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23<sup>rd</sup> August 2002

Mr Derek Higgs  
Non-Executive Directors Review  
Department of Trade and Industry  
Room 2142  
1 Victoria Street  
London SW1H 0ET

Dear Mr Higgs

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

### **A response to the issues raised in the Consultation Paper**

I enclose with this letter my comments on some of the issues you list for consideration in your Consultation Paper.

I conducted research into the work of non-executive directors over a period of five years while on a PhD programme at Henley Management College. In 2001, I submitted for examination a thesis entitled *An empirical analysis of the impact of the Cadbury nexus on the work of non-executive directors of FTSE 350 companies* and most of what I have to say below is based on the research findings reported in that thesis. The comments are my personal responses and should not be taken to represent the views of Henley Management College in any way.

I attach my CV as postscript to this letter.

## **The context of my research**

My programme of research described and discussed recent changes in the pattern of work of non-executive directors of large public limited companies in the UK. An empirical analysis was made of the impact on their work of the series of reports and codes on corporate governance which were published in the UK between 1992 and 1998. This connected series, or nexus, of reports and codes was initiated with the publication of the Cadbury Report in December 1992. I referred to it collectively in the thesis as the 'Cadbury nexus'.

The research findings were based on the views of a group of non-executive directors who, in 1999, were still on the boards of FTSE 350 companies which they had joined during, or prior to, 1992. Their companies were all constituents of the FTSE 350 index. Because they had served on their boards throughout the changes sequentially initiated by the Cadbury nexus, they were in a unique position to assess the impact of those changes on board behaviour within their individual companies.

## **The methods used in the research**

The research programme was implemented in two phases. In the first phase, the respondent directors were asked through a questionnaire compare the situation in 1999 with that in 1992 in order to assess the level of change in their involvement and the involvement of their boards in 38 separately defined tasks and activities.

One non-executive director was identified on the board of each of 102 companies taken from the FTSE 350 as listed on 14<sup>th</sup> June 1999. These 102 were the only FTSE 350 companies which had been PLCs in 1992 and which had on their boards a non-executive director who had been appointed in, or prior to, 1992. The fact that there were not more than 102 companies is possibly a reflection on the pace of change in the structure both of companies and of boards over that seven year period.

By October 1999, 50 completed questionnaire forms had been returned, representing 49.0% of the target total. Letters or messages conveying refusals to complete the survey were received from 19 (18.6%) of the target list. Company policy and pressures on personal time were given by the 19 as the reasons for not completing the survey questionnaire. No replies were received from 33 (32.4%) non-executive directors on the target list.

The second phase of the research was conducted through semi-structured interviews with 35 members of the same group of non-executive directors. They were asked a series of questions, the responses to which were subsequently used to test a series of research propositions about the impact of the Cadbury nexus (see *Appendix A* to this letter for further details of this second phase).

## **A general overview of the research findings**

The first phase of the research showed that there had been marked increases over the seven year period in involvement in the tasks and activities defined in the questionnaire. The greatest increases in the involvement of boards were found in the work of board committees, in determining board composition and in specifying directors' powers. Regarding the involvement of the non-executive directors themselves, the greatest increases reported were first, in ensuring that valid and reliable control procedures were in place and second, in the review and evaluation of opportunities and risks in the environment and of the strengths and weaknesses of the company.

Analysis of the subsequent interviews showed that an overwhelming majority of the respondents supported the view that the focus on the work of board committees, reported in the first phase of the research, had improved the effectiveness of the main board. There was also strong support for the view that the Cadbury nexus had had a positive impact on the board selection processes.

A majority of the respondents believed that they could be sufficiently vigilant in the performance of their duties and most rejected the suggestion that their independence would be threatened by the requirement of the nexus for their greater involvement in the company's activities. Reservations were, however, expressed about whether too much was now being asked of them in terms of the demands upon their time.

Most respondents did not see the emphasis placed by the Cadbury nexus on the role of the non-executive director as threatening the unitary board by creating, in effect, a two-tier board structure. They extolled the advantages of the unitary board and were for the most part not impressed by what they had seen of alternative systems.

The general impression created was that the Cadbury nexus had given the non-executive directors surveyed and interviewed a greater influence on board process and board effectiveness. A strong sense of confidence in their enhanced role was evidenced by this group of non-executive directors. For the most part, they believed that, as a result of the changes introduced by the nexus, they were in a better position to be able to make effective contributions at the board table.

## **Sir Adrian Cadbury's comments on my research**

I discussed my analysis of the transcripts of the interviews with Sir Adrian Cadbury. I recorded and transcribed his comments and refer below to his views in some of my responses to the issues raised in your Consultation Paper.

I attach a copy of the transcript of the interview with Sir Adrian as *Appendix B* to this letter.

## **Developments since 2001**

Since 2001 there have been some spectacular company failures and the media coverage of these failures has suggested that some non-executive directors might have been insufficiently vigilant in the exercise of their responsibilities to the shareholders. Inevitably much of the evidence put forward has been anecdotal. I say ‘inevitably’ because there has always been a paucity of rigorous empirical research into boardroom conduct. Writing in 1995, Pettigrew and McNulty said “*Very little is known of the relational dynamics in and around the boardroom*”. Researchers have always faced difficulties in making contact with the elite group that directors comprise. Even if contact can be made, difficulties can still be encountered. Hill, who conducted research into boards from a social organisation perspective, pointed out in 1995 that “*The normal asymmetry of the interview is reversed when respondents have elite status*”.

Nevertheless, any proposals to change the current regulation of non-executive director behaviour should be based on sound evidence, not on hearsay. For this reason the independent Review which you have been asked to conduct is very timely and welcome, since it will give the opportunity for a broad, evidence-based assessment of the current situation.

## **The format of the presentation below**

Assuming that you will have many responses to your Review, I have tried to make my comments as brief as possible under the specific headings you have set out. Where appropriate, I have tried to match the findings of the research which I conducted to the specific issues raised in the Consultation Paper.

I have included, in *Appendix A* to this letter of response, verbatim extracts from the interview transcripts taken from the second phase of my research, together with my analysis of those extracts. This background detail is therefore available to you in *Appendix A*, if you should wish to examine some of the evidence on which many of my responses to the issues you have raised is based.

Yours sincerely,

**Keith Gay**

## **Biographical Note**

### **Dr Keith Gay BSc (Econ) MPhil PhD FCMI**

In 1950, Keith Gay won the Hume-Lloyd scholarship in Economics awarded by University College, London, and he graduated in 1953. The next two years were spent on National Service, as a pilot in the Royal Air Force. In 1955, he joined Thorn Electrical Industries and worked in the marketing departments of the Ferguson Radio and Atlas Lighting divisions of the company.

In 1964 Keith Gay joined The Wellcome Foundation Limited, the pharmaceutical group, with the intention of developing a career outside the UK. In 1966, after completing a brief assignment in India, he was sent to the Philippines to start up a new subsidiary company for the group there. Other senior expatriate positions with the group's companies in Pakistan and Australia followed and in 1971 he was appointed General Manager, South East Asia, based in the regional office in Singapore. Returning to the UK in 1976, he became General Manager, Africa and Asia, responsible for all the Wellcome group operations throughout the region, which employed over 3,000 local and expatriate staff.

Keith Gay was a director of many subsidiary and associated companies in the Wellcome group, including those in Pakistan and India, which were public companies, quoted on the local exchanges, in which Wellcome had a substantial interest. He was Chairman of the associated company in India for six years from 1986, and remained on that board as a non-executive director following his retirement from the Wellcome group in 1992 and until shortly after Glaxo took over the Wellcome group in 1995.

Keith Gay enrolled as a Research Associate on the MPhil/Phd programme at Henley Management College in 1993. An investigation of the competences required by managers of international companies was the subject chosen for his Master of Philosophy degree, awarded in 1995. The research on competences led to an interest in the personal qualities required by public company directors. Building on the research of Professor Dulewicz and his colleagues at Henley's Centre for Board Effectiveness, Keith Gay focused his own research programme on the role of the non-executive director. He was awarded a doctorate in 2001 following submission of a PhD thesis which examined the impact of corporate governance changes on the work of non-executive directors of FTSE 350 companies.

Keith Gay was appointed a member of the Associate Faculty of Henley Management College in 1999 and has been a Fellow of the Chartered Management Institute (FCMI) since 1978.

**August 2002**

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

### **Responses from Keith Gay to the specific issues raised in the Consultation Paper**

#### **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?*

#### **Response :**

It is not immediately self-evident whether the board or the management is responsible for the running of a company. On the one hand, the board has a clear, legal responsibility. On the other hand, management has the infrastructure, the knowledge, the time and frequently the appetite to shoulder this responsibility.

This distinction helps to identify the major difference between ‘directing’ and ‘managing’. Managing is about being hands-on. Managers are trained to search for problems to resolve and to adopt a convergent thinking and problem solving style that strips out all the apparently redundant information. Directing is about leadership. It requires the ability to tolerate a high level of uncertainty while using it to give direction.

So the board can be seen as a fulcrum where a comprehensive view of corporate activity comes together with responsibility for understanding social, economic and stakeholder demands for performance accountability. The board’s role, in other words, involves judgement and making choices. In exercising this responsibility, the greatest value-added comes from constantly challenging management to see both elements of the bigger picture. Carefully handled, the challenge creates a constructive tension that can lead management to more robust response to the fundamental demands of corporate governance.

So the two key issues for boards are first defining its role in strategy formulation and implementation and second supervising the performance of management. Other tasks are either of secondary importance or liable to be counter-productive. The board of directors is legally liable for strategic outcomes and therefore it must evaluate strategic performance in the light of shareholder interests.

Organising and running the board is the responsibility of the chairman. The chief executive officer (CEO) is responsible for running the company's business. If the CEO is also the chairman of the company, the situation known as duality, then the power of the individual holding the joint post is considerable. The Combined Code argues against duality. Roberts and Stiles conducted an in-depth qualitative study of the relationships between chairman and chief executives in major UK corporations. Their findings showed that splitting the roles was only successful if the individuals could work their way through to complementarity of roles. The splitting of the chairman and chief executive roles placed a co-operative relationship at the heart of the organisation. When failure in these relationships occurred, it was almost invariably where the two remained at a considerable professional and personal distance from each other. Similarly, the relationship between the Chairman and the non-executive directors has to be based on trust and cooperation if the board is to be effective.

### **Evidence :**

This summary has been collated from definitions put forward by : Demb and Neubauer, (1992); Garratt, (1996); Goold, (1996); Goodstein and Boeker, (1991); Finkelstein and D'Aveni, (1994); Roberts and Stiles (1999) : for further details, see **References** below.

*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?*

### **Response :**

Despite the passage of time, the definition of the non-executive director's role put forward by Aris in 1986 can hardly be bettered. He listed the contributions which non-executive directors could make to the board as :

- \* to see issues in their totality and to offer a wider perspective than the serving executive directors, who are often preoccupied with their line management responsibilities;*
- \* to provide information about the outside world that might otherwise not be available;*
- \* by focusing attention on long term, forward looking strategic questions to encourage the chairman and the board to act as a board and not as a day to day management committee;*
- \* to bring specific knowledge, know-how and professional expertise into the boardroom;*
- \* to facilitate the business by providing contacts with customers, sources of finance or government or with other commercial organisations at home or abroad;*
- \* to provide a counter balance to the executive directors;*

*\* to act as independent scrutineers of the company's overall performance and to act as watchdogs on behalf of the shareholders as members of audit and remuneration committees;*

*\* to act as a referee in cases of conflict, either inside the board or where, as in some takeover situations, the interests of the directors and the shareholders are opposed;*

*\* to fire the chairman, if necessary*

One interesting aspect of the list compiled by Aris set out above, is that the emphasis is on the positive, business-creating aspects of the role. The determination of strategy is at the heart of Aris' analysis of the non-executive director's potential contributions towards building the business. Monitoring and control issues are covered in the last four reasons, but the balance of the rationale for the non-executive director's existence appeared, in Aris' view, to favour what are now usually referred to as the advisory or service aspects of the role, rather than the watchdog or controlling aspects.

The contributions which individual non-executive directors make to the board processes will vary depending on the knowledge and expertise which they bring to the particular subject under discussion.

**Evidence :** Aris, (1986); Gay, (1998a and 1998b) : for further details, see **References** below.

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

**Response :**

The debate on corporate governance has dominated the discussion of the performance of public limited companies in the UK throughout most of the past decade. The Combined Code placed great emphasis on the role of the non-executive director. The position came to be seen as critical not only for the transparency and accountability of companies but also for their capability and business credibility. This rediscovery of the role of the non-executive director posed a series of questions concerning how non-executives were selected, how their independence could be assured, what their functions were and how their effectiveness might be assessed.

Key elements of the prescriptive analysis contained in the Combined Code are predicated on the role to be played by the non-executive director in improving the standards of governance. This was a common thread running through the 'Cadbury nexus', culminating in the publication of the Combined Code. Some had regarded this predication as unsound and had suggested that the authors of it were expecting too much from part-time directors. It was questioned whether paragons could be found with the ability to play the contradictory roles of 'watchdog' and 'adviser'. Doubts were also cast on whether non-executive directors could ever be truly independent.

As suggested in the covering letter above, the research which I conducted indicated that the overwhelming view of the non-executive directors interviewed was that the Combined Code's emphasis on their role in the activities of board committees had improved board effectiveness. The responses to Question 1 (see *Appendix A*, pages 36 - 42) indicated that more than 70% of the respondents thought there had been improvement (16 respondents reported a definite improvement and 10 said that there had been some improvement); less than 20% expressed the view that the effectiveness of their board remained unchanged and only 10% were of the opinion that the emphasis on committee work had had a detrimental effect. The deeper levels of knowledge which the extra time provided by committee work permitted facilitated more meaningful discussions at the main board table.

