social, governance (ESG) is the latest embodiment of corporate social responsibility; i.e., that businesses should consider more than profit and shareholders alone. It is a topic of much debate by business leaders, politicians and the press, and it is likely to increase the information and disclosures required from businesses going forward despite arguments against it.

CEO's have many responsibilities, but one of the most valuable is persuading investors and similar that their companies are performing well financially and doing good for the world. If cracks appear in these stories, trouble follows.

Doing good is now frequently measured in ESG terms. The German asset management group DWS appeared to be setting an example; its CEO, Asoka Wöhrmann declared ***"we have placed ESG at the heart of everything we do,"*** in the 2020 annual report. However, the asset manager now stands accused of "greenwashing" by exaggerating the ESG credentials of its investment funds and its offices in Frankfurt were raided in 2022 by German police on suspicion of prospectus fraud. Wöhrmann then resigned.

When discussing future risk, business should rightly question the value of ESG to their business; while many commentators believe it will increase share price overall, many others are concerned the time and cost spent on ESG compliance will not be recouped. Moreover, tales of 'green and impact washing' are to the detriment of businesses who have genuinely tried to realign their companies to meet ESG ideals.

However, for the short term at least the ESG movement is still growing. For this reason businesses should look to incorporate ESG criteria appropriately into their governance framework.

A McKinsey report from 2019 stated ***"excelling in governance calls for mastering not just the letter of the law but also its spirit—such as getting in front of violations before they occur or ensuring transparency and dialogue with regulators instead of formalistically submitting a report and letting the results speak for themselves."***

Governance is therefore a tool to examine ESG in an appropriate way for a business and ESG should have a place on any risk map.

Sustainability

Sustainability and the environmental impact of business have never been more relevant. Whether or not a business manufactures good or provides services, is in aviation or law, sustainability must be considered at a board level. Ignoring sustainability is a risky option for any business.

Looking to the future, the pressure for business to become increasingly sustainable will intensify. The pressure is not just from regulation or reputation but from employees, shareholders and investors. The risk of not doing anything is high, however, boards who understand that risk can also create opportunities may benefit from embracing this.

The black swan

A recent addition to the corporate risk matrix is the black swan – an unknown risk that could arrive suddenly and have high impact on a business in unknown ways. The 2020 global pandemic is an example of this.

While it is nearly impossible to plan or mitigate a complete unknown, modern governance provides tools to help. The business continuity plan – a business disaster reaction process – can provide a framework of matters which will need to be addressed when a sudden event occurs. Planning for such an event in advance allows for any gaps to be identified and where possible mitigated. Following any use of the plan, the board can then consider whether areas of the business (or the plan) need to be enhanced or changed.

Chapter 8 takeaways:

- Governance is fluid – it should evolve not just with a business, but also with environmental changes outside of the business.
- Governance should be appropriate for the size and life stage of a business.
- Educating team members and team leaders about the governance framework and discussing improvements or problems allows the board to get better feedback.
- Deviations from the framework happen and they should be recorded and understood to ensure analysis can take place.
- There is no such thing as a perfect governance framework!

Chapter nine:
A checklist for future corporate governance

'The Checklist Manifesto' by Atul Gawande explores the fundamental importance of a checklist in organising and managing complex processes. Gawande speaks from his own experience, explaining how even the most competent surgeon, operating without a checklist, can miss a critical step.

The increasing complexity of modern surgical procedures, Gawande argues, has made checklists essential.

Gawande focuses on medicine but also delves into the use of checklists in the aviation, construction, and investing industries. In Gawande's view, the elaborate processes that characterise the modern world demand that we turn to the checklist; a simple tool that's been around practically forever.

Checklists not only ensure disciplined completion of essential steps in any process (no matter how complicated), they efficiently guide you through those steps. However, it is vital to understand that whilst the checklist maps out the steps to follow it does not make the journey for you. Forward thinking, problem solving, action and review all have to be undertaken at each step of the checklist. Completing the checklist is not the goal; ensuring good governance is.

What, then, constitutes a good corporate governance checklist? The first challenge is to know what size, scale and context we are talking about.

Checklist Challenge #1: Size, scale and context

As noted in chapter 2, many of the current legal and governance requirements imposed on businesses are a response by government and lawmakers to a crisis or scandal; rarely are they brought in to pre-empt one. However, outside of legal and regulatory obligations, it can be difficult to find the appropriate level of governance for a business let alone find a pre-fabricated governance framework. For this reason many businesses take the easy option of importing a checklist despite it being unsuitable for their business. In most cases this causes more harm than good and dissuades the board from the importance and benefits of governance.

The UK Corporate Governance system for publicly quoted companies is complex, involving many different sets of requirements, from behaviours of company leadership and administration to reporting requirements. The checklist for reporting requirements alone reaches 40 pages! Clearly this is not appropriate for a smaller family-run business, a start-up, or even a midsize established business.

