

Mr. Chris Hodge,
Corporate Governance Unit,
Financial Reporting Council,
Fifth Floor, Aldwych House,
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28 May 2009

Dear Mr. Hodge,

Review of effectiveness of the Combined Code

I write in response to the call for evidence, with specific reference to the question “Are there any aspects of good governance not currently addressed by the Code or its related guidance that should be”. My submission focuses on the importance of **Strategy Audit**.

Corporate Value Associates (CVA) is a firm of strategy consultants which I founded in 1987, initially in Paris and London. Today, CVA has offices in 16 countries employing 300 consultants and has developed long term relationships with many major national and international companies. CVA’s differentiation in the marketplace is based on its total value perspective, enabling chief executives and boards to optimise value for shareholders and other stakeholders by managing the value flow, the source of which is always the customers.

Definitions of value

The purpose of the Combined Code is “directed at helping boards discharge their duties in the best interests of shareholders. Good governance should facilitate efficient, effective and entrepreneurial management that can deliver shareholder value over the longer term.” The text of the Combined Code covers directors and the board; remuneration; accountability and audit (focusing on financial reporting, internal control and risk management, the audit committee and external auditors); relations with shareholders; and institutional shareholders’ relations with the company.

However, to be successful and deliver shareholder value over the longer term, in addition to clarity on accounting value – which is largely historic - and attention to market value – which can be a volatile indicator - it is critical to keep a focus on strategic value.

Three basic definitions of the value of the shareholders’ investment in an enterprise can be described – accounting or financial value (AV), market value (MV) and strategic or intrinsic value (SV). AV is basically given from a perusal of the financial accounts and the assessment therein of the business risks. It is a measure of soundness and control, with the company’s own view validated by the work of their external accountants and their audit committee. MV is basically given by the current stock market quotation. It is dependent on information supplied by the company, on the quality of dialogue with the market and on a host of other factors. SV is basically given by an informed view of the real present value of the enterprise. It has regard to its business strategy and

capacity, its industrial and market context, its relative strengths and weaknesses, and the expected future context.

There is no necessary equivalence between the three definitions of shareholder value, but, assuming good information is given to the market, MV and SV should, over time, track each other quite closely.

The Combined Code focuses on the accuracy of AV and on information to inform MV. But, except implicitly, the Code does not identify or deal with SV or require that boards are well versed in SV. The assumption is either boards do this naturally and well, or SV is not as important a view of enterprise value as MV or AV. Neither is, in my view, correct. A major lesson from the bubble and the ensuing credit crunch is the need to raise the focus on strategy and strategic valuation as an integral part of governance.

Strategy Audit

Strategy Audit is a tool to enable boards to ascertain and take steps to enhance and protect the fundamental, strategic or intrinsic value of their business over the medium to long term, considering the likely scenarios and the strategic options that may be created.

Strategy is the purpose of the company, its relative position, its capability, its vision and future journey and its strengths and weaknesses. Strategic valuation is the translation of strategy into a range of underlying valuations. Strategy and strategic valuation are usually brought to a board by the chief executive.

An audit of strategy should enable the board to challenge, understand and own the strategy and the related strategic valuation. Strategic planning as practised in many companies tends to change a vital concept into a bureaucratic task.

In the current climate, strategy and vision are more needed than ever. It is critical to get the “periscope” above the clouds, see what is really going on and subject the strategy and its valuation to challenge. Effective strategy audit is as important to good governance as financial and risk audit. It should be made an explicit requirement of the Combined Code.

How to make effective Strategy Audit a reality

Boards should audit strategy rigorously and regularly. They should be equipped to do so in order to arrive at a fully informed and considered view. Many boards have strategy committees, but they often tend to be useful talking shops and not have the capability, analytical power or status necessary to challenge the strategy and the strategic valuation put to them by the executive so as to arrive at a well informed view owned by the board as a whole. The checks and balances needed for good governance are often missing in this critical respect.

I recommend the Combined Code be amended to provide for a regular audit of the strategy and the strategic valuation of an enterprise, to be carried out by a board which is competent to the task, if necessary with the support of external experts. The board should signify in its annual report and accounts that it has the capability to conduct such an audit and has done so. Consideration could also be given to whether boards should be required to comment on the strategic valuation of the company and the main assumptions on which it is based.

CVA has well tested methodologies for describing and analysing strategy and arriving at strategic valuation and would be glad to discuss them or any other aspect of this submission if the Financial Reporting Council wishes.

Yours sincerely,



Paul-Andre Rabate
Founder and Managing Partner
Corporate Value Associates