

Corporate Governance in British Home Stores (BHS) Ltd

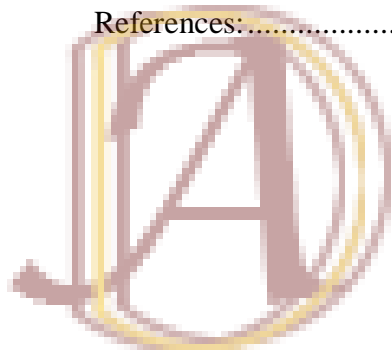
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## ***Introduction***

The modern corporations in the business environment have several great examples of the successes and failures. Among those, British Home Stores (BHS) Ltd is one of them with a clear indication of failure. The company collapsed, representing the unacceptable face of capitalism caused by egregious corporate governance failures<sup>1</sup>. However, the company could have been saved if extant governance rules contained in the UK Corporate Governance Code 2018 were followed. As such, the corporation's failure and its consequential impact on a broad spectrum of interests. It reinforces the need for better governance of corporations in the United Kingdom. Based on that, the claim has been presented with the company's situation and its related impact.

## ***Challenges Associated With Corporate Governance***

Good corporate governance must be "in the interests of our stakeholders." However, this was not the case during Sir Philip Green's reign from 2000 to 2015<sup>2</sup>. When Green bought the company in 2000, their pension fund had a surplus of £ 5 million, but the company was sold to Dominic Chappell. In 2015, having significantly turned into a £ 571 deficit. The pension fund has repeatedly called for increased contributions to the pension scheme (Safari and Gelter, 2019). The CEO of Arcadia (BHS's parent company) has refused to increase the contribution to more than £ 6.5 million. The Pensions Authority also discussed other proposals with Greene to save a black hole in the pension fund, such as a £ 110 million rescue fund in 2014 to help Raytheon's system tackle Greene's pension shortfall<sup>3</sup>. As a result, the decision gets postponed. The Thor project was set up to help 20,000 BHS smart retirees. According to the UK Corporate

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<sup>1</sup> Subramanian S, 'Stewardship Theory Of Corporate Governance And Value System: The Case Of A Family-Owned Business Group In India' (2018) 11 Indian Journal of Corporate Governance

<sup>2</sup> Ibid1

<sup>3</sup> Roger Barker and Iris H-Y Chiu, 'Examining The Wates Principles For Large Private Companies As A Social Contract For Business-Society Relations' [2019] SSRN Electronic Journal.

Governance Code (2018), stakeholder and board relationships must be based on mutual respect, trust and mutual benefit. This is for companies to be successful, sustainable, and progress long-term.

### *Recklessness and Greed*

Connolly and Pyper (2020) drew attention to the root causes of several organizational failures, including the failure of Carillion in 2018. For example, Carillion is a construction company with 43,000 employees. In the whole world and it fell on a £1.5 billion debt. Carillion's fall was accused of negligence and greed for concluding too many risky and unprofitable contracts. In addition, Carillion generates revenue early and incurs overdue costs, uncertain its financial position<sup>4</sup>. In addition, the company is managed for the benefit of the CEOs, not the shareholders, and it receives high compensation. According to an article in the Financial Times (2016), Carillion signed up for high salaries and bonuses, despite failing to meet key performance goals. Speaking of the collapse of the BHS, Green declared a dividend of £ 423 million between 2002 and 2004<sup>5</sup>. It was a split between the Greens, the Greens family, and Arcadia (the parent company of the BHS). Every board member involved in determining their remuneration is in breach of UK leadership (2018).

Almost a month before the actuals ale to Chris Martin, Dominic Chappell and head of pensions were asked by Sir Philip Green to fill out the moral hazard. This was expected to be done in the thin form of explanation of assets that could take from the company and further

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<sup>4</sup> Neshat Safari and Martin Gelter, 'British Home Stores Collapse: The Case For An Employee Derivative Claim' (2018) 19 Journal of Corporate Law Studies.

