

**Review on the Role and Effectiveness of
Non-executive Directors.**

The Consultation Paper dated 7 June 2002 and written by Derek Higgs seeks comment on the above subject.

In submitting these views on the subject I do not intend to reply in detail to the questions asked in the Consultative Paper but merely to submit comment on those matters which I consider to be the most pressing and which, if addressed and adopted, will not only result in significant change in the Role and Effectiveness of Non-executive Directors but will also signify to the business world in general the determination of the London market to not only lead the way in best Corporate Practice but to be actually seen to be doing so.

I submit the following comments for consideration:

1. Board Composition/Duties.

- a. I believe that the best size for a Board is to be less than 10.
- b. Of this number not more than 3 should be executive directors
- c. The balance should be non-executive selected specifically for their particular skill set and focus. Consequently each non-exec will Chair a sub committee, e.g, Audit, Risk, Remuneration, Appointment/Nominations, etc.
- d. Non-execs will be appointed at the AGM for 3 year periods; one-third of their number to retire each year. No non-exec to serve for longer than 6 years.
- e. The non-execs should select the Chairman of the Board from amongst their number. In this way the non-execs will be responsible for collectively ensuring the performance of the Chairman and, effectively therefore, the performance of the Board itself.
- f. The Non-execs appointed to chair the sub-committees will report on activities at each Board Meeting. Each sub-committee will have a second director appointed as Deputy Chairman who will confirm the accuracy of such reports.
- g. The sub-committees will, therefore, consist of two non-execs, at least two members of management and may appoint outside expertise, "Sub directors", to the sub-committees with the prior approval of the main Board and/or Appointments/Nominations Sub – Committee.
- h. The outside Auditors should be invited to attend all meetings of the Audit Committee, not necessarily as members but perhaps as observers.

i. Minutes of ALL sub-committee meetings to be circulated amongst its members, senior management and the company's auditors and to be available to all main board directors on request.

2. Selection of Non-executive Directors.

a. A small number of individuals sit on an unacceptable number of boards. They are, on the whole, all known to each other and, hence, the impression of "jobs for the boys". With a few impressive exceptions many fail to exercise proper supervision. In many cases they know little about the business concerned and, consequently, are unwilling to challenge management. Such a situation can be a recipe for disaster.

b. Many such directors are not naturally incompetent but are simply overworked. Many may already be the CEO of a large company as well as have several non-executive appointments at other companies. They may also, possibly, be a Governor of a School and/or sit on the Committee of a large sporting or religious institution.

c. Many would consider, and rightly so, that the position of CEO or Finance Director of a large public company, etc, should be a full time job. How, therefore, can someone with a full time job find time for other jobs? The answer is, in the majority of cases, he cannot. Hence many Non-execs arrive at Board Meetings poorly prepared. They have not read properly the Board Papers. They miss much of what is being discussed as they are trying to read the papers for the next item on the agenda. Their contribution is minimal and their attendance records often poor.

d. Full time executives of public companies should be precluded from sitting on the boards of other companies unless they do so representing their company as a shareholder. As such the company that employs them, and its shareholders, will receive true value for their money. Such executives may however sit on the committees of educational, sporting or religious bodies with the agreement of their board.

e. The role of the Non-exec should be a full time job. No individual should accept more than four or five non-exec positions. To be a non-exec should be a profession in itself, no different to being a Doctor or an Architect for example and be remunerated accordingly. As such, the quality of non-execs will be significantly enhanced as they will have time to dedicate themselves fully to their role and to keeping up to date with best practice corporate governance as it evolves.

f. The title Non-Executive Director will take on added meaning as such an individual will have no executive position within society at all.

g. In selecting non-execs those responsible must ensure that the individual will have the time to dedicate at least one day per week, preferably more, to the affairs of the company. The selected individual should be asked to certify, upon appointment, that he is satisfied

that he will be able to dedicate the required time and annually certify that he is in fact doing so. Consequently few directors will later be able to argue that they “didn’t know” when and if something goes wrong.

