

**FOUNDATION FOR  
INDEPENDENT DIRECTORS**

**Review of the role and effectiveness  
of non-executive directors**

**Response to the Consultation Document  
from Derek Higgs**

**September 2002**

**PRINCIPAL PROPOSALS**

## **I        WIDENING THE POOL OF NON-EXECUTIVE DIRECTORS**

Reliable data is in short supply but anecdotal evidence suggests that the boards of FTSE 350 companies are comprised in the main of middle aged, white business men (as distinct from business women) who serve already on the boards of one or more other listed companies. There is nothing wrong of course in itself in this category of people and it is not self evident that this category of people has served shareholders of listed companies badly. Nevertheless there is a strong sense, which we share, that, by limiting the pool in this way, nomination committees are denying themselves opportunities to attract people of sound judgement, integrity, commercial ability and experience (“the Desirable Attributes”) from backgrounds other than the category referred to above.

Moreover, sub FTSE 350 companies find it even more difficult to attract people of calibre from the conventional category outlined above because the pool has already been fished. There is no reason in principle why people with the Desirable Attributes cannot be found from amongst, for example, directors of successful and substantial private companies, chief executives and board members from the public and charity sectors, managing partners of professional firms, bankers, senior civil servants and academics. In fact, when one puts one’s mind to it, the range of possibilities becomes interesting.

However, in order to make progress in widening the pool we think that two things need to happen:

1. Institutional investors need to be convinced that this is a desirable project and to influence nomination committees and the recruitment agencies to look further afield for talented people having the Desirable Attributes.
2. Training and development programmes need to be increased and properly recognised to equip suitable people in governance and board dynamics in relation to public companies. Our experience in training potential non executive directors demonstrates that governance and the regulatory environment for public company directors can be taught. Many of the people whom we train have the right characteristics but feel that without public company experience they will not find a place on a public company board. To a large extent this is true. However, there is (or ought to be) no “mystery” about being a director of a public company –what is crucial is that the people concerned start with the Desirable Attributes. Much can be taught so as to give directors the confidence of knowing that they are appropriately versed in the regulatory side of public company directorships.

## II MAKING TRAINING AND DEVELOPMENT A PRIORITY

We would make the following submission:

### 1. **Adequate and continuing training**

Paragraphs 4.19 and 4.20 of the Cadbury Report placed emphatic importance on the need for adequate training for “all” directors—implying that both executive and non-executive directors need training in governance and board dynamics.

It is disturbing that, since that report was written in 1992 and although there are some courses on governance and the role of directors provided by a handful of organisations including some business schools, from our experience there appears to be no significant take up from among current public company directors. This young “industry” of education for directors is in need of further recognition and development.

We assume that the review will hear from those organisations which provide such courses and we think that it would be highly desirable for the review, when dealing with the training issue, to list the courses which have been identified to the review. With that in mind we attach, as an Appendix to these Principal Proposals, a summary of the programme put on by the Foundation through its sister organisation, the NED Forum.

We think it is of fundamental importance that the review should include in its conclusions a requirement for executive and non-executive directors to “sign up” for continuing education by attending courses on governance and the role of the director. Programmes such as that offered by the Foundation provide a neutral setting for a dialogue between executives and non-executives, facilitating better mutual understanding of their respective roles. This is an important component of any such course.

Provision A.1.6 to be a Principle: Overall we are of the view that not nearly enough public company directors (executive and non-executive alike) acknowledge the need for training in governance in their director roles. We suggest that it would help to encourage more training if Provision A.1.6 of the Combined Code were to be elevated to a Principle (so that companies were forced to explain how they apply the Principle.)

### 2. **Professional Recognition for NEDs**

We are of the view that there is a case to be made for some form of professional recognition for NEDs. That recognition could be achieved by participation on courses and commitment to periodic refreshment and updating. Qualifying courses need to carry “certification” by a properly constituted and authorised body. As a first step we suggest a small working group of relevant parties (including the Foundation), or their representatives, be convened to establish course certification criteria. Agreement on the membership and operation of an authorising body would follow.