The challenge therefore is for a board to evaluate the resources available and decide what is appropriate for their business (often, in addition to government rules, helpful guidance is also available from international and domestic institutes and associations for example the OECD, IOD and CIPD). Once the board have decided what is appropriate for their business, they can create the processes and associated checklists to ensure they are applied by relevant team members or the board themselves. Lastly, and an absolute necessity, is ensuring that all those involved understand why the checklist is in place; without this vital step the checklist will be followed blindly without room for flexibility or change as the business grows.

Checklist Challenge #2: Asking the right questions

Professors Lynn Paine and Suraj Srinivasan of Harvard Business School have produced a resource for understanding the debates around governance. They identify eight areas, each with a subsequent series of questions that help create a checklist to future-proof governance for businesses. For the purposes of this paper, we have highlighted some key questions for the board to consider when creating their governance checklist. We suggest reviewing the original document here to think through the topics and questions raised.

- Does the board have in place processes to ensure its ongoing effectiveness and renewal, and are the existing mechanisms for holding directors accountable sufficient?
- How does the understanding of corporate governance differ across regions and cultures within the business? Is one process appropriate for all branches of the business?
- Is the board knowledgeable about the company's shareholders and does it have an effective approach to shareholder engagement?
- As corporations have grown more complex, the demands on boards have increased accordingly, but is the board up to the task expected of it today?
- How does the board determine what time horizon to use in setting strategy and making investments?

The purpose of these questions is to challenge the board to consider their current approach to governance, its processes and how these are implemented. While these questions may not seem standard 'checkbox' questions, they force the board to consider their strategy, performance and accountability both now and in the future.

Checklist Challenge #3: Regular check-ups

It is not enough for the board to create a governance checklist; the board must use it on a regular basis and as the business grows.

The majority of businesses should seek to discuss governance at least on an annual basis and depending on the size of the business it may be appropriate to review the checklist more frequently.

As the board becomes more familiar with reviewing the governance checklist and the questions it asks, the easier (and more productive) the discussion and output will become for the business and its growth.

Chapter 9 takeaways:

- Checklists are vital for complex processes; governance is no exception.
- To be a useful tool a governance checklist must be appropriate for the size and complexity of the business and be put in context (i.e., why it is in place).
- A checklist should challenge the board and ask difficult questions; avoid a 'checkbox' mentality.
- A governance checklist should be used and updated on a regular basis as a business evolves.

A governance summary

"The borderline between business blunder and business brilliance is the merest hairs breadth" (Sir John Harvey-Jones)

Many business leaders – whether famous, revered or feared - are grappling with the governance issues raised in this white paper. Here are our top seven:

1. **Corporate governance is not going away:** Every new scandal increases media attention and the call for greater regulation by government. The 2022 collapse of crypto platform FTX is a case in point: FTX was ponzi scheme with excellent PR bought and paid for by founder, Samuel Bankman-Fried. FTX had less than zero governance. As a result, Samuel Bankman-Fried will now be mentioned in the same breath as Bernie Madoff and Jeffrey Skilling of Enron.

2. **Progress is slow:** Commentators and experts still disagree on basic matters of governance such as the purpose of a business, the role of corporate boards of directors, the rights of shareholders and stakeholders, and the proper way to measure corporate performance.

3. **Basic corporate governance has become necessity for any organisation.** The view that the only duty of business leaders is to make profit for shareholders is a legacy from the 'command and control' view of 80s leadership style promulgated by Jack Welch of GE. Paying lip service to technical compliance with regulations or isolating ethics from business dealings is no longer a viable tactic.

4. **Even the biggest businesses can fail at governance:** Recent high-profile scandals with major aviation, technology and finance corporates demonstrate the impact that the lack of governance can have: major restructure, CEO defenestration or corporate demise.

5. **Good corporate governance benefits society:** Investors, directors, regulators, employees or consumers all benefit from knowing what corporate governance is and how it underpins the success of any business.

6. **Good corporate governance helps achieve corporate goals.** Governance can provide the framework for attaining a company's objectives, from action plans, accountability and internal controls to performance measurement and corporate disclosure.

7. **Checklists are vital for complex processes:** Governance is no exception. Checklists are useful tools; a governance checklist must be appropriate for the size and complexity of the business and be put in context.

Keep the conversation going

At Martyn Fiddler Aviation, we want to start a conversation on governance, as well as start a movement for positive change in governance culture within businesses aviation.

As a new generation of business leaders enter our industry it is vitally important to instil why good governance leads to business success, sustained growth and a stable future.

It is not an easy task but we believe a movement to increase the governance around the board table now will benefit the business of business aviation in the long term.

We welcome your feedback on this whitepaper and thoughts on governance so we can move the conversation forward.

To get in touch please contact heather@martynfiddler.com or find out more information about the services we have to offer at martynfiddler.com