<sup>5</sup> Ilya Kokorin, 'Insolvency Of Significant Non-Financial Enterprises: Lessons From Bank Failures And Bank Resolution' [2020] SSRN Electronic Journal.

managed by the head. The moral hazard form asks for information on dividends paid to BHS, Arcadia (green parent company), management fees, real estate transactions and rents <sup>6</sup>But just a month before the sale, Arcadia fire chief Neville Khan told Martin that Green was a "moral hazard" if forced to do so. When BHS sold for £ 1 in 2015, it was significantly lower than when Green bought it in 2000. Its pension fund had a surplus of £ 5 million. Apart from this, continued high dividends and operating losses of £ 19.4 million and £ 21 million in 2013 and 2014 led to the company's collapse in 2016<sup>7</sup>. According to the UK government (2018), companies can only pay dividends if they are already profitable and unable to pay more than the profits available to them in the current and previous financial years. According to the UK corporate governance rules, this is to ensure the success and sustainability of the company for which the board is responsible.

*Issues of the Strategic Proposals by Non-Executive Directors*

Another important principle of British corporate governance is to ensure that non-executive directors can oppose strategic proposals. External board members are board members, and their role is to review the decisions and performance of the board and board members. The key concept of a non-executive director is independence<sup>8</sup>. It aims to ensure that they can be objective and challenge managers when they make decisions based on agreed performance targets. The UK government sets strict standards to ensure the independence of non-executive directors. But in the case of BHS, non-executive board members were close friends and relatives

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<sup>6</sup> Roger Barker and Iris H-Y Chiu, 'Examining The Wates Principles For Large Private Companies As A Social Contract For Business-Society Relations' [2019] SSRN Electronic Journal.

<sup>7</sup> Ian Clark, 'The British Home Stores Pension Scheme: Privatised Looting?' (2019) 50 Industrial Relations Journal.

<sup>8</sup> John Connolly and Robert Pyper, 'Developing Capacity Within The British Civil Service: The Case Of The Stabilisation Unit' (2020) 40 Public Money & Management.

of Greene and probably did not call him malicious. Some argue that the most important thing that led to the landing of BHS in April was the sale to Dominic Chappell (a retailer)<sup>9</sup>. However, KPMG, which advises pension fund managers on BHS, said that if their sales to retailers were stopped, BHS would be taken over earlier, although BHS is concerned about retail purchases. Non-executives should have acknowledged and questioned the transfer of £1 Green to Dominic Chappell, but this was not due to BHS's poor corporate governance.

### *Future implications of Corporate Governance*

A company's management must keep pace with the rapid changes in the business environment and be constantly evolving to respond to threats and opportunities. A wide-ranging committee with a wide range of expertise is needed to identify these threats and opportunities. At the same time, the board should meet regularly to ensure that its policies are followed and to respond to new trends in the business environment<sup>10</sup>. In addition, boards need to ensure that they involve more stakeholders and always work for themselves, not for themselves.

Finally, encouraging "whistleblowers" in an organization creates an organization with a transparent work culture, which in turn prevents fraud and risk. Laws are also needed to protect these people from promoting a transparent work culture and whistleblowers. This is to ensure that they feel confident to act without being affected.

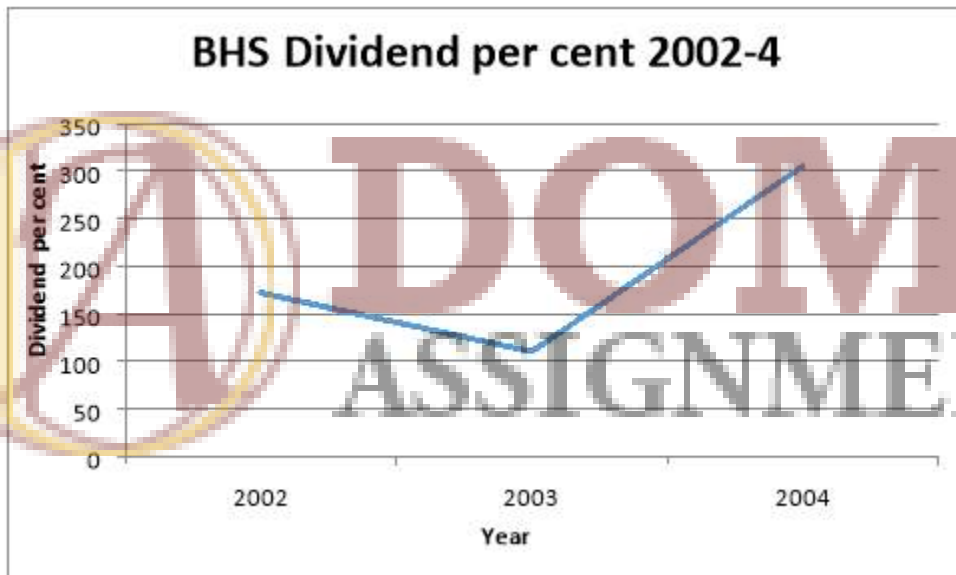
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<sup>9</sup> John Connolly and Robert Pyper, 'Developing Capacity Within The British Civil Service: The Case Of The Stabilisation Unit' (2020) 40 Public Money & Management.

