Navigating future challenges

15 December 2014 by Pooja Kondhia

A look ahead to the issues set to make headlines in 2015

Businesses faced a particularly difficult year in 2014 with major banks falling foul of the regulators due to trading and system failures; retail giants dealing with financial holes; and implementation of new remuneration and bonus clawback rules.

It seems this trend of heavy regulation, implementing new rules and regulations and closer scrutiny – by regulators, media and the public – is set to continue throughout 2015.

Governance + Compliance approached a number of industry professionals for their opinions on the most significant issues that companies will likely be tackling in 2015.

The challenges associated with strategic reporting are likely to remain high on the agenda. A particular issue is the new requirement of putting together a viability statement within the strategic report, as part of changes to the Corporate Governance Code made by the FRC.

The viability statement requires companies to explain operational strategies beyond the next 12 months and is controversial according to Oliver Parry, Corporate Governance Adviser at the Institute of Directors (IoD). He says, 'the future is inherently uncertain and companies do not have crystal balls.'

Investors would like companies to provide them with certainty about their future but it often cannot be guaranteed; Parry also mentions that 'it will be interesting to see which companies are the first to go beyond 12 months and what the quality of explanations are like by those that do not'.

ICSA Policy and Research Director Peter Swabey corroborates this, calling the viability statement 'a challenge … until there is a clear understanding of what investors and the FRC expect to see'. Mala Shah-Coulon, Director of the Corporate

Governance Team at EY, indicated that this new requirement will be a closely scrutinised addition and boards 'will need to consider how best to comply… bearing in mind the expectations of their investors and other stakeholders'.

Shah-Coulon believes that the spotlight will fall on nomination committees in 2015. She notes that 'the effectiveness of the board and its various committees depends on finding the right people to undertake those roles. We know from conversations with boards and investors that succession planning is a particular area of interest.'

Persistent risks

As well as meeting challenges around reporting and investor relations, John Smart, Head of Fraud Investigations and Disputes at EY flagged up an increasingly important external risk to business – cybercrime. He feels this 'is increasingly going undetected'. Smart expands on this, 'boards and management need to regularly refresh their views of risk drivers for the business. New risk emerges from what the organisation does, from changes in the markets in which it operates and from developments in external threats … [of which] one of the most significant examples … is cybercrime.'

He adds that 'organisations face a persistent and sophisticated threat from attackers. Criminals are targeting commercially sensitive information, intellectual property and critical network infrastructures', which EY research suggests organisations are not able to keep pace with.

The Institute of Internal Auditors' Chief Executive Dr Ian Peters agrees that risks around data coupled with increasing regulation will continue to have a significant impact, compounded by operational risks and continuing economic uncertainty. Peters says 'there is still enormous regulatory change at the moment, and no reason to be complacent about the global economy.

Combined with the huge shift still going on in many industries as companies do more online, automate more processes, and make far greater use of data, there is more than enough to keep internal audit teams occupied.'

Sector scrutiny

Delving further into sector and company specifics, we asked the industry experts which sectors in particular they thought would face difficulties in the next 12 months.

Not surprisingly financial institutions were mentioned by many. Mala Shah-Coulon said that 'the financial services sector is likely to have a tough year in 2015, as new capital requirements and ring-fencing for banks, and increased regulatory interventions in the insurance sector, will make their mark.'

GoodCorporation's Director of Business Ethics Advisers Leo Martin also commented on the increased pressures to be felt by the banking sector: '[this] sector is … going to bear the brunt of the challenge on directors' pay from the updated UK Corporate Governance Code. The new Banking Standards Review Council will also push banks to make sure that they are measuring more convincingly their ethical culture and leadership.'

Ben Mathews, Group Company Secretary at HSBC added that 'UK-headquartered banks will continue [to face] regulatory and legislative challenges on remuneration … which, if implemented, will trigger another round of substantial consultation, engagement and approval process with shareholders for any consequential change in the remuneration policy.'

Major changes to the regulatory regime for senior bankers is another fact the sector will have to face in 2015, says Mathews. 'The intention is to make individual responsibility in banking a reality …

These forthcoming regulatory changes will have significant implications for a bank's governance structures, in terms of defining and aligning the scope of responsibilities of individual senior executives and directors, clarifying how the presumption of responsibilities will operate and maintaining a distinction between non-executive directors and senior executives'.

Beyond banking, John Smart said that 'recent high profile examples of governance failure in the retail sector have heightened scrutiny.' The extractive sector is also one which Mala Shah-Coulon says will have challenging year ahead as the 'EU's requirement for country-by-country reporting … is going to be implemented in the UK from January 2015, six months earlier than necessary'.

Dr Keith Smith, Institute for Risk Management board member and consultant comments on the 'specific tightening of regulations around the area of environmental conservation of energy, [which] are increasingly tough to meet', which will prove tough for the construction industry.

Lack of innovation and missing growth opportunities is cited by Tim Copnell, Director of KPMG's UK Audit Committee Institute, as being the biggest issue for all businesses: 'the financial crisis and the increasingly regulatory environment has created a risk adverse culture … Good governance should create a framework where companies knowingly take risk rather than being unwittingly exposed to it'.

Public trust

Satisfying public opinion about good governance will continue to be as important as meeting regulations. Maintaining public trust is identified by several experts as a challenge for 2015. David Thompson, Senior Associate at Branko Limited, said 'it is interesting to see the differing approaches being taken to this. Consumers are now much more sceptical of large business because of past misdemeanours – high profile tax avoidance schemes, the horsemeat scandal, North Staffs NHS, Cooperative Bank, Tesco finances – and are looking for reassurance in companies delivering what they are set up to do, but in a responsible and transparent manner.'

'The expectations of the public, [as well as] politicians and regulators, is the most significant governance challenge facing boards in 2015', says Tim Copnell.

'This is not just because the costs of non-compliance … are on an ever increasing trajectory, but because we live in a world where being seen to comply with perceived governance wisdom is often as important as good governance itself. Thus with their company's and personal reputation at risk, boards are presented with [a] choice – do what they think is in the best interests of their company (their statutory duty) or take the line of least resistance and do what is perceived by others to be the right thing', explains Copnell.

Peter Swabey also believes public trust in business will remain a focal point in 2015, particularly in light of the upcoming general election. 'Taken together, the implications could be significant, as the political parties may see increased regulation as a vote-winner and this could have very serious consequences', Swabey explained.

Public expectations, emerging risks and tightening regulations will likely mean that governance issues continue to hit headlines in 2015.

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Institute of Chartered Secretaries and Administrators
Saffron House, 6-10 Kirby Street, London EC1N 8TS, United Kingdom