Such professional recognition will assist the widening of the pool, and also the maintaining and developing of the requisite professional standards. NEDs are drawn from a population which generically comprises senior and experienced people. We would suggest that passing examinations to “qualify” for the role is not appropriate. Participation in a course carrying the proper certification, on the other hand, we would suggest is an acceptable and workable form of “qualification”.

Such a regime would particularly apply to prospective NEDs, and acceptance of professional recognition as the standard assist in widening the pool and marking out those of the right calibre.

**FOUNDATION FOR  
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**THE NED PROGRAMME**

The NED Programme has evolved a distinctive format in the five years since its inception based upon experienced-based learning and development with in depth analysis and discussion of the non-executive director role and its value in the boardroom. This format differentiates it from, but makes it complementary to, other offerings.

So far some 250 participants of whom most have been directors, some with non-executive experience, have attended. The Programme receives an “overall rating” of “excellent” based upon a formal evaluation completed by participants.

The format combines professional knowledge and experience of governance and of being a non-executive director with institutional investor input. Rigorous analysis of the case study, prepared with the help of extensive research and knowledge of the company and its board, and role play as a non-executive director, provide the focus for learning from the real world and tying together points raised in the supporting sessions. The result is a comprehensive insight into the non-executive director role and guidelines for best practice to both apply and use a frame of reference. The programme is run with a limited number of participants to stimulate open discussions and debate and sharing of experiences. "Chatham House" rules of confidentiality apply. This format has also proved to be a useful stimulus of communication between corporate directors and institutional investors.

The Faculty is well established and comprises governance professionals and experienced non-executive directors including chairmen. The institutional investors' input is provided by fund managers, Hermes and Gartmore.

The Programme is recognised by the National Association of Pension Funds and is supported by an annual dinner to which recognised authorities in governance are invited as guest speakers, e.g. Sir Ronnie Hampel, Sir Adrian Cadbury, Alastair Ross-Goobey and Vanni Treves.

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**(Continued)**

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## A: ROLE

### What role should non-executive directors perform, and how does this compare to the present position ?

1. *What is the role of the board? What is the role of the chairman and how does it relate to the non-executive directors?*

The board is charged with the overall leadership and control of the enterprise. Its responsibilities include:

- agreeing strategy and setting the direction for the management team
- selecting and reviewing the performance of the management team
- agreeing operating budgets
- reviewing performance against strategic and operational objectives
- ensuring adequacy of resources (finance, people, etc.)
- maintaining acceptable standards of corporate governance

The chairman's role is key to board effectiveness and includes:

- leading and managing the board and board processes
- reviewing the performance of directors
- leading the NEDs in the review of the performance of the CEO and executive team and if necessary making changes
- ensuring NEDs are properly involved
- ensuring that all relevant information is available to the board

An effective chairman is an important influence on the contribution from the NEDs. For their part, the NEDs first responsibility is to support the chairman and CEO, assuming this support is justified. The NEDs (with or without executive directors) should include as a duty consideration of the effectiveness of the chairman.

2. *What should be the key roles of non-executive directors on the board and what should be the balance between the different components? Within a board, should all non-executive directors be expected to fulfil each of the different roles?*

A primary component of the NED's role is to support their executive colleagues in fulfilling their duty to shareholders and building sustainable shareholder value.

Additionally components of the role include:

- a. ensuring effective leadership (by the chairman and CEO in particular) including planning for their succession and that of their executive colleagues
- b. the development of strategy
- c. the identification, assessment and management of risks
- d. challenging (constructively) executive management and their decisions
- e. membership of committees (audit, remuneration and nomination)

A common sense view suggests that all these components, including the primary one of support for the executive, need to be in balance with none taking precedence. However, because effective leadership is so key to any enterprise, this component is deserving of particular attention from NEDs.

Not all the NEDs should be expected to fulfil each of the different roles equally because of peoples' different strengths, weaknesses, backgrounds and experience. The key is to seek a complementarity and balance of these amongst the NEDs. This also extends to the mix of NEDs and independent NEDs.

3. *How does this compare with the present position?*

Mainly anecdotal evidence suggests that for a variety of reasons the present position is not in accord with the above.

4. *How independent do non-executives need to be for the different roles?*

The guiding principle should be independence. This does not however eliminate the valuable contribution that can be made by NEDs considered not to be wholly independent.