<sup>10</sup> Michel Keiser, 'The Wates Corporate Governance Principles For Large Private Companies: A Weak Compromise At The Expense Of Employees?' [2020] SSRN Electronic Journal.

## *Quality of Corporate Governance in BHS*

One of the key elements of corporate governance is responsibility. This means accountability to the relevant stakeholders affected or affected by the operation. In the case of BHS, this includes the disclosure of legal information in the financial statements of companies and the accounting of persons affected by BHS's decisions and activities<sup>11</sup>. However, the company appears to comply with legal requirements regarding disclosing expenses in its financial statements. Sir Philip Green (the head) has used various methods, including the use of sale and leaseback transactions and equity and liability issues, all of which are discussed.



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<sup>11</sup> Ilya Kokorin, 'Insolvency Of Significant Non-Financial Enterprises: Lessons From Bank Failures And Bank Resolution' [2020] SSRN Electronic Journal.

<u>YEAR</u>	<u>DIVIDENDS PER CENT</u>
2002	172
2003	110
2004	305

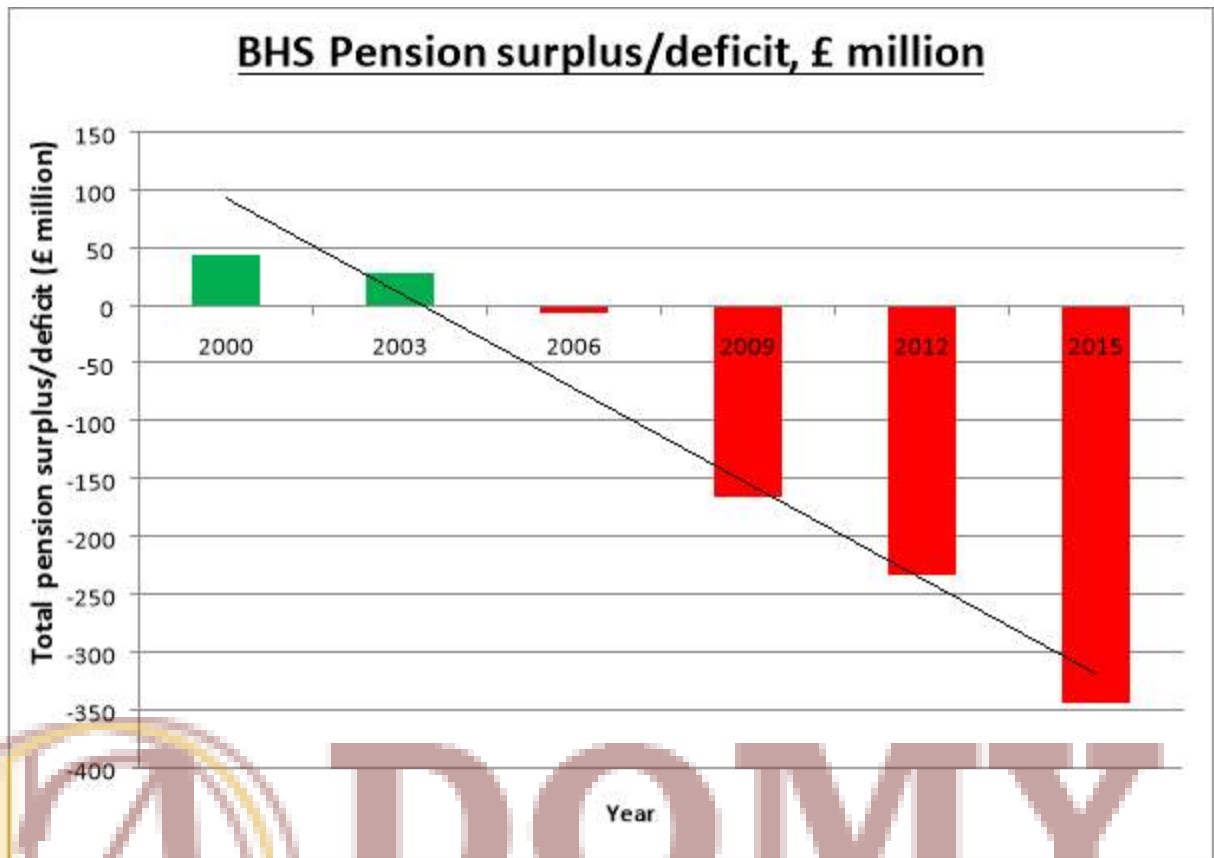
The table and graph above show a large increase in the share of dividends paid by BHS Ltd between 2002 and 2004. BHS Ltd paid GBP 414 million in dividends during the period<sup>12</sup>. However, its profit after tax was GBP 208 million, significantly less than the dividend payment. It raises the question of whether such a dividend would be ideal. This behaviour is because dividends were paid almost twice as much as the after-tax profits during the BHS period. The GBP 414 million dividends paid by BHS Ltd were paid mainly by the parent company BHS Group, which paid GBP 423 million in dividends between 2002 and 2004<sup>13</sup>. This includes BHS Ltd, which paid 414 million pounds. BHS Group also paid £ 423 million, Sir Philip Green and his family allegedly received £ 307 million. The transfer of this money from the BHS to Sir Philip Green and his family led to a shortage of BHS funds for reinvestment and maintenance. Also, it claimed that the pension fund offered by the BHS, as funding for the scheme declined as dividends increased.