Regarding the criticism that committee work was taking up a lot of time, Sir Adrian Cadbury, in my interview with him, expressed the view that it was very difficult to see a way around that problem. The fundamental change had been that the board was now the key-stone in the structure. If that were true and if the non-executive directors were going to accept their responsibility, by being involved and by making a contribution in various areas, then he do not think there was any way around the resulting need to commit the time.

However, Sir Adrian also said that the committees had to avoid getting into too much detail and they must not cross the line between direction and management. There might also be a danger, which some of the interviewees felt, that the committees would begin to play a bigger role in relation to the role of the board. In Sir Adrian's view, it was important that committees should be seen as creatures of the board. They reported to the board, and they must not be allowed to assume a life of their own. He believed that this was always a danger, because it was much easier to get things done with a smaller group. (See *Appendix B*, page 99).

Regarding the balance to be achieved between the 'advisory' and the 'watchdog' elements of the non-executive director's role, perhaps unsurprisingly, most of those interviewed saw the balance in their role as shifting towards control over the seven year period of corporate governance change. Over 50% supported this view, with nearly 40% believing there had been no change and less than 10% reporting a shift towards the advisory aspects (see the responses to Question 4, in *Appendix A*, pages 52 - 55).

Some respondents thought that drawing a line between control and advice served to polarise attitudes. The choice of these words is not helpful to the debate 'control' has pejorative overtones and 'advice' is a friendly and warm word. Nevertheless, the distinction is well understood in the debate on corporate governance and has a well-established provenance. Sir Adrian Cadbury preferred the word 'influence' (see *Appendix B*, pages 101 - 102). Some respondents expressed the view that since non-executive directors were now more involved, their greater depth of knowledge had allowed their influence to develop.

The responses indicated that the Combined Code had obliged all directors, but particularly non-executive directors, to monitor conformance more closely. However, the increased levels of involvement devoted to their work by the individual non-executive directors had allowed more time also to be given to performance enhancing, advisory activities.

**Evidence :** Clarke, (1998); Committee on Corporate Governance, (1998); Ezzamel and Watson, (1997) : for further details, see **References** below. Please also see *Appendix A*, particularly the interviewees' responses to Questions 1 and 4, and *Appendix B*.

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

##### **Response :**

Question 8 (see *Appendix A*, pages 70 - 75) asked the interviewees whether it was possible for non-executive directors to be truly independent, given that greater involvement must lead to greater commitment. Virtually all the interviewees were independent directors, as defined by the Combined Code, and they very strongly rejected the paradox implied by Question 8. The respondents saw independence as a personal attribute or competence without which non-executive directors would find it impossible to meet the demands placed upon them. The majority view was that since independence was a personal attribute, or a 'state of mind' as the respondents themselves preferred to describe it, so it could not be diminished or threatened in any way. The defining characteristics of independence were said to include fearless determination, an acceptance that it might be necessary to offend people in the pursuit of truth and the need to regard the interests of the shareholder as paramount. If this meant that underperforming fellow directors or managers had to be confronted, then so be it.

It was obvious that the interviewees regarded independence as a very important personal quality, rather than as state to be determined by demographic checklists on the lines of those proposed by PIRC or by the Combined Code. The author asked Sir Adrian Cadbury whether it might also be true to say that the definition of independence in the Code is also mechanistic rather than competence based (see *Appendix B*, pages 103 - 104).

Sir Adrian replied that he did not agree with that interpretation. The Code had said "*The majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement*". Issues might be brought before the board in which a particular non-executive director had an interest but that did not mean that he was not an independent director. His or her position could be safeguarded by dropping out of the discussion of that particular issue. What the Cadbury Committee had in mind when they drew up that second part of the definition were those company advisers like bankers and lawyers who might have a professional interest in the company and could not be said to

be independent in that sense. They were not thinking of other types of relationships like cross-shareholdings, which is one of the issues listed in the PIRC definitions.

If independence really is a personal attribute or 'state of mind' then those non-executive directors who possessed it would presumably bring independence to all aspects of the role.

**Evidence :** Cadbury, (1992); Committee on Corporate Governance; (1998); Pensions & Investment Research Consultants, (1998) : for further details, see **References** below. Please also see *Appendix A*, particularly the interviewees' responses to Questions 7 and 8, and *Appendix B*.

*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?*

**Response :**

This issue was not considered in the research I conducted and I therefore offer no comments on it.

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

**Response :**

The non-executive director respondents reported pressures on their time. Some thought that, although they were currently in control of the situation, they might be reaching the limits of their capacities. 15 to 20 days was mentioned as a time commitment which was enough for sufficient vigilance to be exercised. (See *Appendix A*, responses to Question 7b, pages 62 - 65).

Information was collected on other directorships held by the 50 non-executive directors who responded to the first phase of the research (the survey questionnaire). In total the respondent group held 62 directorships in PLCs in addition to the directorship in the respondent's company. These 62 directorships were held between 32 members (64%) of the respondent group; in other words, 18 of the respondents (36%) held only one non-executive director post in a PLC.

Many also held directorships on the boards of Limited Companies and the boards of public sector and charitable bodies. Details of these other appointments were not collated because of the apparent variability of the data.

Four of the respondents held the post of Chief Executive Officer in other PLCs and 15 of the respondents held the post of Chairman in other PLCs. These posts were held by 19 different individuals, representing 38.0% of the total respondents.

There have been critical media reports recently about individuals holding multiple directorships. The average number of directorships held by the 50 respondents was 2.2. The maximum number of posts held was 6 and this figure was achieved by only one of the respondents. Two others held 5 posts each. 18 held only one directorship. Other statistical tests conducted showed that this group of 50 companies was fairly representative of the FTSE 350 as a whole. It would therefore appear that it is comparatively rare for individuals to hold large numbers, say more than four, PLC directorships.

**Evidence :** Please see *Appendix A*, particularly the interviewees' responses to Question 7b.

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

**Response :**

This issue was specifically addressed by Question 10 (see *Appendix A*, pages 79 - 85).

Opinions about the value of the role of senior non-executive director were evenly divided, with a very slight majority of the participants being in favour of the appointment.

The arguments of those who were against could be categorised under three heads. The most frequently expressed view was that the appointment could be superfluous where separation of the posts Chairman and CEO was already in place. Others thought that the appointment could be divisive, that it was an unnecessary diversion which could challenge board authority. A final group suspected that they could see the hidden hand of the institutions. They believed the proposal was just a sop to institutional pressure.

The main arguments of those who supported the proposal were, first, that it helped to form a consensus among non-executive directors by creating a focal point, around which the non-executive directors could congregate. Second, that it recognised status, with the representative emerging naturally. Third, there were those who thought of it as a mechanism for handling crises, a fall back position which acted as a contact point for shareholders, when things were going wrong.

Some participants saw the paradoxical nature of the appointment. If the board needed to put it to use, then it was probably an indicator that something was seriously wrong for which more drastic corrective action would be needed.

Sir Adrian Cadbury (see *Appendix B*, pages 105 - 106) pointed out that his Committee had envisaged that this appointment would only be required where the posts of chairmen

and chief executive were combined. The Cadbury Report said “*Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognised senior member*”. The Hampel Committee then proposed that the appointment should be made even where the posts were separate. Sir Adrian expressed the view that the decision of the Hampel Committee was questionable.

Subsequently Hermes had taken up this idea and said it was an excellent proposal, the Code having laid down that the senior non-executive director should be available for consultation. Hermes’ suggestion was “*Establishing direct channels of communication as a matter of routine should enable difficult issues to be aired before a crisis develops*”. Sir Adrian thought that that suggestion could lead to divisions. The fact that someone was identified to whom outsiders could turn in a formally recognised way was sensible. Sir Adrian was fearful that if the institutions were to press down the route proposed by Hermes, then opinions might change and the appointment could become controversial.

To summarise, there was some support for the view that the Combined Code’s requirement that boards nominate a senior non-executive director would create divisiveness within boards, but the majority view was that divisiveness was only likely to result where there was separation of the posts of chairman and CEO. If there was duality, then the post of senior non-executive director was seen as having a potential for enhancing board performance rather than being divisive.

**Evidence :** Cadbury, (1992); Hampel, (1998); Hermes Investment Management Limited, (1998); Committee on Corporate Governance, (1998) : for further details, see **References** below. Please also see *Appendix A*, particularly the interviewees’ responses to Question 10, and *Appendix B*.

*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?*

**Response :**

This issue was not considered in the research I conducted and I therefore offer no comments on it.

### **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?*

**Response :**

The interviewees suggested several key skills which they believed the non-executive director required (see *Appendix A*, pages 65 - 75). These included :

1. Experience : The non-executive director should have held senior positions and, preferably also should have held a variety of jobs.
2. Business skills : Non-executive directors should have knowledge of how companies work and an appreciation of the dynamics of the corporate environment.
3. Analytical skills : Non-executive directors should possess objectivity and the ability to get to the heart of a problem.
4. Organised life style : The non-executive director should be available when wanted, particularly in an emergency.

The issue of changing skills needs was not addressed in the interviews.

The essential attribute identified was not a skill, but a personal quality : independence. (See the response to 10 below and the response to 4 above).

**Evidence :** Please see *Appendix A*, particularly the interviewees' responses to Questions 7c and 8.

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

**Response :**

The interviewees also suggested several key personal attributes which they believed the non-executive director required (see *Appendix A*, pages 65 - 75). These included :

1. Independence : There needed to be independence both of mind and of the need for financial reward.
2. Interpersonal skills, especially tact : Non-executive directors needed the ability to work with, and get best out of, colleagues. Allied to this was seen to be a need for tact, the ability to challenge without giving offence.
3. Strong-minded : This quality involved having self-belief, making your opinions felt, not being afraid to speak out and having the courage of your convictions.

4. Personal motivation : Non-executive directors should be interested in their job for its own sake, not for the money.

5. Common sense

**Evidence :** Please see *Appendix A*, particularly the interviewees' responses to Questions 7c and 8.

*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.*

**Response :**

This issue was not considered in any depth in the research I conducted and I therefore offer no comments on it.

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

*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?*

**Response :**

Both these issues were address in the responses to Question 2 (see *Appendix A*, pages 42 - 47). Nearly two-thirds of the interviewees thought that the Cadbury nexus had had a positive impact on the determination of board composition. The prescribed need for consultation and to institute more open procedures had letter to better practice. Nevertheless, there was a large minority who remained sceptical. Some believed things had not changed much because boards inevitably contained individuals with strong views and ingrained self-belief.

Those who took a positive view of the Cadbury nexus believed that the selection process had become much more professional and open. There was more transparency and more consultation. However, fears were expressed that the raising of standards and expectations could lead to problems in recruitment of both non-executive and executive directors. Some respondents were firmly of the opinion that the supply of suitable non-executive directors was limited and that the rising demands on their time might cause the system to fail. The new workload could also mean that potential candidates might be deterred by the low levels of financial reward in relation to the time demands and the

statutory liabilities. These same pressures could also discourage senior managers from accepting board appointments.

In reviewing these responses, Sir Adrian Cadbury (see *Appendix B*, pages 99 - 100) cited the case where the interviewee's chairman felt that the nomination committee proposals amounted to a *de facto* decision which had to be accepted by the main board. In Sir Adrian's opinion, Greenbury had been wrong to propose that the remuneration committee should have the power to decide what the remuneration should be; the board was responsible for pay, not the remuneration committee. Greenbury's recommendation was changed in the Combined Code. Directors must understand that these were committees of the board, that they were set up by the board, that the terms of reference were agreed by the board and that their recommendations went to the board for approval.

Sir Adrian also commented on the view expressed by some respondents that the pool of non-executive director talent was finite. This was not Sir Adrian's personal experience and when he was Chairman of PRO NED they had had far more potential candidates than they ever had demand for places. If the role of the non-executive director was made into a responsible and worthwhile job, where candidates could feel that they would be playing a genuine part, then he believed it should be of interest to people who seriously wished to make contribution. Women executives, for example, constituted a group whose potential as non-executive directors had not yet been fully explored.

Recruitment practitioners claim that there is no shortage of suitable candidates (see *Appendix B*, pages ). Whilst the views expressed by the interviewees were strongly held, it was possible that the finite pool of candidates they had in mind was of a similar age, experience and gender as themselves.

The issue of international representation was not touched upon in the research.

**Evidence :** Greenbury (1995) : for further details, see **References** below. Please also see *Appendix A*, particularly the interviewees' responses to Question 2, and *Appendix B*.

*14. Are the rewards for non-executive directors appropriate, both in terms of levels of pay and the form that remuneration takes – e.g. cash/shares/share options? Are current pay levels a significant factor in whether good non-executive directors can be attracted?*

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

**Response :**

These issues were not considered in the research I conducted and I therefore offer no comments on them.

## **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?*

#### **Response :**

The general impression I gained from my research was that the Cadbury nexus had given the non-executive directors surveyed and interviewed a greater influence on board process and board effectiveness. As I said in my covering letter above, a strong sense of confidence in their enhanced role was evidenced by the group of non-executive directors I interviewed. Most of them believed that, as a result of the changes introduced by the nexus, they were in a better position to be able to make effective contributions at the board table. The general support for the Code's emphasis on their role is clearly shown in the responses to Questions 1, 2 and 3 discussed above (see *Appendix A*, pages 36 - 52).

I discussed the definition of independence with Sir Adrian Cadbury. The Combined Code defines it demographically and much of the debate surrounding the definition has been concerned with drawing up lists of disqualifying factors against which an individual might be assessed as being unfit to serve as a non-executive director (for an example, see PIRC, 1998). If this approach is carried too far, much good talent might be lost to boards. I much prefer the view that independence is a personal quality. I am not recommending that psychometric tests should be used by nomination committees; such methods might deter candidates. The best test is reputation; most candidates will have lengthy CVs. Candidates should be able to demonstrate their independence through reference to their conduct on other boards or to their behaviour in situations which simulate board environments (see *Appendix B*, pages 103 - 104).