5. *What are the main potential conflicts of interest which may arise within a company where non-executive directors can play a role in protecting the interests of the company? What can be done to help non-executive directors to be effective in relation to these conflicts ?*

The main potential conflicts of interest are:

- (a) the compilation and reporting of financial information: Executive remuneration packages rightly should be based on performance, but the risk is thereby created that the compilation of profits and the reporting of financial information may be skewed so as to maximise apparent performance. Non-executive directors need training and outside independent help via the audit committee to understand the nature of the profits being reported (revenue recognition and deductibles and liabilities being written off etc);
- (b) internal controls: For the same reason as in (a) above there may be a tendency to soft pedal on internal controls. Outside independent auditing of and reporting on internal controls say every other year would help.
- (c) remuneration of executives: self evident. Criticisms even from well informed and intentioned sources still abound that too much of the remuneration is a one way bet. The proposed Remuneration Regulations should help remuneration committees to concentrate their minds on defensible packages and shareholders to speak their minds-we would suggest that time be given to see if the Regulations bite as intended.
- (d) nomination of executive directors: recent US experience should not be taken as happening in the UK but nevertheless there will in some cases be a temptation for CEO's to promote or appoint senior executives who will fall into line with the CEO's agenda. It is exceptionally difficult for executives who owe their appointments and promotion to a CEO to take an independent line. Nomination committees should consist of independent directors who should enlist outside help not only in making new appointments and every promotion from within but also have available the recognised power to appraise in confidence the performance of all senior executives. That won't necessarily fix the problem but it may create a forum in which issues can be picked up.

6. *What time commitment is needed for the role of chairman and non-executive director and how does this vary between different companies? Are there any implications for the number of non-executive posts that one person can sensibly take on.*

Not committing the necessary time to any one appointment, particularly as an NED, is perhaps one of the major weaknesses today. Whether chairman or NED, it is however wrong to be prescriptive on time – it requires whatever it takes to be effective. Sensible limits on the number of appointments could help facilitate this and we support the following:

- a. for solely NEDs - 5 appointments (including significant public/not for profit sector appointments)
- b. for chairman – 3 NED appointments (or less if more than one chairmanship)
- c. for executive directors – only 1 NED appointment

7. *Should there be a special role for a senior independent non-executive director?*

Under normal circumstances, assuming the roles of chairman and CEO are separated, the chairman fills the role. On boards with a deputy chairman, then the incumbent naturally fills the role when difficulties with the chairman emerge (or in cases where the role of chairman and CEO are combined). Aside from these circumstances, formalising the position is not really necessary. In a crisis one would emerge as a point of contact for the institutions.

8. *Do you have comments on the proposed statutory statement of directors' duties, which does not seek to distinguish between the legal duties of executive and non executive directors?*

We are in favour of the statutory statement as set out draft clause 19 and schedule 2 of the draft clauses set out in cm 5553-II. The risk is that the interpretation of the statement will be exhaustively litigated but we think that the benefit well outweighs the risk. We do not favour making a statutory distinction between executive and non executive duties which we think would lead to loophole seeking and in any case wrong in principle so long as the unitary board remains in existence in the UK.

Manifestly however non executive directors will tend to be vulnerable to being caught up in decision (or non-decision) making based on mis or non-information or misconduct by executive directors and therefore be less culpable than executive directors. We feel however that the courts should be encouraged to make greater use of s.727 of the Companies Act 1985 (which it is hoped will be incorporated into a new Companies Act ) and which gives a judge discretion to take all the circumstances into account before imposing penalties on directors. The section has in our view been wisely used in cases such as *Bairstow and ors v Queens Moat Houses* and should lead to just results.

## B. ATTRACTING AND APPOINTING NON-EXECUTIVES

### What knowledge, skills and attributes are needed , and what can be done to attract, recruit and appoint the best people to non-executive roles?

9. *What are the key skills, knowledge and experience which are needed by non-executive directors to perform the role effectively and how is this likely to change over the next, say, 10 years? Are some skills essential and if so what are they?*

The particular skills, knowledge and experience needed will obviously be dictated by each company's situation so as to both add to and complement those of the executive directors. But more generally experience and/or understanding of business from a senior perspective is essential, together with the ability to:

- take an overall perspective
- add to strategic thinking and development
- contribute to the judgement of senior people and their performance

All NEDs should have an understanding of finance and accounting, and it is essential for some to be particularly skilled in this area. The capacity to challenge the financial implications of a proposed M & A initiative, for instance, is a case in point.

