

Non –Executive Directors Review Submission

From: Eryl Morris

Date: 14:8:02

Introduction

I would like to address what I believe to be two critical issues which are inter-related:

- The independence of non-executive directors
- Who a non-executive director can speak to when he strongly believes action is being taken that is not in the best interests of shareholders.

My comments relate to the extreme situations where differences cannot be resolved satisfactorily at Board level and against the background of my strong agreement with the following comment from the Hampel review “Non-executive directors should command the respect of the executives and be able to work with them in a cohesive team to further the company’s interests”

Personal background

I write from the perspective of someone who has been a non-executive director of a number of PLCs and also a Chairman of a number of private equity backed businesses.

The issues

As a non-executive director of a PLC, one is appointed by a group of existing directors with the Chairman and Chief Executive having a major influence. One then continues to serve at their pleasure. Contrast this with the situation in the private equity arena where as Chairman, one is nominated by one of the major shareholders and continues to serve at his pleasure.

In the private equity arena it is clear that one’s responsibilities are to the major shareholders. When one is seriously unhappy with the action of the executive directors and cannot resolve matters with them, one can speak directly to the major shareholders. They can then decide on the action that should be taken in the shareholders best interests.

In the PLC arena, while it may be theoretically possible for a non-executive director to go to some of the major shareholders with his concerns, this is not a practical option and the only real option for a non-executive director is to resign. Such action on a point of principle generally goes unnoticed.

The end result is that a PLC non-executive director is not really independent. Like in most “clubs” he has to fit in with the general views and behaviour patterns of the majority or resign. Strong dissent is not welcome. I believe this is responsible for many of the recent corporate governance problems and it is also the reason why it is generally difficult for Remuneration Committees to take a truly objective and independent view. Consensus and harmony does not necessarily lead to the right answers as shown by cases like Marconi, Enron and Equitable Life.

A possible solution

One possible solution is for the major shareholding institutions to share out responsibility for appointing non-executive directors to PLCs in which they have significant stakes. These shareholder appointed non-executive directors would then hold office at the pleasure of the shareholders rather than of the Chairman and Chief Executive, and they would become genuinely independent. Furthermore, such non-executive directors would have a direct line to the major shareholders if they were genuinely concerned that the action being taken by the executive directors was not in the best interests of shareholders, and the issues could not be resolved at Board level.

I appreciate that there are difficulties with issues such as major shareholders not wanting to become insiders, and executive directors not wanting spies in the camp. However if the objective is to get more effective corporate governance and if shareholders want to protect and enhance the value of their investments as well as get more influence over executive director remuneration, then I believe my suggestions merit consideration. After all what I am proposing seems to work in the private equity arena.