**Evidence :** Please see *Appendix A*, particularly the interviewees' responses to Questions 1, 2 and 3, and also *Appendix B*.

*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?*

#### **Response :**

The analysis of the interviews showed that an overwhelming majority of the respondents supported the view that the focus on the work of board committees had improved the effectiveness of the main board. There was also strong support for the view that the

Cadbury nexus had had a positive impact on the board selection processes (see the responses to Questions 1, 2 and 3 in *Appendix A*).

Board meeting procedures were not discussed with the interviewees.

Information was collected on the size the boards of the 50 non-executive directors who responded to the first phase of the research (the survey questionnaire). The size varied from a minimum of 5 members to a maximum of 18. The average board size was just over 10. The number of non-executive directors serving on those boards averaged 5.4 per board. The total number of non-executive directors on all the 50 boards represented 52.6% of the total number of directors. The percentage of non-executive directors on the boards ranged from 33.3% to 75.0%.

The interviewees did not comment on what they thought might be optimum figures for the sizes of boards or for the percentage of non-executive directors. Common sense suggests that boards could be too small or too big for the effective conduct of their business. However, boards themselves have to decide whether they are an effective working group. No evidence came out of the research which might have indicated that the non-executive directors themselves thought that there was a problem here which needed a prescriptive answer.

I expressed the personal view to Sir Adrian Cadbury that boards could have too high a proportion of non-executive directors, citing the example of the then newly-created board of GlaxoSmithKline (see *Appendix B*, page 107). Although the US follows a unitary system, a common format there is for the only executive director on the board to be Chairman/CEO, the rest of the board being non-executive directors (this issue is discussed further under G below). The strongly held view of the interview respondents was that the UK unitary board format was working well and that an approximate balance between executive and non-executive directors was thought to be best for effective outcomes.

**Evidence :** Please see *Appendix A*, particularly the interviewees' responses to Questions 1, 2 and 3, and also *Appendix B*.

*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?*

*19. Similarly, do you have comments on the composition, duties or operation in practice of Nomination and Remuneration Committees?*

**Response :** Although these issues are considered in the responses to Questions 1, 2 and 3 in *Appendix A*, they were not dealt with in sufficient depth to allow for meaningful comment.

*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?*

**Response :**

In this general area of monitoring performance, the interviewees were of the opinion that the Cadbury nexus had not had a marked impact on the determination of strategy, despite the greater involvement of non-executive directors in the monitoring processes, which had been recorded in the results of the questionnaire survey. Only 40% believed that there had been a definite or slight increase in their input to strategy, while 60% thought that their inputs had remained much the same. Some diversity within the reported historical experiences was inevitable; there were those who reported positive change and who saw the Cadbury nexus as providing a much needed professional framework for strategic discussions.

But the overwhelming impression was that the non-executive director's role in relation to strategy had not changed much; the role was seen as being reactive, through the application both of common sense and of the benefits of experience. Formulation of strategy was probably not their work, but challenging and developing it certainly was. Formulation of strategy was the work of the executive, particularly of the CEO. If a non-executive director had such detailed knowledge, he was possibly too close to the competition.

Sir Adrian Cadbury thought that there might be conflicting expectations between CEOs and their non-executives with regard to their respective roles in determining strategy (see *Appendix B*, pages 100 - 101). Certainly my research has always indicated that non-executive directors are keen to participate in the strategy debate – to be advisers rather than watchdogs.

The general view was that reviewing strategy had always been a key element of the non-executive director's work and the Cadbury nexus had not done much to change that. However, the higher levels of involvement of individual non-executive directors, as reported through the results of the Survey, had led to improvements in the quality of the debates on strategy which were now conducted more rigorously.

**Evidence :** Please see *Appendix A*, particularly the interviewees' responses to Question 3, and also *Appendix B*.

*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?*

**Response :**

This issue was not considered in the research I conducted and I therefore offer no comments on it.

*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?*

**Response :**

Question 6 (see *Appendix A*, pages 59 - 61) dealt with the subject of vigilance. The respondents overwhelmingly believed that non-executive directors could be properly vigilant, despite the extra demands on their time. More than 80% of the participants thought appropriate vigilance was possible. The contrary, minority, view saw the potential for conspiracy and cover-up, But the interviewees had few doubts that they could be sufficiently vigilant, despite the limited time available to them to attend to the company's business.

Sir Adrian Cadbury, perhaps unsurprisingly, took encouragement from the interviewees' strong confidence in their ability to be properly vigilant. In my interview with Sir Adrian he said "*Of all the answers to the questions you put to them, that, to me, was the most encouraging. Here we have the great majority of people saying, yes, we can do it. That gets us away from the box ticking, from any idea that they are doing it just to satisfy the rules, it gets us away from some of the cynicism which has been expressed elsewhere. These are the people who are actually doing the job.*" (See *Appendix B*, page 103).

The research reported here was conducted in 1999 and 2000. Reference was made in my letter above to the more recent spectacular company failures. The media coverage of these failures has suggested that some non-executive directors might have been insufficiently vigilant in the exercise of their responsibilities to the shareholders. So has the position dramatically changed in the past two years? I doubt it. Most directors of PLCs are fallible human beings who do their best to do a competent and honest job. The line between incompetence and dishonesty has been crossed very infrequently in the history of FTSE quoted companies; the line between competence and incompetence has been crossed many times. But in the absence of rigorous evidence, we have no way of saying whether that latter line was crossed more frequently in 2001 than it was in 1999.

I hope that dramatic changes will not be proposed to counter the media interest in these spectacular failures. Regulations brought in to deal with infrequently occurring events are quite often counter-productive.

**Evidence :** Please see *Appendix A*, particularly the interviewees' responses to Question 3, and also *Appendix B*.

**D: Relationships with shareholders and others**  
**Do existing relationships with shareholders or others need to be strengthened?**

**Response :**

The issues raised under D were not considered in sufficient depth in the research I conducted and I therefore offer no comments on them.

**E: Support**  
**How can non-executive directors best be supported to perform their role?**

**Response :**

The issues raised under E were not considered in sufficient depth in the research I conducted and I therefore offer no comments on them.

## **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?*

#### **Response :**

My research was concerned solely with the changing pattern of the work of non-executive directors of FTSE 350 companies. The impact of corporate governance changes on smaller listed companies was not examined. However, a review of theories relating to boards, which I conducted in preparing myself for the research programme, did lead me to some conclusions which I should like put forward here for your consideration.

As Tricker pointed out, governance is different from management. If management is about running businesses, governance is about seeing that the business is run properly. According to Hart, corporate governance issues arise whenever there is an agency problem, or conflict of interest, involving members of the organisation, be they owners, managers, workers or consumers. Agency theory, as its name implies, looks upon the agent-principal relationship as key to the understanding of the governing board. An agency relationship is a contract under which one or more persons, the principals, engage another person, the agent, to perform some service on their behalf which involves delegating authority to the agent.

The problems inherent in this relationship were first described by Adam Smith when he wrote : *“The directors of ...(joint stock) ...companies, however, being the managers rather of other people’s money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master’s honour, and very easily give themselves a dispensation for having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.”* In the text of their seminal paper on agency theory, Jensen and Meckling acknowledged this historical link to their own work. Williamson argued that the board of directors should be regarded primarily as a governance structure safeguard between the firm and the owners of its equity capital and secondarily as a way by which to safeguard the contractual relation between the firm and its management.

The driving forces behind the evolution of the Cadbury nexus in the UK owed much to the tenets of agency theory; the Code tried to make boards, which had sometimes been inefficient and occasionally corrupt, more transparent and more accountable to their shareholders. The findings of my research indicated that some progress had been made towards this aim.

During the 1990s, a new theory was put forward to explain board behaviour. Stewardship theory, first described by Donaldson, is based on a view of human behaviour which is diametrically opposed to that taken by agency theory. Its supporters believe that there is no conflict of interest between managers and owners and that the desideratum is to find an organisational structure that allows co-ordination to be achieved most effectively. Managers are assumed to be team players and the optimal structure is one that authorises them to act, given that they will act in the best interests of the owners. Managers are not opportunistic agents, according to this theory, but are good stewards. The agency theory model of the strong, independent board, with a majority of outside directors, is believed to miss the point for two reasons. First, in the time available to it, such a board is unable to check and control management. Second, if managers are good stewards and work diligently to attain high levels of corporate profit and hence shareholder returns, then such controls and checks are not necessary anyway.

As early support for the theory, Donaldson and Davis produced evidence relating to the question of Chairman/CEO duality. 'Duality', the situation where one individual is simultaneously Chairman and CEO of the company, had for long been a common feature in the boards of US companies and in 1991 the practice was found in about 80% of large corporations. Agency theory had suggested that shareholder interests would be safeguarded only where the two posts were held by separate individuals. It was noted above that one of the stated aims of the Cadbury nexus was the elimination of duality. Donaldson and Davis examined a sample of 321 US companies drawn from Standard and Poor's data base. On 76% of the boards of those companies the posts of Chairman and CEO were held by the same individual. They found that shareholder returns, in terms of return on investment, were superior in those companies. They suggested that "*the safeguarding of returns to shareholders may be along the track, not of placing management under greater control by owners, but of empowering managers to take autonomous executive action*".

More recently, Muth and Donaldson produced further evidence in support of stewardship theory. The financial results of 145 companies listed on the Australian Stock Exchange were analysed and related to their board structures. In order to introduce a time lag into the analysis, board structures in 1992 were compared with results achieved in 1993 and 1994. The analysis showed significantly better results were achieved by those companies with fewer independent directors and by those companies where the roles of Chairman and CEO were combined. Smaller boards almost exclusively composed of executive directors seemed to protect shareholder interests better than larger boards with a high proportion of non-executives. Muth and Donaldson suggested that further research in the UK or the USA should be undertaken in an attempt to replicate these results in other cultural settings.

The companies Muth and Donaldson studied were constituents of the Australian stock exchange, which were nationally owned companies, not foreign multinationals. They were, for the most part, small companies relative to those in the FTSE 350. Their managers would be have been more entrepreneurial, with a work ethic rooted in a different culture. Muth and Donaldson found that in the companies they investigated a

higher level of performance was negatively associated with board independence. Entrepreneurial companies are driven forward by strong leaders. In the better performing companies there was chairman/CEO duality and the executive directors were dominant. Muth and Donaldson conceded that stewardship theory might fail to hold as a universal theory, but their evidence suggested that it was valid under conditions of high network connections, which would be present in entrepreneurial environments.

Earlier this year, I wrote an article entitled *Board Theories and Governance Practices : Agents, Stewards and their Relationships with Stakeholders*, which was published in the Journal of General Management. In that article, I suggested that it might be possible that agency theory's validity is limited to the environment found within larger corporations. Much of the research into corporate governance in the UK has been conducted within the domain of the large public limited companies and we have little evidence of its appropriateness to the board of the smaller organisation. Stewardship theory might be a more appropriate paradigm for the smaller, entrepreneurial company, particularly companies where the directors are also substantial shareholders.

I therefore suggest that, in relation to the role of the non-executive director, the 'one size fits all' approach to corporate governance should be viewed with caution. Perhaps uniformly structured corporate governance codes are not the answer. Consideration should be given to incorporating more flexibility into listing requirements.

**Evidence :** Adam Smith (1776), Jensen and Meckling, (1976), Tricker (1984), Williamson (1985), Lawrence, (1994), Hart (1995), Donaldson, (1990), Donaldson and Davis, (1991 and 1994), Muth and Donaldson (1998), Gay, (2002) : for further details, see **References** below.

## **G: International context**

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

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

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

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

## Response :

My research touched upon these issues by looking at the comparative advantages of different board structures. Question 11 (see *Appendix A*, pages 86 - 95) examined whether the emphasis placed by the Cadbury nexus on the role of the non-executive director might lead to a *de facto* two tier board, with the executive and the non-executive forming opposing camps. Some 80% of the interviewees did not see the newly-empowered non-executive director as a threat to the unitary board. They extolled the advantages of the unitary board and were, for the most part, not impressed by what they had seen of alternative systems. However a small minority of respondents did believe that the changes in corporate governance were leading to a two tier system and they saw this prospect as a dangerous trend.

In their responses, the participants identified a number of advantages inherent in the unitary board system :

\* As a single forum, it allowed flexibility and informality. Since directors were all equal there tended to be non-divisive, healthy engagement.

\* It had given rise to a robust, proven system. Improved performance followed, because small groups were better able to perform, while large groups tended to play politics.

\* As a result of the corporate governance changes flowing from the Cadbury nexus, the committee system had strengthened unitary board and outside interests were better represented.

The disadvantages inherent in the UK model of the unitary board system were also identified in the discussion. There was a need to preserve a good balance. Too many non-executive directors might stifle the executives, or give a free hand to the ambitious CEO.

The general conclusion was that the unitary board system in the UK was in robust health after the impact of the Cadbury nexus.

For Sir Adrian Cadbury, the most important point to emerge from these responses to Question 11 was the identification of the need for constructive engagement between the executive and the non-executive members of the board. “*That sums up the huge advantage that the unitary board has*” (see *Appendix B*, page 106).

Some of the interviewees thought that boards should be given the option to chose whichever structure they thought worked best for them.

Sir Adrian Cadbury suggested that it was possible to for a UK board to set up whatever structure it thought appropriate. Company law in the past had said almost nothing about board structure so it would be possible to have a two-tier system, but it would not be the kind of two-tier structure as recognised by European law. For example, a company could

have an advisory board at one level and an executive board at another level (see *Appendix B*, pages 106 - 111).