Looking to the future we would suggest a growing need for an ability to contribute to a company's policies on interaction with society, the environment and on ethics.

10. *What personal qualities and attributes are needed?*

Key personal qualities needed are:

- integrity
- sound judgement
- independence of mind
- **and** the courage to be tenacious in asking the important probing question, and holding fast to firmly held views.

In addition to be most effective the NED needs to be both a good **listener** and **communicator**.

We would also suggest that, given the increasing complexity and demands of the role, a willingness to learn and continually develop the role's requisite professional knowledge and skills is also necessary.

11. *What sort of mix of experience and attributes is desirable on a board? Specific examples of cases where non-executive directors have contributed with particular effect to company performance, or to corporate governance, would be helpful.*

See 9.

12. *How easy is it to recruit non-executive directors with the right skills and attributes? Could recruitment and appointment mechanisms, including nomination committees, but improved?*

There is evidence to indicate reluctance amongst some high quality candidates to being appointed NEDs. The grounds for this reluctance appear to be potential personal liability,

reputational risk and, significantly, an imbalance between the demands of the role, commitment and reward.

There is also ample evidence to demonstrate that currently NEDs are drawn from a restricted pool, thus limiting the opportunity to bring fresh thinking and judgement to board decisions. Take for instance the boards of quoted companies which have an inclination to dip into the same pool of people serving on similar boards, not least as CEOs. Clearly more thought and consideration needs to be applied to expanding the pool and, as important, **to the sources of the NEDs of the future.**

Selection of NEDs remains a key issue still to be tackled. Without a proper selection process the probability of an ineffective appointment must be high. The question is, therefore, to what extent is selection of NEDs on merit to match a well thought out specification replacing other less objective processes? The evidence would suggest that the answer is slowly. Many companies still do not take selection of NEDs nearly seriously enough. This is inconsistent with the importance of their role.

The above has implications for strengthening the role of nomination committees and also for raising standards of recruitment services provided by some of the search firms.

13. *What could be done to widen the pool of potential non-executive directors and introduce greater diversity into appointments? What are the constraints on this? Is there scope for greater international representation on UK boards?*

See Principal Proposals.

14. *Are the rewards for non-executive directors appropriate, both in terms of level of pay and the form that remuneration takes? Are current pay levels a significant factor in whether good non-executive directors can be attracted?*

Considered objectively the level of rewards for NEDs generally do appear too low for the commitment and demands on professionalism required to be effective in the role. However, rewards should be set on a case by case basis.

Rewards may be cash or a combination of cash and shares (not options), subject to agreement between the NED and host company. It seems most sensible to restrict trading in the shares by the NED until his term of office has expired in order to better align the NED's interests with those of the shareholders.

See also 12.

15. *Do you have comments on the issue of risks or insurance provision for non-executive directors ?*

This is a specialist area outside our expertise, but from observation we would comment :

a. All Non-executive directors should be covered by insurance by the companies on whose boards they serve- of course there is a risk that the existence of D & O policies simply encourages litigation , and there is also the risk that cover itself will lead to directors assuming that they can take risks in the knowledge that they are covered, but we think nevertheless that cover should be made available wherever practicable.

- b. In our experience directors rarely read “the small print” and they assume that they are covered for any liability. Often, however, policies will, for example, not cover directors against claims by the company itself under the “insured v insured” rule. It is however possible to include such claims provided that they are made by a board a majority of whose directors are different from the board at the time of the original breach of duty or a liquidator in the case of insolvency. Directors need advice on these aspects and probably the company secretary is the right person to take the newly appointed director through the policy. If necessary the director should be encouraged to get advice from his own adviser.