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<sup>12</sup> Michel Keiser, 'The Wates Corporate Governance Principles For Large Private Companies: A Weak Compromise At The Expense Of Employees?' [2020] SSRN Electronic Journal.

<sup>13</sup> Neshat Safari and Martin Gelter, 'British Home Stores Collapse: The Case For An Employee Derivative Claim' (2018) 19 Journal of Corporate Law Studies.



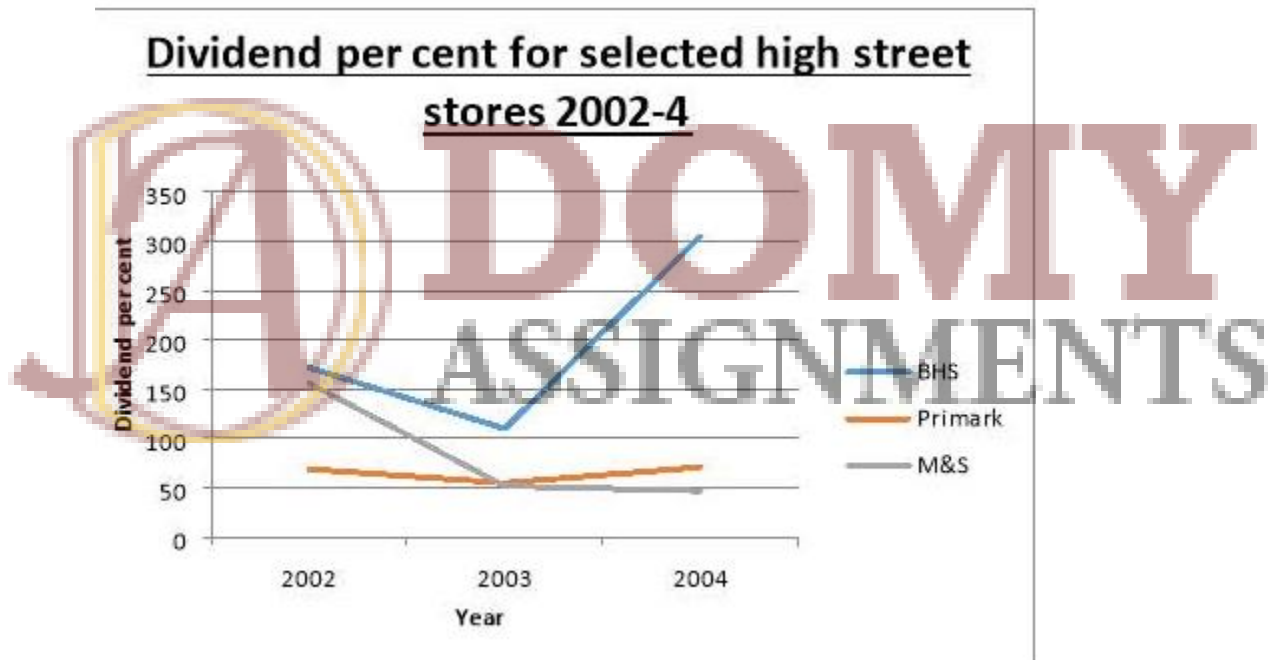


As per the graph above, the BHS pension fund had a surplus of £ 43 million when Sir Philip Green bought BHS for the first time in 2000. After 4 years, there has been a sharp decline, as mentioned earlier, in the systematic withdrawal of dividends from the BHS. This continued growth of pension funds is unsustainable<sup>14</sup>. Apart from this, no additional funds will be added after the cuts. The linear turnover line shown in the graph shows the sharp decline in BHS funding<sup>15</sup>. It is negatively correlated with the increase in years and the decrease in cash contributions due to the longer-discussed increase in BHS dividends.

<sup>14</sup> Neshat Safari and Martin Gelter, 'British Home Stores Collapse: The Case For An Employee Derivative Claim' (2018) 19 Journal of Corporate Law Studies.

<sup>15</sup> S. Subramanian, 'Stewardship Theory Of Corporate Governance And Value System: The Case Of A Family-Owned Business Group In India' (2018) 11 Indian Journal of Corporate Governance.

<u>Dividend per cent for selected high street stores 2002-4</u>			
<u>YEAR</u>	<u>BHS</u>	<u>Primark</u>	<u>M&amp;S</u>
2002	172	69	156
2003	110	55	52
2004	305	71	47



As mentioned above, between 2002 and 2004, BHS significantly increased its dividend payments. Most of which were paid to Sir Philip Green and his family to assess the legality of the significant increase in dividends. Has been compiled the table above compares the BHS dividend ratio with similar companies as a measure<sup>16</sup>. After reviewing the charts based on the

<sup>16</sup> Subramanian S, 'Stewardship Theory Of Corporate Governance And Value System: The Case Of A Family-Owned Business Group In India' (2018) 11 Indian Journal of Corporate Governance