**Evidence :** Please see *Appendix A*, particularly the interviewees' responses to Question 11, and also *Appendix B*.

(Additional note for this Review : My research did not examine alternative corporate governance systems in place in the EU, but I have recently come across a report published in January 2002 by Weil, Gotshal and Manges on behalf of the European Commission entitled *Comparative Study of Corporate Governance Codes Relevant to the European Union and Its Member States*, which might be of interest.)

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**Keith Gay**  
**August 2002**

## *Appendix A*

*Appendix A* consists of extracts from the text of “*An empirical analysis of the impact of the Cadbury nexus on the work of non-executive directors of FTSE 350 companies*”, a doctoral thesis submitted to Henley Management College by Keith Gay in 2001. The extracts are taken mainly from Chapter 8, which constituted pages 195 to 266 of the thesis.

### **Research Findings : The Interviews**

#### **Selecting of the interviewees and conducting the interviews**

50 non-executive directors had completed the survey questionnaire and 31 of those respondents were subsequently interviewed by the author. A further 4 non-executive directors from the original survey target list of 102 directors were interviewed. These four directors had said that they did not, for various reasons, wish to complete the questionnaire, but they had indicated their willingness to participate in other ways in the research programme. This gave a total of 35 interviewees.

The interviews were conducted by telephone. Advance warning of the questions to be discussed was not given. The method used was that of the semi-structured interview, based on the eleven questions described below. In this way the lack of flexibility of the structured interview was avoided and the analysis of the responses enabled comparisons to be made which the unstructured interview would not have so readily facilitated. The underlying structure was imposed by the prepared questions, but the interviews were conducted in a conversational way in order to allow the respondents to talk as freely as possible. The question format was not always slavishly followed and the discussion was allowed to digress, when points of wider interest arose. Owing to the pressures on their time, pressures which all busy people face, not all the questions could be discussed with all the participants.

The interviewees were given assurances that their identities would not be revealed by the author and for these assurances to be acceptable, a certain level of trust had to be created between the author and the interviewees. Access to elites has long been a source of constraint on the study of them (Pettigrew, 1992). Gaining access to conduct research into board activities requires the researcher to understand the uniqueness of the milieu in which those activities occur. The author of this thesis has had direct experience of working as a board director, which has possibly made him more sensitive to the rather rarefied atmosphere in which board meetings often take place. The original questionnaire package had included a brief CV of the author, so the interviewees were aware of his experience in this field. The respondents' efforts in completing the questionnaire had been acknowledged by the posting to them of a summarised version of the results and this probably also helped to foster trust.

The interviews were recorded, with the participants' permission, and all were subsequently transcribed; the transcription process produced a document totalling about 75,000 words. To preserve the anonymity which had been guaranteed to the participants, they were identified within the transcripts only by code numbers and all references to the names of companies or individuals were disguised in the transcribed texts.

### **The Questions**

The respondents were asked for their views on the following questions :

**Question 1 : The survey findings have confirmed a marked increase in the involvement of directors in the activities of board committees, as required by the Combined Code. What has been the impact of this greater involvement on board effectiveness?**

**Question 2 : The second major area of increasing board involvement identified by the survey was in specifying the powers of directors, determining board composition and in appointing, developing and removing directors. Have the changes initiated**

**by the Cadbury Report and confirmed by the Combined Code had an impact on those activities?**

**Question 3 : The main areas of increasing involvement reported by the individual non-executive directors who responded to the survey, were in ensuring that information was available to monitor performance, in reviewing strengths, weaknesses and opportunities and in implementing strategies. Have the changes initiated by the Cadbury Report and confirmed by the Combined Code had an impact on those activities?**

**Question 4 : Has there been a change in the balance between the ‘control’ and the ‘advisory’ aspects of the role of the non-executive director?**

**Question 5 : What do you believe is driving this agenda for change in governance standards?**

**Question 6 : Can non-executive directors be sufficiently vigilant, given the limitations imposed by the time available to them for participation in board activities?**

**Question 7a : Is too much being now being asked of the non-executive director?**

**Question 7b : Given the requirements of the Code, is the job doable?**

**Question 7c : If the job is doable, what are the personal qualities required to do it?**

**Question 8 : Is it possible for non-executive directors to be truly independent, given that greater involvement must lead to greater commitment?**

**Question 9 : Are we moving towards a situation where we have professional non-executive directors?**

**Question 10 : What is your view of the proposal for the appointment of a senior non-executive director? Will problems arise from the Code's requirement for this appointment?**

**Question 11 : Does the fact that the balance in board composition is progressively moving in favour of non-executive directors diminish the advantages of the unitary board structure? Might the changes lead to two-tier boards?**

**Question 1, Question 2 and Question 3** were derived directly from the survey results. The responses to the survey questionnaire had shown that the respondents believed that their boards were much more involved in 1999 with the activities of board committees than they had been in 1992 and specifically, the boards were more involved in the activities associated with determining board composition and specifying powers of the directors. The responses to the survey had also shown that the individual non-executive directors believed that they had become more involved in strategy processes and in monitoring performance. These changes in emphasis were predicated by the Cadbury nexus. These three questions were designed to investigate whether the respondents believed that the reported changes had improved the effectiveness of their boards. The reported 'involvement' might have been no more than conformance; an observance of the form rather than the spirit of the Code's requirements (Samuels, Greenfield and Piper, 1996; Cassidy, 2000).

**Question 4** was designed to get some empirical insights into the much-discussed control/advice dichotomy, which is an ever-present dilemma confronting the non-executive director's work. **Question 4** has clear links to **Question 3**; the survey results had shown that 78% the responses of the individual non-executive directors recorded increases in involvement in the activity of ensuring that internal control procedures provided valid and reliable information for monitoring operations and performance. It could be anticipated that the prescriptive aspects of the Cadbury nexus, linked to agency theory, might change the balance of the work of the non-executive director. Indeed, some

had suggested that it would not be possible for non-executive directors to be both advisors and watchdogs, as the nexus demanded (e.g. Ezzamel and Watson, 1997).

**Question 5** was formulated in order to examine the underlying reasons for the Cadbury nexus changes. The widely-held view is that the changes had been driven by scandal and malpractice (Stiles and Taylor, 1993). Perhaps Adam Smith was right in his belief that negligence and profusion must always prevail, more or less (Smith, 1776). However, the greater diversity found today both in the business environment and in societal behaviour might suggest that more complex patterns of causality underlie the sea change that has taken place in attitudes towards governance over the last ten years.

The next group of questions investigated the possible future impact of the Cadbury nexus and the implementation of the Combined Code on the personal attributes and ethical standards which the non-executive director would need to bring to the role in these changed circumstances. There are three questions in this group :

**Question 6, Question 7 and Question 8** explore the general domain of directorial competence. Attention has already been drawn to the suggestion in the final report of the Committee on Corporate Governance (1998) that the prior commercial experience of non-executive directors qualified them for both a constructive policy-making and a monitoring role. It was envisaged that non-executive directors from other backgrounds might be appointed for their technical knowledge. A diversity of competence and expertise might be desirable (Hampel, 1998, p. 27, para.3.15).

Demb and Neubauer (1992) suggested that non-executive directors were most valued for their independence, their objectivity and their wide range of experience with matters outside the company and its industry. However they also drew attention to the paradox that lies at the heart of the role. Non-executive directors were supposed to exercise a judgement that was both critical and independent. To be critical meant that the director had to have a thorough, in-depth knowledge of the company and its business. On the other hand independence implied detachment from the business. They questioned whether the job was doable (Demb and Neubauer, 1992). It might not be possible to find

candidate non-executive directors with the personal qualities needed to fulfil the wide expectations of the Cadbury nexus (Ezzamel and Watson, 1997).

As reported earlier, directorial competence was empirically investigated by the Henley board standards project (Dulewicz and Gay, 1997). The nexus had placed overriding emphasis on independence as the defining, *threshold* competence (Spencer and Spencer, 1993) which the non-executive director needed to possess. A narrow interpretation of this requirement links independence to control, within the context of an agency theory framework for the protection of owners' interests. However the advisory aspect of the role is enhanced by independence and objectivity, so the exercise by the non-executive director of independence is also compatible with stewardship theory.

One possible consequence of the emphasis on independence, explored by **Question 9**, could be the development of a new class of non-executive directors. These would make a virtue of their detachment, owing allegiance to no single company and not holding an executive position in any company or organisation. By assembling a portfolio of appointments, they could earn a cumulative living wage and even develop a 'professional' status.

Specific proposals have been put forward on these lines in the US (e.g. Jones and Goldberg, 1982; Gilson and Kraakman, 1991). On the other hand, it has been suggested that once a non-executive director withdraws from direct participation in an executive or line role elsewhere, his or her contribution to the board debate will diminish in value (Clutterbuck and Waine, 1994).

Finally, there were two questions which examined the impact of these changes on the formal structure of the board and the implications for possible future changes in company law. Early in 1999 there was a vigorous debate in the financial pages of the UK press about the controversial recommendation in the final report of the Committee on Corporate Governance that boards should appoint a senior non-executive director (Hampel, 1998, p.29, para.3.18). **Question 10** explores this proposal, which was

subsequently confirmed in the Combined Code (Committee on Corporate Governance, 1998, p.14, para.A.2.1). As has been reported earlier, Lorsch had proposed that where there was duality on a board, the outside directors should select one of their number to lead their discussions when they met as a group, and to work with the CEO to plan board activities (Lorsch, 1995, p.112). Duality is less common in the UK than in the US, and the Hampel committee proposal was seen as potentially divisive by many commentators.

**Question 11** develops this same theme of potential divisiveness. The reports of the various committees which form the backbone of the Cadbury nexus had warned of the danger posed by paying too much attention to the monitoring aspects of the enhanced role of the non-executive director. The Cadbury report had tried to redress this potential imbalance by stressing that the emphasis on their control function ... *“should not in any way detract from the primary and positive contribution which .. (non-executive directors) .. are expected to make, as equal board members, to the leadership of the company”* (Cadbury, 1992a, p.22, para.4.10). Those words were repeated in the Hampel report (Hampel, 1998). The danger which was foreseen was that this newly-empowered group could form a ‘board within the board’, a schism which might threaten the very existence of the unitary board itself. The powers given to board committees, whose members were to be drawn overwhelmingly from the ranks of the non-executive, could render such a schism more likely.

Political considerations complicate this debate. Reference has been made above to the company law review currently being undertaken in the UK (Company Law Review Steering Group, 2000). There is support in the EU for the ‘Germanic’ model. The Germanic model is a two-tier structure with separate executive and non-executive boards. This is a formal structure, but a similar separation could exist in an informal way within a nominally unitary, ‘Anglo-Saxon’ structure. Indeed, this situation can be found in the US, where the unitary board often consists entirely of outside directors, apart from the sole chairman/CEO. The executive sit on a separate management board, headed by the CEO. **Question 11** would help to examine these issues.

## **Analysing the interviews and testing the research propositions**

The main findings of the analysis of the responses, supported by verbatim quotes from the transcript texts, are reported below. The individual respondents are identified by the numbers 1 to 35. The numbers were arbitrarily allocated to the respondents and no significance should be attributed to the order in which they were allocated.

Comments on some of these key findings are added. Reference has already been made to the fact that Sir Adrian Cadbury discussed these verbatim quotes with the author of this thesis. The extracts from the interviews quoted below, which were sent to the participants by way of feedback to them, had also been sent to Sir Adrian Cadbury. His views on the quotes, together with his views on possible future corporate governance developments in the UK, are reproduced in the full transcript of the discussion, which is attached as an Appendix below. Sir Adrian approved the transcript as a complete and accurate record of that discussion. Where appropriate, reference is made to Sir Adrian Cadbury's views in the text of the commentary which follows. The analysis was used to test each research proposition and a summary of the conclusions reached is set out at the end of each section below.

### **Question 1 : The Survey findings have confirmed a marked increase in the involvement of directors in the activities of board committees, as required by the Combined Code. What has been the impact of this greater involvement on board effectiveness?**

Several years before the publication of the Cadbury Report, Tricker had reported that at that time, little interest was shown in boards in assessing their effectiveness (Tricker, 1987). The picture seems to have changed after 1992, although survey evidence showed that directors had inconsistent views about the effectiveness of their boards (Top Pay Research Group, 1998). The Cadbury Report had suggested that tests of board

effectiveness included the way in which the members of the board as a whole worked together and their collective ability to provide both the leadership and the checks and balances which effective governance demanded (1992, p.20).

The overwhelming view of the interviewees was that the greater emphasis on the activities of board committees had improved board effectiveness. A classification of the 35 responses to this question indicated that more than 70% of the respondents thought there had been improvement (16 respondents reported a definite improvement and 10 said that there had been some improvement); less than 20% expressed the view that the effectiveness of their board remained unchanged and only 10% were of the opinion that the emphasis on committee work had had a detrimental effect.

Some of the views expressing the belief that there had been an improvement were based on the deeper levels of knowledge which the extra time provided by committee work permitted and that this in turn facilitated more meaningful discussions at the main board table.

***“Inevitably it has had an impact because it means that the main board themselves have deepened their knowledge of the specific subjects which come up before the committees on which they sit. It means that the executives have to prepare detailed papers for the committees on the various subjects which are covered by those various committees and therefore the board, inevitably, is drawn into much greater detail of the activities of the company than it would be without them.”***

**Respondent 33**

***“Yes, very much so, in that the board, with a very heavy agenda, and of course they have been getting heavier, the agendas, year in and year out, would not have the time to concentrate on the details, the minutiae, of the matters that come before the committees ... I have a very positive view of the creation of these committees.”***

**Respondent 26**

***“I think the audit committee, in particular, has had a significant impact. Certainly, the non-executive directors are very much better informed as a result of the audit committee’s work. The discipline that the audit committee imposes on the financial management I am sure is helpful ... let me put it this way, it is now hard to remember what it was like without an audit committee, and how we managed without it.”***

**Respondent 19**

Several of the respondents had been converted to the merits of the committee system over time.