## C: STRUCTURES AND ACCOUNTABILITY

### Do existing structures and procedures facilitate effective performance by non-executive directors?

16. *How is the Combined Code working in practice? In particular, how are the provisions on the balance between executive and non-executive directors and the role of independent non-executive directors working? Is further definition needed of independence in the Combined Code and, if so, what would a sensible definition be?*

Our comments are as follows:

- a. In general we think that the Combined Code is an effective and comprehensive set of quasi-regulations and that time is needed to develop best practice in relation the Code.
- b. The problem is that in our experience few public company directors have been taken through the Code line by line as part of their training. let alone been tutored in the meaning and significance of its provisions. If our observations are right, the consequence is that few public company directors know the Code. This is a serious limitation and needs to be addressed.
- c. There are a few amendments which might be of value:
- Provision A.2.1. should be more robust in discouraging a combination of chairman and CEO roles
  - All instead of a majority of the directors on the audit committee should be independent;
  - Provision A.1.6 (training) should be converted into a Principle in order to force companies to explain how they apply the principle. The governance statement appears to us mostly to ignore provision A.1.6.
  - Principle D.3 and the corresponding Provisions (Audit committee and auditors) need extensive overhaul in the light of the Treasury/DTI Co-ordinating Group on auditor independence and accounting practices (e.g. that the audit committee would process the appointment of auditors for recommendation to the shareholders; etc etc)
- d. We think that the definition of “independence” in the Code is a good one. However, we also think that it would be highly desirable to include a note or appendix describing best practice as to cases which do **not** constitute independence along the lines of the Joint NAPF/ABI guidelines. In our experience the question of independence is one which exercises chairmen a lot since the Code tends to leave it to individual boards to make the call. This is understandable but in our view boards and their advisers would find it helpful to see such a note of

guidance in black and white in the Code itself. This is not meant to refute the proposition that in the final analysis independence is as much a state of mind.

17. *Do the recommended structures for board committees facilitate governance and an effective contribution by non-executive directors? Are board meeting procedures working effectively? Do you have comments on board size?*

The structures do facilitate governance. See also 1 for emphasis of the crucial role the chairman plays in board effectiveness. Boards should be as small as possible but with the experience needed to guide the business, e.g. 5 executive and 4 non-executive directors is a model for most large companies; 2 executives and 3 non-executives works well in small companies.

18. *Do you have comments on the composition and duties of audit committees? How effectively are audit committees working in practice? Do you see a need to strengthen the existing Combined Code provisions on audit committees?*

A fundamental point is that auditors have to be appointed by **shareholders**. The Companies Act 1985 requires that their appointment be put to members each year at the same meeting as the presentation of the annual accounts (usually the AGM - and a pretty perfunctory item that has hitherto been).

However, the reality is that in the minds of many auditors the key relationship is with the Finance Director, not the audit committee let alone the shareholders.

Reforms are needed to "liberate" the Finance Director from the task of hiring and firing the auditors and that job should be brought back nearer to the principle of shareholder accountability by making this the task of the audit committee subject to approval by shareholders. Independent non executive directors have a vital part to play in that process.

Surprisingly, provision D.3 of the Combined Code requires only that a **majority** of the audit committee should comprise independent non executives. Clearly the Code should be changed so that the audit committee comprises only independent non executives. Alongside that change there needs to be a transformation brought about by the audit committee in the relationship between the executive directors (particularly the CEO and FD), the auditors, the audit committee, and managers of the internal audit function so as to inculcate a firm understanding by everyone that the auditors' key relationship is with the audit committee as a whole - and not, incidentally, just with the chairman of the audit committee. That can only be achieved by in depth and regular discussions between the audit committee and members of the audit team followed up by in depth and regular discussions between the audit committee and the FD and members of the internal function. The job of the audit committee should be to supervise on behalf of the board (whose job it is under law to prepare the accounts - as correctly emphasised by the original Cadbury Report but still often misunderstood) the preparation of the draft accounts before inviting the auditors to come in and conduct the audit.

The key issue task for the audit committee is to achieve all this in a way which ultimately feels to the executive arm of the board like co-shouldering the task of preparing accounts of integrity rather than unwelcome intrusion into a cosy affair in which the shareholders have no place of importance.

19. *Similarly, do you have comments on the composition, duties or operation in practice of nomination and remuneration committees?*

The case for remuneration committees being composed entirely of independent NEDs (as for the audit committee) is probably now well made. We suggest that for nomination committees to properly fulfil their responsibilities they should comprise in the first instance a majority of independent NEDs.

