

Directorbank

THE IMMEDIATE SOURCE OF LEADING DIRECTORS

Response to Review of the Role and Effectiveness of Non-Executive Directors September 2002

We believe that matching the right NXD to the right company is crucial to the health of corporate governance. We agree with the basic premise of the review, that there is a key requirement to strengthen the quality, independence and effectiveness of NXDs, and that there should be tangible measures introduced to promote more effective Boards. However, we believe that the key issue is not the regulatory framework in which Public Company Boards operate, but the quality and suitability of the appointments made. In our experience, successful Boards are ones where the individual working relationships forged between Board members are strong, based on respect for each other as colleagues. The measures introduced should be designed to increase the chances of getting the right calibre of NXD on to the Board in the first place and then giving the Board some simple tools to enable it to increase its own effectiveness.

Before commenting in detail on the issues raised in the consultation paper, it might be helpful if we set out the clear steps which we encourage our clients and our candidates to take to ensure successful appointments:

- 1 Clarity among executive Board members as to why they are seeking to appoint an NXD, with the development of a specific brief detailing the attributes of the required candidate and the contribution expected
- 2 Pulling together a shortlist of potential candidates, from a variety of backgrounds, who meet the brief. Encouraging as many executive directors as possible to meet as many candidates as they can
- 3 Choosing candidates using a similar level of care as executive appointments e.g. competitive interview, checking references, the use of personality profiling, looking for evidence of ability to influence and independence of mind
- 4 Appointing someone who will command the respect of all the executives, and whose contribution will be valued
- 5 Agreement of a comprehensive job description with the appointee
- 6 A formal and wide-ranging training and induction programme
- 7 Regular appraisal and evaluation, with 360° feedback and goals set for future performance
- 8 Regular rotation among committee members and fixed terms of appointment

We also believe that the Review should carefully consider the very great responsibility placed upon the shoulders of the members of the Audit Committee, in particular the Chairman. We believe that someone who does not have recent experience as a Group Finance Director can rarely handle this role. We also believe that it requires significantly more time commitment than any other NXD role and carries significantly higher risk, there may therefore be a case for differential pay for an NXD prepared to undertake the challenge.

Finally we would add that many NXDs seem to be prepared to take roles at companies despite misgivings about the quality and probity of the other Board members. We encourage our candidates to view acceptance of an NXD position as similar to a decision to invest in the company - it should only be done if the candidate has real confidence in the management team he or she will be joining. NXDs should be aware that investors could see their very presence on a Board as a sign of approval. Similarly, if a company finds it difficult to fill NXD posts with acceptable candidates, the message to the stock market will be clear.

Specific Responses

A. Role

NXDs will seldom be able to challenge a Board on the detail of a business. Their role is to encourage the CEO and other executives to define a strategy for the Company and to demonstrate that all elements of the business are correctly aligned to achieve that strategy.

The Chairman's role goes beyond the area of challenge in that he or she must also be prepared to represent the Board externally and to act as a figurehead. There is also likely to be regular dialogue between the Chairman and the CEO who reports directly to the Chair on strategic matters.

The currently accepted three committee system which we see working most frequently (audit, remuneration and nomination) covers the key aspects of corporate governance. But we believe it is essential to recognise the pivotal role of the Audit Committee as the ultimate guardian of shareholder value as reflected in the financial statements of the Company. We believe that the leadership of this committee comprises the key NXD appointment and that companies must be able to demonstrate the competence of the members to perform their duties.

We would not wish to see regulation of Boards to the extent of proscribed Board composition, nor do we believe it is appropriate to regulate the number of directorships held. The best safeguard to ensure that shareholders are being properly considered would be much tighter definition of roles, and documentation of the time commitment implied therein. In our experience, the most common issue raised by Board members is that lack of clarity in the initial stages has left both the executive and NXDs uncertain about what is expected and thus disenchantment sets in.

Not all NXDs need to be 'independent', but there needs to be a substantial proportion of the Board complement who are.