***“Actually, I thought the whole thing was a lot of nonsense when it started, but I now believe that it has done a lot of good.”***

Respondent 19

However, a price has had to be paid for this improvement. Non-executive directors had found that the demands on their time had increased.

PRO NED reported quite early on in the development of the Cadbury nexus that larger companies were requiring increasing commitment from their non-executive directors in terms of the number of days per year devoted to the company. Companies with more than £2bn turnover reported that the number of days had increased from 16 in 1994 to 27 in 1996. It appeared that this trend was in part a function of the fact that the work of the non-executive director was no longer only in the main board meeting but had extended to playing a key role in board committees (PRO NED, 1996).

***“My concern has always been that the number of meetings, which probably started out at 18 or 20, is probably moving into the 30s a year now, particularly on remuneration and appointments with management changes and any mergers or acquisitions ... You might very well find that the people you want most are so stretched with other jobs and other commitments that they cannot devote the time to where they really ought to be, where you really want the four- and five- star individuals.”***

Respondent 34

***“There is a risk there ... too much time is being required from the non-executive director. If they are good non-executives, part of their role should be that they have a wide experience outside the business either running their own business or being involved in other activities. If the role of the non-executive director becomes too time-consuming one loses part of the value.”***

Respondent 02

*“It amounts to quite a few days extra by the time you have hammered through the papers. Committee meetings are becoming increasingly time-consuming and some of them are as long as board meetings. There is a lot of detail to assimilate.”*

Respondent 25

*“I suppose 10 years ago we had about 8 board meetings a year and each of them lasted about half a day and if you put down another half a day for preparation and the occasional in-between meeting depending on various things. Nowadays we still have the same number of board meetings but I guess that I'm spending at least twice, if not two and a half times, the amount of time in doing virtually the same job.”*

Respondent 04

Others suggested that potential divisions might have been created through this new concentration of power in the hands of the non-executive directors.

*“What the Cadbury process has done has increased the responsibility of the non-executive directors, particularly in areas like the audit committee, which we have just discussed, or in the remuneration committee. So it has caused a division between the two sets of directors and so you have to work very hard at keeping the team together. There is very definitely the feeling on most boards, brought about by the fact that the non-executive directors usually have much broader experience, that they are the headmasters looking over the shoulder of the pupils.”*

Respondent 10

In some cases, compliance had removed individual responsibility and even created the ‘box ticking’ which was such an anathema to Hampel (1998).

*“Really, for some of the same reasons that I believe that the steady progression of accounting requirements is of dubious value in the wealth creation process. What tends to happen is that each of these developments is regarded as an intrusion and as a restraint to be dealt with by the organisation in the best way possible. The best way possible is normally to mouth the appropriate words, make the appropriate appearances and stuff them into the Directors’ Report, which nobody ever reads, and you have done your politically correct bit and you can get on with the real business. I am over-stating the case, really, but there is to my mind a distinct downside to all this insofar as the people concerned do not actually regard it as contributing to wealth creation, to the maximising of shareholders’ wealth.”*

Respondent 31

***“So I think the activities of the remuneration committee have had more effect on remuneration than they have had on board effectiveness! There has been a lot of emphasis on complying with the rules.”***  
Respondent 07

On the other hand, the Cadbury nexus had led, for some, to more shared responsibility and accountability, to more sense of being part of a team, with a new sense of equality around the board table.

***“ ...I have to say, and this is a view shared by a lot of other colleagues, that we dislike this distinction between executive and non-executive directors because we are all liable. It is correct to say that we play different roles and that the non-executive director is not immersed in the business to the same degree, but in the end the actual responsibility is literally the same. This is the crucial issue. If the responsibility is the same, can the roles be different?”***  
Respondent 10

***“... it is crucially important that the team works as a team and the executives with their inevitably more narrow focus on what they are doing are having the courage to be more judgmental on the wider issues. So this must have a beneficial effect on the interchange.”***  
Respondent 21

There was also more attention to board focus, and the delegation of work to the committees had improved decision-making. Cadbury was given credit for what was seen as fundamental change for the better in terms of effectiveness.

***“The answer is that I think that all the attention has improved board effectiveness. Chief Executives running reasonably large companies, if they attempt to manage through using the full board it is difficult to go into the necessary detail. But board committees when they are set up to study particular issues can do this job very well. They can get people together in quite a short time frame and really focus on the issue in question and make strong recommendations once all the points have been considered.”***  
Respondent 24

***“I think the first effect is that it has made non-executive directors ... more conscious of their own responsibilities and therefore more committed to those responsibilities.”***  
Respondent 35

***“Well, the advent of the audit committee, the remuneration committee and, to a lesser degree, the nomination committee has greatly increased the power and influence of the non-executive director and they are, to a large extent, the tools through which the non-executive director exercises this power and influence to advance his governance role. Now, that it did not exist until Cadbury.”***

**Respondent 17**

There was also a more satisfying identification with the needs of the shareholder, the implication being that improvements in performance would be reflected in improvements in shareholder value.

***“Yes, I think it has added a further tier of discipline into what you do. In the long run I suppose this will have a beneficial effect. Taking for example the audit committee of which I am the chairman, in this respect that is a developing skill, a developing art, because ten or fifteen years ago these committees were more or less unheard of. There is no doubt that this has increased the efficiency of communication with shareholders.”***

**Respondent 29**

***“The committee work has challenged the effectiveness of the main board, keeping management in line with the shareholders.”***

**Respondent 05**

Those opposed to the ‘box ticking’ approach believed that changes had happened because they were the correct way forward, not because new rules had been introduced.

***“It is a question of how the non-executive director can achieve what he wants ... You actually seek, by having a dialogue with the chairman to suggest to him that various things might be a good idea. I don't think that that has changed very much as a result of Cadbury, Hampel etc., because if you had to say that you think that the corporate governance rules require this and that therefore the board must do it, this is an unsatisfactory approach. We are doing it because it is the right thing to do, not because it is a requirement to do it.”***

**Respondent 14**

Sir Adrian Cadbury (see Appendix attached) said that he was encouraged by the finding that over 70% of the respondents felt that board committees were necessary and that they had improved board effectiveness.

Regarding the criticism that committee work was taking up a lot of time, Sir Adrian thought that it was very difficult to see a way around that problem. The fundamental change had been that the board was now the key-stone in the structure. If that were true and if the non-executive directors were going to accept their responsibility, by being involved and by making a contribution in various areas, then he do not think there was any way around the resulting need to commit the time.

However, the committees had to avoid getting into too much detail and they must not cross the line between direction and management. There might also be a danger, which some of the interviewees felt, that the committees would begin to play a bigger role in relation to the role of the board. In Sir Adrian's view, it was important that committees should be seen as creatures of the board. They reported to the board, and they must not be allowed to assume a life of their own. He believed that this was always a danger, because it was much easier to get things done with a smaller group.

The survey results had shown that the involvement of boards in committee work had increased substantially since the publication of the Cadbury Report in 1992. **Question 1** had asked what impact this greater involvement of board committees might have had on board effectiveness. A large majority of the non-executive directors interviewed was convinced that greater involvement had improved board effectiveness.

**Question 2 : The second major area of increasing board involvement identified by the Survey was in specifying the powers of directors, determining board composition and in appointing, developing and removing directors. Have the changes initiated by the Cadbury Report and confirmed by the Combined Code had an impact on those activities?**

Nearly two-thirds of participants responding to this question thought that the Cadbury nexus had had a positive impact on the determination of board composition. The

prescribed need for consultation and to institute more open procedures had letter to better practice.

***“Yes, I think it has. I think it has in the sense that the old prevailing assumption that an all-powerful chairman/chief executive would actually make the decisions, either with no consultation or with token consultation, has been severely dented. In the case of XXX, that never was the prevailing assumption because there has always been a very strong non-executive and very close consultation. But I would nevertheless say that even in our case there has been a change in the direction of more consultation.”***

Respondent 31

***“In a well-balanced company this has always been part of the role of the non-executive director. The influence of Cadbury has simply been to make it clearer. Clarity about who is independent and who is not independent, for example. Clarity about the processes you have to go through when appointing executive or non-executive directors and in preparing your annual accounts and so on. I think it has been of significant help to formalise good practice for boards.”***

Respondent 32

***“I think it has strengthened the quality of non-executive directors. The fact is that the old boy network that used to dictate 90% of the appointments probably operates in no more than 10% of cases nowadays. Certainly not in the reputable companies. I think because of that there is a very much more professional approach to these appointments. Without question, this has been a positive change.”***

Respondent 25

Nevertheless, there was a large minority who remained sceptical. Some believed things had not changed much because boards inevitably contained individuals with strong views and ingrained self-belief.

***“The reality, of course, in just about any company, is that one or two dominant individuals, usually the chairman or the chief executive, will know just how they want the board to be constructed, and who the parties will be. Therefore, although the non-executive directors might provide a structure to the board and a forum for those discussions, in the end of the day, it is important that the people who are running the business have the correct tools and the correct support to run it. I think that this probably has not changed a great deal in reality, whatever the formal structures may be. Formal structures might give the opportunity for questions, for cautionary***

*opinions to be expressed, and things like that, but the process of consultation with a small number of colleagues in identifying individuals and discussing the basis of their involvement, probably is not hugely different today from what it has been.”*

Respondent 11

Others suggested that the new rules might have been interpreted too rigidly and that some committees, particularly the nominations committee, might now have too much power.

*“ ... the process was important, because it introduced some formality. But there are two areas where I think dangers have arisen. One is the area of the nominations committee, which tends to have formed a little clique of people who look into the nominations. This does not matter, provided their recommendations are clearly regarded as recommendations. But very often the chairman takes a view that the committee was appointed to decide on nominations and the board must therefore accept their decisions. In my opinion, the Cadbury process, applied like that, has not been very helpful.”*

Respondent 09

Enlarging on the viewpoints expressed above, those who took a positive view of the Cadbury nexus believed that the selection process had become much more professional and open. There was more transparency and more consultation.

*“Yes, I think it is much more overt than it was. Whereas in the dirty old days, the chairman had a couple of old friends and he used to ring them up, now you have an open nominations process. Almost all the hiring is being done, at least ostensibly, by using head hunters and interviewing, including interviewing of the candidates by the non-executive directors and not just by the chief executive and the chairman, in most worthwhile companies. That is a great step forward, although I have to say that there is still a great deal of the old boy network operating. Not particularly at XXX because we have made sure of that. We are out in the market at the moment looking for a new non-executive director and that is being handled by very reputable head hunters and we are all waiting to see the results of their searches. It is true that our people can nominate to the head hunters people who are known to them, and indeed I think this is healthy, but the final selection will take place without any regard to that and without allowing the nominator to have his way. There is nowadays much greater transparency in good companies. I stress ‘in good companies’. But there are still some large companies where the chairman is very strong and they are hand in glove with the chief executive, and the non-executive directors have got to be very strong to resist the possible distortion of the transparency.”*

Respondent 26

***“So the old boy network, I’m saying to you, has its good side. There is no point in throwing the baby out with the bath water. I think though, on the whole, you do have to have a nominations committee, you do have to go to people like head hunters, but that does not mean that you should totally close the door to people at the back door. We have just appointed AAA recently, for environmental reasons. That was a very sensible appointment. He does not bring much to the board in terms of the finance director’s area but he brings an awful lot elsewhere. He has got a vast knowledge of Europe and the European environment and that is the way we are going to have to go. So somebody like him is invaluable. But you do not necessarily want to go to a head hunter for that sort of appointment. So I think you have to keep both. Keep the best of the old and let the new in. I think Cadbury has made a huge difference on that.”***

**Respondent 12**

In some circumstances rules could be helpful in giving structure where there had been reluctance previously to face up to issues, particularly with regard to length of service.

***“ ... the time people spend on boards is much more closely defined nowadays. The advice regarding six and nine year periods is looked at much more closely. In my experience, this recommendation is not always applied, but it is always thought about. That, frankly, is how it should be. Also, in a curious way, it has strengthened the chairman's arm, because it has meant that the chairman now has natural break points which did not exist before. In the old days it could be quite embarrassing for the chairman to have to raise retirement questions. It has now formalised that process, and I think it has been helpful.”***

**Respondent 08**

However, fears were expressed that the raising of standards and expectations could lead to problems in recruitment of both non-executive and executive directors. Some respondents were firmly of the opinion that the supply of suitable non-executive directors was limited and that the rising demands on their time might cause the system to fail. The new workload could also mean that potential candidates might be deterred by the low levels of financial reward in relation to the time demands and the statutory liabilities. These same pressures could also discourage senior managers from accepting board appointments.