20. *What processes are in place for setting objectives and reviewing performance against those objectives, for the board as a whole and for individual directors?*

This is a weak area with very few examples to date.

21. *Could more be done to review performance? Should more information on board performance be reported to shareholders? Should companies provide more information on the performance of non-executive directors?*

Yes. The Directors' report should say that performance of the board and the individual directors has been formally reviewed.

22. *Are non-executive directors able successfully to challenge executive decisions or expose serious problems? Should it be made easier for them to do so and, if so, how?*

Yes. NEDs can successfully challenge, but it is a question of power, personality, ratio of NEDs to executive directors and the number of independent NEDs.

## **D: RELATIONSHIPS WITH SHAREHOLDERS AND OTHERS**

### **Do existing relationships with shareholders or others need to be strengthened?**

23. *How well do relationships between non-executive directors and shareholders and stakeholders work, and could they be improved? For example, we would be interested to hear views on what the relationship might be between non-executive directors and institutional shareholders. How could this relationship be strengthened?*

Normally there is no regular channel of communication between NEDs and shareholders, but with the CEO, FD and chairman. We suggest that there is a case for NEDs to be more in contact with shareholders.

24. *To what extent are chairmen creating the conditions for non-executive directors to be effective? Is there more that they could do, by promoting constructive relationships, managing the discussion processes, encouraging challenging and effective contributions in board meetings and ensuring appropriate information flows, or otherwise?*

The crucial role the chairman plays in board effectiveness has already been emphasised (see 1).

Some chairmen do all this well, others do not. It is down to the individual. There is scope for a great deal more training and sharing of experience for chairmen and NEDs.

25. *What should be the relationship between non-executive directors and executive directors, and with senior management? What should their relationship be with the chairman and the CEO? What should their relationship be with key advisers to the company?*

The relationship of NEDs and chairman, CEO and executive directors has been covered previously (see 1). In addition NEDs should seek to interact with senior management. This should be a totally open process with difficult issues discussed freely at the board and outside.

We firmly recommend that NEDs need to take more interest in the selection and behaviour of advisers.

26. *How can company secretaries support effective performance by non-executive directors?*
- a. The company secretary should work with the chairman to devise and supervise the induction process. The current practice widely adopted of simply providing a new director with an induction pack and leaving him/ her to get on with it is not enough. Instead the chairman and secretary should spend a day going through the induction file with the new director and should discuss in depth how the board works in that particular company. The secretary should then arrange a training programme with an appropriate organisation along the lines of the training ideas outlined under 28 below .
  - b. Thereafter the company secretary should ensure that NEDs receive refresher training at regular intervals.
  - c. The company secretary should also sit in attendance on all committees of the board so that their work is co-ordinated in a “joined up” way and relevant information can be communicated to the directors of different committees.
  - d. Finally, it should be the company secretary who supervises, with the chairman, the information dissemination process pursuant to principle A.4 and provision A.4.1. of the Code.- (see also 27 below).

## **E: SUPPORT**

### **How can non-executive directors best be supported to perform their role ?**

27. *How much access to information from management do non-executive directors need to be effective? In practice, are information flows and communication channels sufficiently open and unrestricted?*

Starting with the second question, in our experience we have never known of cases where information was being deliberately withheld or non-executive directors denied access to information. That does not mean of course that it does not happen and it is up to the chairman (as stated in the Code ) to ensure the free flow of information. A brief review which we have made of annual reports of public companies discloses that the part of governance reports dealing with Principle A.4 is bland and uninformative in most cases.

The essential problem is trying to work out the answer to the first question. The issue which it raises is fundamental .

It was admirably summed up in para 4.14 of the Cadbury Report as follows:

*“Non-executive directors lack the inside knowledge of the company of the executive directors, but have the same right of access to information as they do. Their effectiveness turns to a considerable extent on the quality of the information which they receive and the use which they make of it. Boards should regularly review the form and the extent of the information which is provided to all directors.”*

The Combined Code (provision A.4.1.) buttresses this proposition, including the appropriately sceptical point that: *“information volunteered by management is unlikely to be enough in all circumstances and directors should make further enquiries as necessary”*.