B. Attracting and Appointing NXDs

We believe that attracting the right calibre of NXD will become increasingly difficult in the current climate. In our experience, the best motivation for accepting an NXD role is ‘the challenge, the interest’. This is independent of the level of financial reward and is more likely to lead to a genuine interest being taken in the day-to-day life of the Company. We do not believe that the current level of NXD remuneration needs particular review; it is very rarely a key factor in a candidate’s decision about whether to accept a job. Concern about risk and reward is rising, but should be met with increased focus on liability insurance and, crucially, on the candidate’s level of confidence in the quality of the Board he is joining.

The only essential skill is the ability to influence. NXDs who have no impact on their colleagues are redundant; to ensure continued harmonious operation of the Board, the ability to listen and persuade is key.

Each Board requires at least one robust financially literate individual to chair an Audit Committee. We would always recommend that this position be filled by a current, or very recently practising, Finance Director. All other skills are optional and should be driven by the needs of the particular company, but we believe that a true blend of skills, age, experience, nationality and gender can be the most creative.

In terms of widening the pool of potential recruits, it is important to look beyond the usual list of senior retired PLC directors, to bring in recruits from the public and voluntary sectors and to encourage younger managers to take one NXD post as a crucial element in their own career progression. Directorbank actively enlists candidates from within the private equity sector, from the Arts and Public sectors, and has a particularly keen focus on recruiting more female NXDs.

We are also investigating the role of psychometric profiling to establish what makes a good NXD and to analyse Boards to identify skills gaps.

The Nomination Committee should be required to report publicly on the source of introduction of new NXDs and to discuss the competitive process by which the appointment was made. This will lead to much more clarity on the true ‘independence’ of any NXD.

C. Structures and accountability

One definition of an independent NXD might be someone who was appointed following a rigorous competitive process as the best fit to a pre-agreed set of objective criteria. We feel there is currently very little clarity on this.

The feedback from the many NXDs with whom we work is extremely mixed. There are two common factors to the Boards that do seem to work well, one is process driven – that Board papers need to be rigorously produced to a high standard and circulated in good time. The other is that the more effort an NXD is prepared to put into the Company between Board Meetings, the better the contribution they make and the more respect they command from their executive colleagues.

We do not believe that Board size should be fixed as we have seen many different structures working well or badly in different companies – the key issue is to review the size and composition of the Board at regular intervals.

We have commented above on the importance of the Audit committee and the need to strengthen the quality of the membership in many cases.

With regard to the processes in place for setting objectives and reviewing performance, we would suggest that this is still relatively unusual, but introducing more formal communication of objectives to NXDs could have a dramatic impact on the effectiveness of many Boards. Similarly, service contracts for NXDs should be improved to include more information on duties and roles, and would then be available to shareholders at the AGM.

Many NXDs claim that it is difficult to challenge their colleagues. This must be blamed on mistakes being made at the time of appointment. NXDs should not take up positions where they are in danger of being ignored, and if issues arise subsequently then NXDs of reasonable calibre should be able to work together to improve the situation. Otherwise we might end up in an unfortunate situation where NXD resignations were the only way to signal difficulties within the company.

D. Relationships with shareholders and others

We have no comment on relationships with shareholders.

We would support the suggestion that many Chairmen could do more to help NXDs to become more effective. The mark of a good Chairman is the ability to get the best contribution out of every attendee at a Board meeting. Corporate governance can be improved by giving all Board members access to training and guidance, to be funded from shareholders' funds. If the pool of potential NXD candidates is to be successfully widened to increase the talent base and reap the benefits of diversity, then more training will be needed. This should cover the basics of the legal and regulatory framework, but could be combined with elements of existing senior business education programmes to improve the overall level of constructive contribution at Board meetings.

E. Support

All companies should be encouraged to review their NXD induction programmes. The programme needs to speed up the NXD's learning curve in gaining familiarity with the Company he or she is joining – we often hear that NXDs take 2-3 years to become really effective, we would suggest that this could be improved dramatically by better investment in the initial familiarisation process. There are many good publications available to help an NXD find his or her way around the regulatory environment and to improve their ability to contribute in meetings, but they could be brought together into an internet-available resource, supported by external training courses.

F. Smaller listed companies

We would not advocate imposing any further regulations on smaller listed companies – in our experience this would lead to even more companies, mostly very well run, exiting from the public markets. As we believe that the best way to improve corporate governance is to improve the quality of the NXDs being appointed and to encourage more clarity and definition of the role they are expected to perform, there will be of equal value to any size of company.