*“I believe that in the good companies it has always been done in that way. But I think it has been good to formalise that. However, and again this is a very subtle point, there is a small and finite pool of non-executive directors. They are only going to be effective after the time they retire, say between the ages of 60 and 70. If you go to the chief executive of other companies and ask them to be non-executive directors, they were only able to sit on one board, so you have a small pool. Also the non-executive directors who are working executives in other companies cannot afford the time to sit on all the committees. So the nature of the non-executive directors involvement is such that those who, like myself, have retired from full-time employment get worked really hard by their companies. And you have to remember also that 50% of those in the finite pool to which I referred, would rather go home and grow their tomatoes than do this sort of thing. So there is now a chronic shortage of non-executive directors for top companies. And if the remuneration is not improved that source will dry up.*

*Another side issue is that the pressure which there is at the present time on the subject of executive pay means that many top executives are saying that they do not want to be on the board and they would rather stay as senior executives. In the American system the only people on the board are the CEO and possibly the finance vice-president, the rest are non-executives. The top American executive does not sit on the board. He is a very senior, well-remunerated person who runs his section of the business. He likes to be the baron running his bit, but you don't get people in the American system wanting to be on the board and taking shared responsibility for the whole system. I actually do not think that that is a good thing. Now, if in England we go that way and you have a senior executives saying ‘I do not want my salary to be scrutinised’ and ‘I do not want to stand up at the AGM’ this could be a problem. I know that on some of the companies I am on, certain directors have come and said ‘I do not want to take a pay rise’ and ‘I am uneasy about it because I do not want to stand up’. But this leaves you with other problems because you're not rewarding them in line with the market. So you have a double pressure which may shape the future pool of talent available.”*

Respondent 10

In reviewing these responses, Sir Adrian Cadbury (see Appendix attached) cited the case where the interviewee's chairman felt that the nomination committee proposals amounted to a *de facto* decision which had to be accepted by the main board. In Sir Adrian's opinion, Greenbury (1995) had been wrong to propose that the remuneration committee should have the power to decide what the remuneration should be; the board was responsible for pay, not the remuneration committee. Greenbury's recommendation was changed in the Combined Code (Committee on Corporate Governance, 1998). Directors must understand that these were committees of the board, that they were set up by the board, that the terms of reference were agreed by the board and that their recommendations went to the board for approval.

Sir Adrian also commented on the view expressed by some respondents that the pool of non-executive director talent was finite. This was not Sir Adrian's personal experience and when he was Chairman of PRO NED they had had far more potential candidates than they ever had demand for places. If the role of the non-executive director was made into a responsible and worthwhile job, where candidates could feel that they would be playing a genuine part, then he believed it should be of interest to people who seriously wished to make contribution. Women executives, for example, constituted a group whose potential as non-executive directors had not yet been fully explored. The author has also found that practitioners claim that there is no shortage of suitable candidates. Whilst the views expressed by the interviewees were strongly held, it was possible that the finite pool of candidates they had in mind was of a similar age, experience and gender as themselves.

**Question 2** asked whether the changes initiated by the Cadbury nexus had impacted on the powers of directors. Increasing involvement of directors in the work of the nomination and remuneration committees was seen by a considerable majority of the respondents to have improved the ways in which boards specify directors' powers, determine board composition and appoint, develop and remove directors.

**Question 3 : The main areas of increasing involvement reported by the individual non-executive directors who responded to the Survey, were in ensuring that information was available to monitor performance, in reviewing strengths, weaknesses and opportunities and in implementing strategies. Have the changes initiated by the Cadbury Report and confirmed by the Combined Code had an impact on those activities?**

In this general area of monitoring performance, the participants were of the opinion that the Cadbury nexus had not had a marked impact on the determination of strategy, despite the greater involvement of non-executive directors in the monitoring processes, which had been recorded in the Survey. Only 40% believed that there had been a definite or

slight increase in their input to strategy, while 60% thought that their inputs had remained much the same.

*“I don't think it has had an impact on the determination of strategy. What I do think is that it has given the non-executive directors greater insight into the businesses. They now have much more dialogue with the executives, and because they have got that greater input into the businesses I think there are better placed, frankly, to contribute to the strategy debate.”*

Respondent 25

*“...the area where Cadbury has really stiffened up attitudes has been in financial surveillance and financial controls and I think this impinges on the area of strategy. Yes, I think non-executive directors do have to show greater concern with and understanding for what the company's objectives are and how they are going to develop. Without sounding too complacent, I would say again that good boards had this before, but because the Code has highlighted the emphasis on internal controls the fact is that you cannot be involved in these processes unless you are taking a view on strategy.”*

Respondent 32

*“...the influence of the Cadbury process in this area has been very limited. This has perhaps being an area in which non-executive directors have been traditionally involved.”*

Respondent 22

*“I doubt that it has had so much impact there as it has elsewhere. I think that boards always had a strong input into strategy. That is what they are there for. I doubt if that has changed very much. I think they have always seen themselves as doing that.”*

Respondent 35

*“I would think that is probably more neutral. There is an argument that it has diverted directors from that role. I don't think that is true, I think it is neutral. The role is still important and Cadbury has not had much impact on it.”*

Respondent 17

*“I think that most companies had some kind of strategic review before Cadbury. They held forward thinking weekends, strategy conferences. The day or two out of the office when these things were looked at. I don't think the Cadbury process has had much impact. Well run businesses have always had these things, even if perhaps previously they were not so well documented.”*

Respondent 06

Some diversity within the reported historical experiences was inevitable; there were those who reported positive change and who saw the Cadbury nexus as providing a much needed professional framework for strategic discussions.

***“Traditionally this has been the major area for non-executive directors which in the past had not been formalised. I think Cadbury has tightened up the process. Previously I think it was very much an informal process. Formal discussion of strategy, such as is being held in ‘away days’ by boards now, is something relatively new. The process is taken much more seriously nowadays. This is possibly a reflection of the fact that the environment within which companies operate is much more fluid nowadays, as world markets expand, and there is a need for a more professional approach.”***

Respondent 28

***“Strategic changes do take place but if companies have got sound core businesses these changes are not of an extreme nature. Most companies do better at sticking to what they know well and doing it better. The area where I think the role of the non-executive director has been strengthened is in the situation where a new chief executive comes in and wants to change the direction of the company dramatically and they are able to provide continuity with the past. I think the Code helps in that area because the non-executive directors do have a greater degree of responsibility than perhaps they had chosen to exercise in the past.”***

Respondent 32

But the overwhelming impression was that the non-executive director’s role in relation to strategy had not changed much; the role was seen as being reactive, through the application both of common sense and of the benefits of experience. Formulation of strategy was probably not their work, but challenging and developing it certainly was.

***“Perhaps, but I would think that it is limited, frankly. The non-executive directors are not hired to formulate strategy. They are not hired simultaneously as a body, like a management team. Their role is very much reactive, as a sounding board, providing outside experience, ‘have you looked at what other companies are doing?’, rather than to formulate strategy.”***

Respondent 13

***“I would not put it down to the Cadbury process. I think rather it is corporate ethos. There is no doubt that non-executive directors are more involved in the process by which strategy is approved by the board. There has definitely been a positive change in that direction, but I do not necessarily put it down to Cadbury. It is probably just common sense.”***

Respondent 16

***“I don't know that it is particularly Cadbury. All modern professional directors, both executive and non-executive, are much more focused nowadays on getting clear strategy, for internal and external reasons. This is seen as a prerequisite for good management. Certainly, the non-executive directors, in my experience in all the companies I am on, play a very big role in setting a challenging strategy and in making sure that the objectives are clear. Not necessarily initiating strategy but developing it.”***

Respondent 05

Formulation of strategy was the work of the executive, particularly of the CEO. If a non-executive director had such detailed knowledge, he was possibly too close to the competition.

***“...there has been a lot of misapprehension about the non-executive director's role in connection with strategy. I do not believe that it is the non-executive director's role to formulate strategy. That must be the task of one man, and it is probably the task of the chief executive. It is often said, I think quite wrongly, that one of the things that a non-executive director must bring to the board is new strategic ideas. I do not believe that that is right at all. If he is in a position to give really pointed strategic ideas, then he is almost certainly working for a competitor, and he should not be on that board at all! No, his job is to apply his general experience to probing the strategy ...”***

Respondent 09

Sir Adrian Cadbury thought that there might be conflicting expectations between CEOs and their non-executives with regard to their respective roles in determining strategy (see Appendix attached). Certainly the author has always found that non-executive directors are keen to participate in the strategy debate – to be advisers rather than watchdogs. One non-executive director interviewed by the author in an earlier research programme summed up the generally held view by saying “...it would be very unfortunate if we ended up spending all our time on that kind of watchdog work. That would be terribly boring, and I would not bother with it. I would not be interested in doing that. I don't think you should appoint people who are necessarily suited to that at all. You should

*appoint eminent business people and identify those who have an attitude to do the committee type work.”* The research conducted by Dulewicz and Herbert (1999) confirmed that the influence of non-executive directors was felt strongly in those Tasks of the Board related to Strategy and Structure.

The author acknowledges that it could be considered a weakness of the research programme described in this thesis that the views of chairmen and CEOs were not sought. This point is explored further in the conclusions discussed in the next chapter. The author believed that the freedom with which the non-executive directors spoke to him could have been compromised had they believed that the views of their fellow directors on the same board were also being sought.

However the views expressed above are similar to those uncovered by Stiles (1998) in the interviews he conducted with directors. Stiles interviewed chairmen, CEOs and executive directors, as well as non-executive directors. He drew the following conclusion : *“Non-executive directors were originally cast in the role of corporate ‘policemen’ by commentators after the publication of the Cadbury report. Though they were acknowledged as important as checks and balances in the boardroom, the finding from this research was that they were valued for their expertise, their contacts and ‘outside’ view. They were important in the process, too, of weeding out underperforming directors”* (1998, p.248).

**Question 3** asked whether the Cadbury nexus and the implementation of the Combined Code had led to improvements in the ways in which non-executive directors monitor performance, review strengths weaknesses and opportunities and assist in the determination and implementation of strategy.

The general view was that reviewing strategy had always been a key element of the non-executive director’s work and the Cadbury nexus had not done much to change that. However, the higher levels of involvement of individual non-executive directors, as

reported through the results of the Survey, had led to improvements in the quality of the debates on strategy which were now conducted more rigorously.

**Question 4 : Has there been a change in the balance between the ‘control’ and the ‘advisory’ aspects of the role of the non-executive director?**

Perhaps unsurprisingly, most participants saw the balance in their role as shifting towards control over the seven year period of corporate governance change. Over 50% supported this view, with nearly 40% believing there had been no change and less than 10% reporting a shift towards the advisory aspects. Various influences were detected :

*“I think the control aspects have become more prominent, yes. And certainly there has been another twist in that direction with Turnbull.”*

**Respondent 35**

*“Yes, the role has shifted from being largely advisory to being one of control. I think this change has taken place particularly through the influence of the audit committee. The remuneration committee sorted out the vexed question of executive remuneration, possibly in a better way than it had been done before, but the work of the audit committee has had more influence.”*

**Respondent 22**

*“ ... non-executive directors are being drawn into rather specialist aspects of governance. Turnbull is probably a good example of this. You don't want a board made up entirely of chartered accountants. In fact sometimes chartered accountants are not the best people to have on audit committees. They try to be too clever.”*

**Respondent 02**

The references to Turnbull (Institute of Chartered Accountants in England and Wales, 1999) are significant. The emphasis on the audit committee has strengthened the influence of those with financial qualifications and this is resented, possibly feared, by some who do not have that professional background. ‘Them and us’ can be taken to represent this distinction, but also refers to possible divisions between executive and non-executive directors.

***“Yes, I think the balance has very much shifted towards the control aspects. That has its difficulties, because if you are not very careful you get a ‘them and us’ attitude around the board table, which needs some delicate handling. I have been on both sides of the fence, and I know what it is like.”***

**Respondent 25**

Some thought that drawing a line between control and advice served to polarise attitudes. The author admits that the choice of these words is not helpful to the debate and, to that extent, it might be possible to criticise the drafting of Question 4. ‘Control’ has pejorative overtones and ‘advice’ is a friendly and warm word. Nevertheless, the distinction is well understood in the debate on corporate governance and has a well-established provenance.

***“Yes, but I think it is a mixture of the two, to be accurate. Basically the same relationships are involved and you are the same person in those relationships before, during and after. I think the Cadbury process has had beneficial effects on both aspects of the role.”***

**Respondent 29**

***“I would not think the management of XXX would have said that the non-executive directors developed more control over the period. The word influence might be the right word. I guess this word falls somewhere between advice and control. And I think the influence of the non-executive directors was significantly higher at the end of the period than it was of the beginning, higher in 1999 than it was in 1992.”***

**Respondent 27**

Sir Adrian Cadbury also preferred the word ‘influence’ (see Appendix attached). Some respondents expressed the view that since non-executive directors were now more involved, their greater depth of knowledge had allowed their influence to develop.

***“The Cadbury process has certainly moved the supervisory aspects of the role up the agenda. What I would say, though, is that from a personal satisfaction point of view and indeed for most of the companies I have been associated with, being able to make a contribution which is valued in terms of running the businesses, I find far more satisfying. I think the boards of the companies I am involved with find non-executive directors far more helpful than would be the case in a purely supervisory role.”***

**Respondent 11**

***“ ...in percentage terms it has probably increased the control and vigilance aspects of the role. But in absolute terms, because we are spending more time on all activities, the total amount of time involved has gone up, so we are probably spending more time on the advisory roles as well.”***

**Respondent 04**

***“I think a director is a director. After all, they are legally responsible. I think people realise that it has to be a team. Undoubtedly, nowadays non-executive directors play a much bigger role and take up more responsibility. They are involved in key decisions on motivation, picking key executive directors, supporting the chief executive and also sometimes terminating the chief executive. There is much more real activity in that area, more participation. But I don't think this is anything to do with Cadbury at all. I think the situation has just evolved. Perhaps it is due to the fact that this is much more an international or global economy nowadays. The fact is that these practices are developing quite fast. Whether it is because of, or as well as, or in addition to, Cadbury, I can't be sure. It is certainly not a Cadbury box-ticking job. I think it is real involvement.”***

**Respondent 05**

This strengthening of the non-executive director role was believed to have been greatly beneficial to board processes. Sir Adrian Cadbury made two points about the responses to this question. First, it was apparent that non-executive directors were participating more in board activities. Second, they were spending more time on both control and on advice. So the work was more demanding in its totality and this had an impact on both aspects.