BHS corporate accounts. It is clear that although the dividend rates of Primark and M & S either decreased or were relatively stable between 2002 and 2004. The dividend ratio of BHS was significantly higher. As a result, BHS's dividend increases appear to be very different from other companies in the same industry. For example, Primark's dividend ratio increased by 2.89% between 2002 and 2004, while M&S's ratio decreased by 69.87% (Barker and Chiu, 2019). Primark's slower growth and the sharp decline in mergers and acquisitions contrast with the 77.33% increase in dividends between 2002 and 2004. It may indicate that the prevailing economic conditions were not particularly favourable, forcing companies in the business sector to limit dividend growth. Primark, or just dividend cuts like M&S makes, raises the question of why BHS has increased its dividend payments.

2012-2014 submitted results of the BHS claimed that profit for the year indicates a decrease, and no cash was received. It was shown in the company's internal profit and loss account. In the table below, the gross and net margin of BHS has been calculated for 2012-2014<sup>17</sup>.

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<sup>17</sup> Neshat Safari and Martin Gelter, 'British Home Stores Collapse: The Case For An Employee Derivative Claim' (2018) 19 Journal of Corporate Law Studies.

Year	2012	2013	2014
Sales £	699769000	675653000	668037000
Cost of Sales £	709602000	667999000	673666000
Gross Profit/Loss £	-9833000	7654000	-5629000
Gross Profit Margin	-1.41%	1.13%	-0.84%
Net Profit/Loss £	-82118000	-55290000	-69080000
Net Profit Margin	-11.74%	-8.18%	-10.34%



As shown by the gross and net profit chart for 2012-2014, which has been prepared using the company's annual reports and internal financial statements, BHS has been negative in terms

of net profit<sup>18</sup>. This further raises the question that if a company is doing so well? Its board members and shareholders should decide that BHS's business model and processes need to change because it does not appear to be successful in this environment. In addition, BHS's position affected the decline in market share from 2.3% in 2000 to 1.4% in 2016. The decline in BHS's market share may have affected the company's management. It hurt BHS's profitability, as shown in the graph prepared for 2012-2014.