3. Qualifications of Non-executive Directors.

a. Most non-execs are well qualified, usually by experience, to be directors of companies. It is, however, one of the few areas of public life that seems to require little or no formal qualification.

b. A number of business schools have attempted to run courses for non-execs but companies are loath to pay. The Chairman often says “ We appointed him for what he already knows so what use would a course be?” As such knowledge levels remain static and other areas are not developed. This might suit the Chairman but not, surely, the overall good of the company.

c. Non-execs, particularly of FTSE listed companies, should have relevant experience of business. They should be able to provide advice to Chief Executives and Executive Directors. They should be able to monitor the performance and the financial and legal probity of the company. It is difficult, therefore, to see how anybody under the age of 35 could ever qualify for such a position.

d. As such, many non-execs will come from the ranks of retired executives. Given that the non-exec job will be a full time one it might encourage a number of quality executives to retire a little earlier than might otherwise be the case.

e. Whilst experience is a vital ingredient non-execs must also be encouraged to keep up to date with developments relating to best practice corporate governance. They should be required to attend an annual two-day course held by an approved business school, e.g, Cranfield, Henley, LBS, etc. The syllabus would be decided by The Institute of Directors in consultation with the Department of Trade and Industry and be regularly reviewed. All non-execs would be required to be members of The Institute of Directors and pay the appropriate fees.

f. The Institute would not run such courses themselves but would be responsible for policing the correctness and standards of the courses run by the approved business schools. For this they would receive a fee from the Business Schools based on the number of “students” that take the courses. The Institute could run seminars, conferences, etc, and publish an NED Magazine covering matters of specific interest to non-execs.

g. The Institute of Directors would in effect act similarly to The Institute of Bankers and would be charged with the objective of ensuring the quality of the non-execs within the UK. The courses offered by the business schools would cover matters such as the

changing role of the non-exec, board procedures, chairing sub-committees, changes in remuneration policies within the market, changes in company law and the effects of such changes, corporate governance in other countries such as the USA, lectures on Risk, etc, changes in accounting policy both on and off balance sheet, requirements of the Regulating Authorities, Audit requirements and changes thereto. The list is endless but it is clear that such courses would greatly improve the effectiveness and quality of non-execs within the UK. Other countries, Australia, South Africa, India etc, might also send directors on such courses or become 'affiliated' to The Institute of Directors so that they too can embrace the standards and example of the UK market.

h. The concept of a full time cadre of non-execs, properly qualified to protect the interests of shareholders and of the public can only be to the advantage of all concerned. Such a development would also add greatly to the worldwide reputation of the London/UK market.

4. Remuneration of Non-executive Directors.

a. It is difficult to be prescriptive in this regard. Tax considerations, an individuals circumstances and public perceptions of corporate greed all serve to make it difficult to lay down a 'pay scale'. However, unless non-execs feel that they are being fairly remunerated for their work and responsibility then the quality of the individuals prepared to undertake such duties will fall with a commensurate knock-on effect to the market itself.

b. It would, therefore, be appropriate for guidelines to be laid down from time to time by The Institute of Directors in consultation with The Department of Trade and Industry. Such guidelines could "suggest" that a non-exec of a FTSE 100 company could expect to earn, say, £40,000 p.a. Non-execs of FTSE 101 to 500 companies might expect to earn, say, £ 25,000 p.a. and so on. The guidelines would not say how the money was to be paid but would encourage payment in shares and in attendance fees. Clearly senior non-execs might expect more than the guidelines whilst new appointees might receive less.

c. The concept of paying fees in shares would be designed to tie in the non-exec to the long term performance of the company rather than options designed to pump-up short term performance as has been the perception in the recent past. A non-exec who has his own money effectively invested in the company is likely to be considerably more diligent than if he did not. The shares could only be sold after they had been owned for a period, say, 3 years.

d. A good non-exec with 5 non-exec positions might earn, say, £ 150,000 p.a. In addition to this would be the capital gain on shares assuming good performance by the issuing company. As such, total remuneration of between £ 150,000 and £250,000 should not be unexpected and would be in line with earnings in other professions.

e. A bonus of one years pay could be payable at the end of each 3 year appointment.

5. General.

a. Non-execs should be encouraged to travel around the offices/factories of the companies on whose boards they sit. They should see things working at first hand and thus get a better feeling for the business and morale of the company as a whole.

b. Non-execs should be able to have meetings with senior members of management on a one to one basis if they wish so as to satisfy themselves as to the quality of management and to the accuracy of information that they are being given.

c. The Office of the Company Secretary should be staffed sufficiently to provide non-execs with the necessary secretarial and support functions.

d. The non-exec who is Chairman of the Audit Committee should be obliged to report direct to the AGM on the results and accuracy of the accounts which will have first been adopted and signed by the main board.

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