One respondent saw this as a global trend :

***“ ...there has certainly been a tendency for non-executive directors to take their role more seriously and for the public to take more seriously the non-executive director's role. I don't think this tendency is limited only to this country. It has also happened in the USA. In the old days there would have been no question of the board of General Motors sacking their boss! It is happening, even now, in France. All these things are linked together as part of the trend of things becoming global. National influences have been diminishing in this context. And the mergers and acquisitions activities across national boundaries have begun to influence, quite markedly, the practices of how boards behave, what the role of the non-executive director is and even what their pay structure should be. Some of the mergers, particularly with American companies, have resulted in the non-executive directors being paid double what they were before, to bring them in line with American practice. All those things are linked together. Whether or not the Cadbury Report has been a significant influence on that I would not like to judge. I don't think we shall ever know.”***

**Respondent 18**

**Question 4** had enquired whether there had been a change in the balance of the work of the non-executive director, leading to greater emphasis on the ‘control’ aspects of the role. The responses indicated that the Code had obliged all directors, but particularly non-executive directors, to monitor conformance more closely. However, the increased levels of involvement devoted to their work by the individual non-executive directors had allowed more time also to be given to performance enhancing, advisory activities.

**Question 5 : What do you believe is driving this agenda for change in governance standards?**

The interviewees put forward a variety of explanations for the changes which had taken place in corporate governance standards in the UK, and the consequential impact on the pattern of their boardroom work. These explanations have been placed under separate heads below, but they overlap and they are not necessarily mutually exclusive. They have been listed in descending order of the frequency with which they were mentioned in the interviews.

**1. Self regulation** - the need for the Stock Exchange to put its own house in order :

***“ ...Cadbury genuinely thought, and I think he was quite right, that corporate governance was out of hand. It was an incestuous world, controlled like a club, and becoming more and more controlled by industrialists who had experience of running companies but who were feeding on each other to the detriment of shareholders. Something needed to be done about it to make sure that the words ‘corporate governance’, in itself a dreadful expression, but we all roughly know what it means, meant that they should be more honest and more fair. I think he was right, but he was only scratching the surface and we have come along long way since those early days. Now we are exploring the much more important territory, from the point of view of the company, where we are trying to extend financial control to compliance and operational control, where, if it is done properly, you see both faces of the risk/reward coin. This can be greatly to the executive advantage in better managing the company and in making more profit.”***

**Respondent 26**

*“The Accounting Standards Board, once it got its teeth sharpened, made it absolutely clear that certain practices, which had been used to disguise figures, were no longer acceptable. I think in so doing, it restored some dignity to the audit profession. The work of the audit committee was driven and re-invigorated by the Accounting Standards Board changes. There should be a statue to David Tweedie somewhere. That had an impact which preceded Cadbury. Cadbury then had the remaining impact, which was indeed very considerable.”*

Respondent 09

2. Scandal - high profile cases of malpractice which caught the attention of the media :

*“I think the changes came about as a result of what one might call ‘regrettable disasters’. Some really bad cases achieved the headlines and the general feeling was that something should be done to avoid such things happening in the future.”*

Respondent 22

*“Unfortunately there are companies who continue to bend the rules and indeed break the rules. And particularly for shareholders, as well as for public accountability, there are issues like environment and so on. But I think you could argue that some of the requirements have been over the top. But so long as organisations continue to flout good practice and legislation, the requirement will be there. I don't think good companies have anything to fear from it.”*

Respondent 20

However, some were doubtful about the chances that human nature could be changed through the introduction of regulatory frameworks :

*“ ...it was a couple of scandals basically. They got it rolling. I think they are largely driven by emotive issues, I'm afraid. The case of Dr Shipman is going to change the whole regulation of the medical system. Just as Robert Maxwell has changed the whole of the regulation of pensions. And no amount of regulation is going to stop another Shipman appearing in the next 500 years. Or another Maxwell doing what Maxwell did. We get to these gut reactions which are media and politically driven. This very often creates a quite unnecessary degree of regulation and bureaucracy, which contributes absolutely nothing.”*

Respondent 19

3. Social Climate – changing expectations in our contemporary social environment as to what are regarded as acceptable standards in public life. There was a public expectation

that regulation would ensure that mistakes would not be made. There were signs that some participants were not in sympathy with certain aspects of this new social climate :

***“The world today is more sympathetic towards the regulatory approach as opposed to the self-regulatory approach.”***

Respondent 14

***“ ...one of the difficulties that has emerged over recent years, and this is not just to do with companies, I think it is pervasive throughout our society, is that there is less trust as between people. In the old days in a board, if one of your colleagues had been involved in something with you, you tended to trust him. The same applied to public life, but nowadays there is a desire to have an almost foolproof system to deal with issues which in fact cannot be foolproof. The primary role, as I see it, of the audit committee is to be satisfied with the processes available to the business and to the implementation of those processes rather than the audit committee having to double check and tick everything.”***

Respondent 02

***“Well, nothing is ever anybody's fault these days. There is always somebody you can sue. So there is an awful lot of backside protection going on in a lot of companies. This has an effect on their corporate ways of doing things. You have to make sure that you are covering everything.”***

Respondent 06

***“I see it, to some extent, as part of the whole trend in society towards political correctness, to use the compendious term, towards conformity. No doubt you will have already detected that I am not in sympathy with that trend because I think it stultifies creative imagination. It makes people frightened, paradoxically, which is of course a highly undesirable trend. ...Now how that relates to the role of the non-executive director, I am not sure, but I think that is part of the strand. Another part of this strand has to do, of course, with the position of the institutional shareholders, who possibly see this as the means of discharging their responsibilities in an indirect way rather than doing what they should do, which is to vote. They should exercise their vote, and exercise their muscle in an appropriate way.”***

Respondent 31

4. Institutions - pressure from institutions and other activists for improved standards :

*“ ...it is the institutions. The big insurance companies and the pension funds. They want to have more control of what is going on.”*

Respondent 24

*“I think it is professional shareholder information. I'll be frank with you. I think the complexities of reporting nowadays are such that I would be astonished if it has not eluded the ordinary shareholder, the private investor. Now presumably, professional investors are getting more comfort from these changes. You can see so many chief executives depart now as soon as there is any trouble and I presume it is because they are very much better informed than they used to be.”*

Respondent 25

*“ ...there are two things at work. One is that institutional shareholders have realised that this is the way in which they can ensure that the board takes their position into account instead of being swept along by a generalised board responsibility. The second thing is that there is a very strong force coming from the auditing and accounting professions which is tending to push companies in this direction of control.”*

Respondent 35

5. Improving Efficiency - making the operation of the board more effective :

*“ ...there are a number of factors. One is the general globalisation of activity. Another is the realisation that one has to be competitive in all departments. And that also the perception of the stock markets is very much tied to effective boards, information supply, a measure of transparency ... When we went on Nasdaq, the standard of analysis and the requirements for transparency and information went up to an unbelievable extent. In London, they still do not realise the superior standards of analysis. Analysis, in turn, requires consistently good figures and the good analysts in the various sectors know far more about the company than the people who run them.”*

Respondent 13

*“ ...it is part of a general wish to improve performance and transparency. For the good companies, I think the last point is the dominant one.”*

Respondent 32

6. Transparency : demands for the activities of boards to be more open to scrutiny :

*“I suppose in general terms it is the growth towards greater information and, I suppose greater democracy. More transparency and democracy in the way things get done.”*

Respondent 16

*“I think it is, in the sense of the concept of accountability being applied to the private sector just as much as to the public-sector. Accountability was not a word used in that world before.”*

Respondent 17

*“I think accountability and transparency are two good words. Responsibility is another.”*

Respondent 20

Much of the academic debate on causality, reported earlier in this thesis concentrated on a narrow range of drivers, particularly malpractice and the need to improve performance. The latter driver was associated closely with the desire of the institutions to put PLC boards on a more accountable footing. The interviewees referred to a wider range of drivers, drawing attention to the expectations of society. Sir Adrian Cadbury thought that accountability, transparency and responsibility summed up the positive aspects of these expectations. But there was an impression that the respondents believed that some of the expectations were unrealistic.

The responses to **Question 5** showed that the interviewees felt that there were multiple influences at work driving the Cadbury nexus. There were broad societal influences and narrower influences expressed by some active shareholders.

**Question 6 : Can non-executive directors be sufficiently vigilant, given the limitations imposed by the time available to them for participation in board activities?**

The respondents overwhelmingly believed that non-executive directors could be properly vigilant, despite the extra demands on their time. More than 80% of the participants thought appropriate vigilance was possible. Some of the comments supporting this view were :

***“ ...the answer to that is a very clear yes. There is no doubt that things have improved over the last five or ten years. When did Cadbury start, 1992? Eight years ago. I think there has been a beneficial effect of this Cadbury process, leading on now to the Turnbull report with its concern with finance and risk. I see this as a process which has enabled us as non-executive directors to get the information which enables us to be vigilant. There is no problem as far as that is concerned with the non-executive directors of XXX. We have completely and total free access to all information.”***

Respondent 29

***“We meet once every month, but there is a great deal of discussion which goes outside the normal board meeting. We have an extremely good chairman and he is very careful to consult with the non-executive directors so there is a good bit of discussion outside the main board . Most of this is done by telephone. We had recently to recruit a new chief executive after one who had been very successful had retired. So certainly a great deal more time. Can it be done, on the basis that you have enough information? I think you can only judge that company by company. If as a non-executive director you are not being given the right information then you have to make efforts to get it. If you cannot get it, you have to review your position. In the companies I am involved with that is not a problem. So I feel that I can be sufficiently vigilant. In some cases there is perhaps too much information but certainly all the information I need is there.”***

Respondent 32

***“ ...they can be sufficiently vigilant. But I think it is very important that people do not over-burden themselves with so many jobs that they cannot be sufficiently vigilant. I think the principal responsibility lies with the individual concerned to ensure that they do have time. They should leave enough time and remember that they may be called upon in emergencies, for example when there is a bid and so on.”***

Respondent 35

***“I would like to think the answer is, yes, they can. Certainly, if they accept a position then they should be prepared to be vigilant. If you don't think that you are going to be able to perform in that way, then the decent thing to do is to say, ‘no, thank you very much, I am already fully booked’. I think if you accept, then you are duty bound. If the people you are working with do give you all the information that you seek, and I would like to think that I was lucky in that respect, but I do not think there is any guarantee that every company divulges sufficient information.”***

Respondent 15

The contrary, minority, view saw the potential for conspiracy and cover-up :

*“Let's face it, frauds still occur, greed still emerges in the upper regions of companies, improper collusion and conspiracy among two or three of the senior executives, and if people are by design covert and secretive, how vigilant can you be? Similarly, smaller scale inefficiencies in one particular branch or plant which is not performing, this can be covered up and massaged, by saying, for example, ‘Well, it is quite a small plant so let us put it in with six other plants in the board papers’, or ‘We've reviewed by countries rather than by companies’ there are a thousand ways of doing it, and there is a limit through constraints on time as to what one can ferret out.”*

Respondent 13

The responses to **Question 6** indicated that the interviewees had few doubts that they could be sufficiently vigilant, despite the limited time available to them to attend to the company's business.

**Question 7a : Is too much being now being asked of the non-executive director?**

The responses to **Question 7a** showed an even split between those who thought too much was being asked and those who did not. Some thought the question raised wider issues about demands on time and about rewards for the job.

*“Well, in one way I have indicated that it is. This is a very difficult question, I think. What you want is a younger non-executive director from another company, so that there is cross-fertilisation between companies, and this is desirable. That, and secondly, if you get that sort of chap, at the age of about 50 ... the probability is that it does make demands on those sort of people ... where someone continues to work full-time as an executive director it is very difficult for them to get time off to meet the extra demands. I am in a slightly better position, because I am self-employed and I can sometimes juggle my various appointments. I have a huge amount of businesses to run and I am probably as busy as anybody else on the board, but at least I am my own boss in general although I am on two or three companies now, but I have more flexibility, so for example if we are going to America, and I know long enough ahead that we are going, I can put aside the days.”*

Respondent 12

*“Yes, I think that is a problem. It also starts to bring up the question of what exactly you pay them. The two questions are more or less combined in my mind. You are beginning to ask so much of them and yet the average salary which is paid to a non-executive director is about £1000 per day. It is not looking right any longer.”*

Respondent 09

*“Well, I don't think that too much is asked of them, although the degree of responsibility is now large. What I do think is that they are not adequately remunerated for that additional responsibility, for the additional time that they have to spend on corporate affairs.”*

Respondent 33

Others thought that it was important that the job was not taken on unless the candidate was confident of doing it adequately.

*“No, I have always taken the view that if you take on responsibilities like that, then you have to find the time that is required for it. This should be put into the context of how many you take on, in relation to your other commitments and responsibilities.”*

Respondent 11

#### **Question 7b : Given the requirements of the Code, is the job doable?**

Despite all the pressures, a large majority of participants thought the job of the non-executive director was doable. Over 80%, about the same proportion as responded positively to **Question 6** about vigilance, thought that they were able to perform satisfactorily.