It can be argued that increased competition or declining market share will reduce the quality of corporate Governance (Connolly and Pyper, 2020). While these factors can help overcome proxies by creating relationships between shareholders and board members. They can help improve its financial position to prevent bankruptcy and job losses. However, this can lead to a decline in the quality of a company's management. The management board members who employ them must not look after the interests of all stakeholders<sup>19</sup>. This should only have targeted the interests of the shareholders and members of the management board.

This is clear in the case of BHS, where it can be seen that to increase BHS's wealth. BHS shareholders and board members are willing to maintain high dividend payments during the economic crisis and the continuity of the company's operations. Despite the indirect economic challenges, BHS points out that between 2002 and 2004<sup>20</sup>. This is related to keeping money in the company rather than withdrawing it as dividends. It could have supported the maintenance and growth of BHS in favour of BHS sustainability.

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<sup>18</sup> Michel Keiser, 'The Wates Corporate Governance Principles For Large Private Companies: A Weak Compromise At The Expense Of Employees?' [2020] SSRN Electronic Journal.

<sup>19</sup> Roger Barker and Iris H-Y Chiu, 'Examining The Wates Principles For Large Private Companies As A Social Contract For Business-Society Relations' [2019] SSRN Electronic Journal.

<sup>20</sup> Ian Clark, 'The British Home Stores Pension Scheme: Privatised Looting?' (2019) 50 Industrial Relations Journal.

One of the most prominent aspects of corporate Governance is related to sustainability. It can ensure the growth and continuity of the business. Based on that, all the decisions and actions took place through maintaining development and the company's success. One of the main ways to ensure sustainability is to prevent the organization from running out of business and resources. It can continue to support its maintenance and development. Unfortunately, for BHS, the behaviour of shareholders and board members is almost inherently parasitic<sup>21</sup>. They benefit from taking money at the expense of BHS pension fund users and other sources such as the issuance of BHS fund bonds. This created a huge deficit of £ 571 million, with continued withdrawals from the pension fund. In turn, it was a major factor in the collapse of the BHS, where heavy debt became a burden and the £ 571 million deficit passed.

Other aspects of corporate Governance is related to responsiveness. It served the interest of the stakeholders who fit with the company at a specific time. They can take a timely decision and act accordingly<sup>22</sup>. This could be done based on available information. BHS stakeholders, such as shareholders, do not have relevant information on business continuity. They are unaware of the decline in BHS, so BHS leaders may be surprised, as many could have stopped it if they had known about BHS before. The uncertainty they face is part of their business.

Apart from the shareholders, the future of the users of the BHS pension funds is also at stake. The BHS does not serve the interests of the members of the BHS pension fund, as evidenced by the pension fund's deficit of GBP 571 million<sup>23</sup>. Abundant and ongoing dividend payments to shareholders, primarily £ 400 million to Sir Philip Green. This unsustainable

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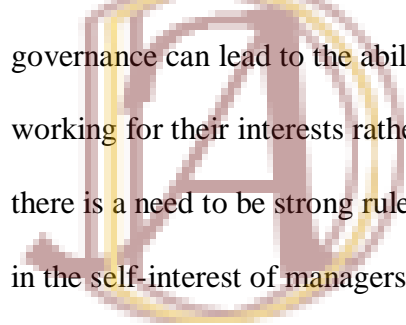
<sup>22</sup> Neshat Safari and Martin Gelter, 'British Home Stores Collapse: The Case For An Employee Derivative Claim' (2018) 19 Journal of Corporate Law Studies.

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withdrawal of unfunded pension funds eventually led to the bankruptcy of BHS. It leads to the loss of 11,000 jobs and the risk of 20,000 people retiring.

### *Conclusion*

The Corporate Governance of companies is determined so that it does not create conflicts of interest. It ensures the activities of the management board at all times and decisions in the best interests of the company. Also, they take all stakeholders, not themselves or a family member, into account. The situation of BHS has become worst due to such major issues. Also, there is a significant conflict of interest among company managers. At least seven of these managers have interests in several companies in the same group, which could undermine the role of managers. Therefore, it is recommended for companies to consider this situation. The benefits of corporate governance can lead to the ability to work and make decisions for their benefit. It leads to working for their interests rather than those of the company and its stakeholders. That's why there is a need to be strong rulers in this situation. This will help to overcome the risks inherent in the self-interest of managers.



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