The issue becomes even more serious in the light of the proposed codification of directors’ duties in the recent White Paper for company law reform. We say this because liquidators of failed companies, or more likely successor boards of failing companies (e.g. Equitable Life), will examine whether there has been a breach of the duty of care provisions of the proposed new Companies Act and ask what information the directors had; and insofar as they did not have information, should they have made further enquiry? The risk is that non-executive directors will feel the need, in order to discharge their duty of care, to demand ever more information, to micro-manage the company and second guess the executive arm.

It is extremely difficult to lay down prescriptive rules on this issue given the multitude of different circumstances, but we would start with the suggestion that a call be made by the Higgs review, first, for a review by every company of the “matters which should be reserved to the Board” pursuant to Provision A.1.2 of the Combined Code; and, second, for a review at board level by all companies of the information which is currently made available to directors. We are not convinced that sufficient companies have recently reviewed these matters. An “ideal” list of Board reserved matters might be considered appropriate for inclusion in this review for insertion in the Combined Code as an appendix of best practice in relation to the provision of information - our point being that, if this list is adhered to (and reviewed from time to time), then the information flow relating to those matters should be reasonably easy to identify.

28. *What training and development opportunities are available? Could they be improved and, if so, how?*

See Principal Proposals.

29. *Can induction for non-executive directors be improved?*

Yes, see 26.

30. *Do non-executive directors get clear guidance on what is expected of them and do they get feedback on whether they are meeting expectations?*

Practice varies very widely in our experience but it has to be said that a surprising number of companies (particularly the sub FTSE 100 companies) offer no guidance and no feedback. We think that Provision A.1.6. of the Combined Code should, as stated in 28, be elevated to a Principle and that a corresponding Provision be inserted to the effect that all NEDs should receive a letter of appointment which should set out expectations, and that there should be regular two way “appraisal” discussions with the chairman.

## **F. SMALLER LISTED COMPANIES**

### **In what ways is the position different for smaller listed companies?**

31. *To what extent do different factors apply in the case of smaller listed companies? Is different provision necessary?*

We would endorse the conclusions of the Hampel Report to the effect that there should be no distinction made on grounds of size. There is a widespread view we think among smaller listed companies that the full rigour of governance codes does not apply to them and we think that it would help if the review disabused them of this view.

The real problem is the difficulty of getting NEDs of sufficient calibre. This is where our views on the widening of the pool may be of help.

## **G. INTERNATIONAL CONTEXT**

### **What can we learn from international experience?**

In the answers we give below we would gratefully wish to acknowledge the help of Dr Marco Becht, Director of the European Corporate Governance Institute, Brussels.

32. *What lessons can be learnt from international experience, either in terms of structures or behaviours?*

Corporate governance institutions and arrangements differ widely across countries, yet boards always play the central role.

There are interesting (less well known) arrangements in other EU countries that might be worth thinking about in the UK context:

- France allows companies to choose between a one and two tier structure
- Mandatory German co-determination is not the only form of employee involvement; Finland has a voluntary regime which seems to work very well, with many companies implementing employee representation on a voluntary basis.

33. *Do other models of corporate governance or different boardroom roles or dynamics contribute more to company performance?*

The link between corporate governance and company performance generally is complex and the answer is not clear. Recognised research conducted on a scientific basis is limited and generally confined to the US. EU research may be expected to appear soon now that most EU countries have adopted governance codes and the improvement in disclosure which goes with that regime.

There is however no conclusive evidence that, for example, German co-determination is bad.

34. *Would it be beneficial to bring UK practice more in line with that in any other country? If so, why and how?*

The main difference between the UK and other countries in continental Europe is the absence of large blockholders (see “The control of corporate Europe” – Barca/Brecht, OUP.2001); there is some evidence that more involvement by large (not dominant) shareholders in the UK would be beneficial.

The UK has relatively large institutional investors and the continental model suggests that they should be more involved at the board level; more directors would thereby be dependent on institutional shareholders. This might require changes in insider trading rules and other regulations which discourage institutional investors from appointing board members. Indeed, under the continental model, institutional investors should be encouraged/required to field directors for election to the board and it should be disclosed who they are.