

Roy Close, CBE

12 July, 2002

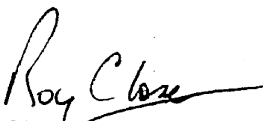
Dear Mr. Higgs,

I have presumed to write to you on this subject of the role of non-executive directors because of a recent discussion with a business colleague following an exchange of correspondence in which I recalled my own role at an earlier time of concern about corporate behaviour when the CBI, the BIM, the Bank, Sir Adrian Cadbury, and institutional investors set up PRONED to promote the idea of non-execs and establish a register of carefully selected candidates, and provide an advisory service. I was Director General of the BIM at the time. Subsequently I have had some experience as a non-exec mainly with small companies.

I enclose a copy of my letter to my colleague because, though written in the context of a slightly different argument, it contains the main observations I wish to make, and which I hope are pertinent to your Review. My credentials are stated briefly in the letter, and they appear in more detail in Whos Who.

The only additional comment I would like to make, is that, as indicated in the letter, the problems of effective corporate governance depends equally on the careful appointment of executives as directors based on their assessed ability to *direct* the affairs of the company (not just because they are very good senior executives) as it does on the careful selection of non-execs who will follow through in some detail the purpose of their role. On reflection I am coming to the view that a non-exec Board of Directors with a Management Board, as is practiced in some companies here and more widely in the USA, may be the the most effective Board structure.

Yours sincerely,


Roy Close.

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9 May, 2002.

Thank you for sending me a copy of your letter to Colin Marshall . As one who had a hand in setting up ProNed, I am very interested in the subject . I can't remember how long ago—perhaps '83/'84---there was, as there has been since, great concern about corporate governance . Sir Henry Benson, then an eminent senior accountant and business man, joined the Bank of England to investigate and recommend . One of his recommendations was that companies should have on their Boards, Directors who were not executives in the company, but who could bring to the Board expertise from other companies, other professions, other fields of activity .

(Just to get rid of the pedantic argument that there is no such animal as a non-executive director, the title simply means a director who does not hold an executive position in that company —perhaps elsewhere—and as a director he carries the same responsibility for performance and behaviour of that company, legally—company law and all other pertinent laws--, and morally, as all other directors .)

I was director-general of BIM at the time . I ; the d.g of CBI; the Bank ; representatives of insurance and investment houses ; and Adrian Cadbury (then a member of the Court of the Bank) formed an organising committee and set up ProNed to draw up a register (c.v's. etc) of potential non-execs, which was made available, together with appropriate advice, as a free service to companies . (Interestingly, IOD stood apart, wanting to protect their internal register for their members .) . Jonathan Charkham ran it and our committee stayed in a *non-exec* supervisory role . The Government of the day was supportive . I think it's true to say it set the ball rolling for a wider understanding of the role of non-execs, and for encouraging companies to make their exccs available for non-exec directoral roles in other companies . Many of its publications are relevant today . Eventually the 'free service' method was abandoned ; then it was run as a commercial concern by Colin St. Johnstone and partner ; and then sold on .

So much for history and for my credentials to pontificate . I'm sure that since then the non-exec contribution to good corporate government has been positive . I agree with you on that . The focus on some high profile failures should not obscure that . As I see it the

success still depends---as it always has---on how a company chooses people for a non-exec role . It must be a rigorous process, identifying areas of experience needed, and searching for the right people to provide it and who will exercise a *bold and independent* point of view There is, I am afraid, still a tendency in some companies (a) to look for people who will 'not rock the boat' and (b) to look for 'titles' or 'names' people who add prestige to the letterhead and company report . That does not mean that people who are titled and/or have a good reputation in their field do not make good independent non-execs, but the choice must be on the criteria of the experience and contribution needed . And people who have 'gone plural' on non-exec directorships --making a career out of them--- should be avoided . With the best will in the world they cannot focus sufficiently on each one . Companies should be encouraged by, say the CBI and IOD not to appoint as non-exec anyone who has already four or five directorships, and to make the point clear, the company should be required to publish in their annual reports the other directorships and appointments held by their own non-execs .

Now in my humble opinion there is a flip side to all this---the executive members of the Board . Here too are matters affecting good governance and corporate success . To extend the last point above . Companies should also publish the non-exec appointments held by the executives (including the chairman) on their Boards . Not to be restrictive but to show (a) how the company is playing its part in developing the role and practice of non-exec directorships in the economy , and (b) to show shareholders the breadth of experience thus gained for the benefit of the company .

Another issue concerning the executive directors (bearing in mind they are fully paid senior executives ---often division or department or 'function' heads---who have been made directors for which they should receive a director's fee) on which the non-execs should exercise judgement and advise The two roles of executive directors are separate . They can and do report to the Board on their department/ function , but their duty to the Board is that of directing the company in all its meaning . Too often companies have used the appointment of executives to the Board as a promotion device or to provide the successful executive with 'status', forgetting perhaps that the exec.can be 'Director of,say marketing/ personnel' without having to be a director of the company . It's unfortunately true that a successful senior exec. at the head of his function does not necessarily make a good company director requiring a strategic view and knowledge of the industry, and vision . The success as an executive of such a man should be recognised and remunerated in a different way .

Another difficulty of the habit of putting senior execs on Boards is the problem of equivalence : 'Production sits on the Board so should I as Marketing' . Yet another is the relationship between the 'functional' exec. as a director, and the managing director . The hard truth is that the exec. director has in his function to report to the m.d. His future depends on that relationship . It is hard for him at Board level to raise criticisms of how his function is handled, or of how another function is handled . Rocking the boat . Yet he may have a point . I believe that the non-exec has two roles here when it comes to re-electing a director . First, he should be able to exercise, and express, a judgement as to whether 'x' is really a *director* or 'just' a bloody good senior exec, and discuss his opinion

with colleague non-execs and the chairman when it comes to putting names forward for re-election .. Secondly he should get to know the exec. directors outside the Board but in the context of their function . Visit the company at different times, talk to people in their function ; what do they *really* think . They have the right to do that and they have the right to ask for any information they want ; those rights should not be delegated to anyone . Non-execs are there to make those kinds of judgements in the interests of the company . When I was on the Board (non-exec) of Chloride Ind. Batteries etc. I made a point of doing this, visiting between Boards and talking to the various function heads . I found they appreciated a visit from someone from the Board for a confidential, off the record discussion . As a result I had a better insight of the problems, which I think was helpful at Board level--and I did not make an enemy of the m.d !

Now in your letter, Brian, you say that in the present climate 'non-execs might want to protect themselves by insisting that the companies they represent are assessed by truly independent --retained--people' ---you, rating agencies, etc. I think you must be very careful not to thereby make it easy for non-execs. to push off their responsibility for doing just that . All the information you suggest the independent agency can gather should be obtained by the non-execs as part of their role . There is a danger that the independent agency will be just another level through which info. is passed and its accuracy, relevance depends on yet another level of expertise . I think it will be helpful to offer Boards generally an independent analytical service, but that is what we do . You can't save non-nexecs. where they are failing by taking over part of the function they should be performing .

Discuss .

Best wishes and regards,