Some were quite definite about it :

*“Can non-executive directors overall do the job? I think you can only judge by your own experience. You can do it if you are clear about the terms on which you're going to do it right from the beginning. If you are clear about the roles of the committees and if you are prepared to make your position plain when it matters. It all depends on the complex of relationships between you and the board. This was not clear in one of*

*the boards I joined much earlier and eventually I resigned. I had felt that the relationship between the chairman and the chief executive was not right and the dominance of the chief executive was not healthy. If you cannot change things under these circumstances then you have only one course of action.*” Respondent 32

*“ ...the job is doable. You remember that saying that you should find a busy person if you want to get something done. I guess that most non-executive directors, certainly the ones I know of, bring to the job the experience of another job, or another field, so what might be daunting for that non-executive director in his role is not so daunting because he is trading on his experience and knowledge. I do think non- executive directors are far busier than they used to be, but they are often by themselves thinking and reading at home or in a car or train.”* Respondent 18

*“I think the job is doable and I don't think it is worth doing except in that way. There must have been a fair degree of rubber stamping in the past. It depends how much time you can give to it and how much time you want to give to it. This also leads to the question as to whether you should hold more than a certain number of directorships. If you think the job needs so much time then you should limit the number you take on. But there is a huge value in sitting on other boards. Because the lateral thought process is crucially important. It informs your own decision-making as to what is important to the particular board you are on.”* Respondent 21

One doubter could see that the learning process could be a period of under-achievement :

*“It is not doable in the full sense, I think. I think it is doable in practice, inasmuch as if you are an experienced businessman coming from elsewhere you know what information to call for and you know what to do. The very nature is the fact that you're not in the process and you can only call for things. This is a thought I'm having for the first time! If you think about when things go wrong, if there is then a select committee, for example, which looks at that, then you know what you are calling for. But not being in the process, and to have to call prospectively for information does not work. If you are monitoring someone who is doing a bad job or doing it in a bad way, the first time he does something bad you're not going to catch it - that is going to be the time that alerts you to the fact that something is going wrong. Once you have encountered it you can set up a monitoring system, but you cannot foreshadow it.”* Respondent 10

Others thought that, although they were currently in control of the situation, they might be reaching the limits of their capacities. The question of demands on their time was raised again :

***“ ...we are alright at the moment. I think the elastic is being stretched. A lot depends upon the age of the individual. I think we now have to ask for a written understanding. I think most of the companies I have been involved with have now said that non-executive directors have got to retire by 67 or 68. I have been on some boards where some of the directors were 74 even 78. They now find it difficult to make progress. So I think a lot depends upon the age of the individual and enthusiasm of the individual and their preparedness to undertake hard work. I have not really found people shirking their duties. They will always turn up on Sundays, if the company is involved in takeovers or acquisitions or some other emergency.”***

Respondent 34

***“It can be very time-consuming. The audit committee is extremely time-consuming. Not just the meeting itself, but the reading for the meeting. The preparatory work.”***

Respondent 35

***“ ...the job has become over-burdensome with all these new requirements. But then it is all based on a typical Anglo-Saxon legal fiction that the responsibilities of executive directors and non-executive directors are identical. When you actually get down to the wire, the English judges have interpreted that by looking at what the reasonable person would do, their actual state of knowledge etc. If you proceed from that fiction, you tend to get into a mess, in strict logic. There is no doubt that there is a hell of a lot more required of non-executive directors nowadays than there used to be, but then I think they tend to be better regarded and better paid, and certainly they have an improved status, just as they have an improved responsibility and vulnerability. To answer your question, I think the job is doable until you get an impossible situation.”***

Respondent 13

As a result of these resource pressures, relationships with external advisors had grown in importance :

***“I think that these are good questions. It is not possible to give a straight black and white answer. I think the workload of the non-executive director has expanded exponentially ...going back to the heart of the question, non-executive directors, by personal research, cannot get at the detail that is required to do ‘Insight’ reports like the Sunday Times on matters that they might feel doubtful about. So they have to rely on honest answers and in the end it's a judgement about people. They have to rely on honest answers. Of course they have to dig and ask the questions, be resistant to things***

*they are not sure of and go for it when they find something they do not quite like. In the end, they rely on the executives and on professional advisers, and I emphasise the latter because professional advisers, particularly the auditors, can be very important if you are going to get behind the executives. Non-executive directors have to have close relationships with the outside advisers.”*

Respondent 26

Ultimately, it was important to get terms clear from the start so that what was expected could, in practice, actually be delivered :

*“Yes, I think you can. I think it is important to set things out right from the beginning. One of the other boards I am on is a small start-up company. I have been asked to spend only four or five days a year as a non-executive director on it. I find that I can't really do the job in that amount of time. On the other hand at XXX I have 15 to 20 days and within that context there is more than enough time for you to be vigilant. I was also very fortunate on XXX that I was made the chairman of the pension fund trustees and that gives me an excuse, if you like, to spend more time with the company and to become more involved with the finance director and the company secretary for briefings. However it is always up to the non-executive director to ask for information and not necessarily for the company to give it to him. You set the rules and you have to say that if you want me to do this job, do it properly by having proper meetings. How am I getting information and what sort of information am I getting.”*

Respondent 20

Sir Adrian Cadbury was interested in the high level of confidence expressed by the respondents in their ability to exercise appropriate vigilance and for their opinion that their job was doable. He drew attention to the doubts expressed by many academics and practitioners, but here was a group “...saying yes, we can do it (and) ...these are the people who are actually doing the job” (see Appendix attached).

**Question 7c : If the job is doable, what are the personal qualities required to do it?**

**Question 7c** had not been on the list originally prepared for the interview schedule, but as time passed, it emerged naturally from the discussions, as a postscript to the previous question.

Only about half of the participants volunteered their opinions so no firm conclusions can be drawn, but the various personal qualities mentioned by those participants are listed below, along with selected quotations by way of illustration.

### Experience

The non-executive director should have held senior positions and, preferably also should have held a variety of jobs :

***“In my view, he needs to bring some breadth of experience. I think the worst non-executives are those coming from a single-experience background. Frequently such people can be a pain in the neck because they have never seen anything else and they think that the only way you can do things is the way that it was done in their one experience. So I would always tried to avoid a single-experience non-executive director. I think this puts a lot of premium on ensuring that you get multi-experience people.”***

Respondent 08

### Business skills

Non-executive directors should have knowledge of how companies work and an appreciation of the dynamics of the corporate environment :

***“...they have to be experienced enough to be able to understand the issues facing the company. These include, of course, commercial issues, but also where the enterprise is in relation to society at large, attitudes towards the government and society generally. So they have to be familiar with those issues.”***

Respondent 35

### Independence

There needed to be independence both of mind and of the need for financial reward :

***“I believe that one has to have independence, and again a lot is implied in that. The non-executive director must not be deterred from resigning if a resignation is necessary. It is therefore undesirable that the non-executive director should be dependent upon the company concerned for a large proportion of his income. I do not regard this as an overriding disadvantage, because I think that there are people who are capable of behaving with independence and integrity at personal cost, but this is an important factor, I think.”***

Respondent 31

### Analytical skills

Non-executive directors should possess objectivity and the ability to get to the heart of a problem :

***“ ...the quality required is to be able to get to the nub of the problem, without getting stuck too much in the weeds.”*** Respondent 16

### Interpersonal skills, especially tact

They needed the ability to work with, and get best out of, colleagues. Allied to this was seen to be a need for tact, the ability to challenge without giving offence :

***“ ...he needs to be able to keep a balance between encouraging the executive directors and making useful comment.”*** Respondent 30

***“An ability to challenge the executive and the chairman, without actually getting up everybody's nose in the process.”*** Respondent 06

### Strong-minded

This quality involved having self-belief, making your opinions felt, not being afraid to speak out and having the courage of your convictions :

***“They have also got to be sufficiently strong-minded and of such a character and with personal characteristics which enable them to get their point of view across. So they have to be the right personality both to work with the executive management and to be able to make their own opinion felt, even when that is not in accordance with the wishes of the executive management.”*** Respondent 35

### Personal motivation

Non-executive directors should be interested in their job for its own sake, not for the money :

***“They need, first of all, to bring personal motivation. They need to feel that they have a contribution to make and not that the appointment is just another medal to pin on their chests, or another bit of income.”***

Respondent 18

### Common sense

***“Objectivity, common sense. I have spent my life in a service which Harold Macmillan described as needing one quality and one quality only and that is common sense. I think that that is exactly what the non-executive director has to bring to the board.”***

Respondent 01

### Organised life style

The non-executive director should be available when wanted, particularly in an emergency :

***“The other important quality is that I think people should be well organised in their business life. They must be able to operate good secretarial relationships. I have a rule that my secretary always knows where I am and I will always answer a question within three hours of it being telephoned to my office. This way you are valuable to the company, because they don't want the advice next week, they wanted immediately. In this way you find that you are the non-executive director who gets consulted, because you are the one who responds. So well-organised non-executive directors is another factor. I have heard many complaints that so-and-so is a good chap, but we never see him. This is a complete waste of time. Time availability is all about good organisation so when you asking someone if they would be a non-executive director, press very hard to find out how he runs his life.”***

Respondent 08

These responses were compared with analysis of the personal competences of non-executive directors which had been published by Dulewicz and Gay (1997) and by Gay and Dulewicz (1997a and 1997b). The first two qualities identified above by the respondents, Experience and Business Skills, are not competences; they can more properly be classified as aspects of expertise or knowledge and understanding. They represent specific attributes, which have been acquired and developed throughout a career.

The next quality identified, Independence, was discussed earlier in this thesis and will be discussed further in the analysis of the responses to **Question 8** below. The emphasis the Cadbury nexus has placed on the independence of the non-executive director has led to a situation where this quality can now be thought of as a *threshold competence* (Spencer and Spencer, 1993). The research conducted by Dulewicz and Gay (1997) rated 'Integrity' as the most important personal competence, not only for non-executive, but also for executive directors. It was at the top of the lists also for chairmen and for CEOs (Gay and Dulewicz, 1997a). The juxtaposition of the definitions for 'Integrity' and for 'Independence', used in the Henley standards project (Dulewicz, MacMillan and Herbert, 1995a and 1995b) shows some areas of overlap in setting standards for conviction-based behaviour :

'Integrity' : *Is truthful and trustworthy, can be relied upon to keep his/her word.  
Does not have double standards and does not compromise on matters  
of moral principle*

'Independence' : *Takes action in which the dominant influence is his/her own  
convictions rather than the influence of other people's opinions*

Organised life style does not appear to have a close equivalent in the list prepared by Dulewicz and Gay, despite the strong case made for this quality by one particular respondent. However, for all the other qualities put forward, strong similarities can be identified with competences ranked highly by the respondents in the Henley board standards study.

Analytical Skills, can be compared with two competences rated very highly in the list. These are 'Critical Faculty', which was ranked second and 'Helicopter', ranked third. These competences defined the ability to probe facts, challenge assumptions and to rise above immediate problems and see wider issues.

Interpersonal Skills finds echoes in 'Listening' ranked fifth, 'Organisational Awareness' ranked seventh and 'Oral Communication' ranked eleventh. Similarly, Strong-minded has some affinity with 'Resilience' ranked twelfth; Personal Motivation would seem to

have a direct equivalence with ‘Achievement Motivation’ ranked fourteenth and Common sense can be linked to ‘Judgement’ ranked ninth, the definition of which includes the ability to make sensible decisions or recommendations.

There was some ambivalence in the responses to the separate parts of Question 7. A large majority of the respondents was firmly of the opinion that the job was doable, but a substantial number thought that too much was being asked of them. It is possible that non-executive directors might be close to the limits of their capacity for taking on further responsibilities.

**Question 8 : Is it possible for non-executive directors to be truly independent, given that greater involvement must lead to greater commitment?**

There was almost unanimity among the participants in their responses to this question; virtually all believed that it was possible for non-executive directors to preserve their independence during these challenging times for FTSE 350 companies.

*“I think now we have a better breed. I think independence was at a premium in the old days. Most people, as Cadbury spotted on day one, had a lack of independence. But independence is a state of mind and a good company is looking for people with that state of mind. People who are fearless and who will not be put off the scent, who have bulldog determination to get at the truth even if that involves deeply offending people and perhaps even offending people wrongly. If people have got those qualities they do not go away even when the pressure is on. A good company will be looking for people with that frame of mind.”*

Respondent 26

As already indicated above, independence was thought of as a state of mind, a descriptive phrase repeated time and again by the respondents.

*“I don't think that greater involvement is a threat to independence. I think independence is a state of mind. I have no question in my own mind that anyone who is doing a professional job in the non-executive director's role, frankly, is not going to be non-independent.”*

Respondent 25

***“That is another interesting question. Yes, I do think it is possible to preserve independence. I think independence is probably a state of mind.”*** Respondent 30

The defining characteristics of independence were said to include fearless determination, an acceptance that it might be necessary to offend people in the pursuit of truth and the need to regard the interests of the shareholder as paramount. If this meant that underperforming fellow directors or managers have to be confronted, then so be it.

***“I always find it difficult to get a definition ..... of mutuality when you are looking at building societies and banks. No one can ever describe it to me. I think that independence is similar to that. It is difficult to define. You have to remember that you are part of a team and that you are there to develop shareholder value. You are there for the benefit of the republic, pro bono publica, you have got to have that first and foremost. You have got to be ready to be a whistleblower and then you have got to speak your mind.”*** Respondent 34

***“If you don't like it, you have to go. I have been a member of a board, some time ago, when I had to pull the plug. That is the time when all directors, whether they are executive or non-executive, are up against it. For example, the company is in difficulties - should it be allowed to continue to trade? That kind of issue has not changed.”*** Respondent 03

***“Independence of mind implies a complete willingness to speak out, not necessarily all the time because that is just tedious, but when the chips are down, then you just have to do it.”*** Respondent 09

However, respondents were clear that independence was not threatened by involvement in the affairs of the company.

***“I do think it is extraordinarily important for the non-executive director not to become executive. But, that said, I think the non-executive directors should be totally involved in the business. I mean totally, utterly involved and completely loyal. So I do not see that as a factor.”*** Respondent 31

***“With the question in the way in which you put it, with reference to total involvement, I personally do not believe that it compromises my independence at all. In fact the more questions you ask and the deeper you go into a subject the more you tend to question things, quite frankly. The only thing that the institutions would say is that once you have been in the job for ten years, or something like that, then are you sufficiently detached, or have you got to know the people so that they have become buddies. But I think that independence is a state of mind and that should not come into it.”***

**Respondent 04**

The length of time which had been served on the board was not important. PIRC's criteria were ill-conceived and irrelevant.

***“...the idea that your independence changes after you have been on the company for a number of years is wrong. If you're doing the job properly and you are getting all the information you require there is no difficulty about maintaining your independence. Independence is a state of mind and it's a state of relationships. I have certainly found at XXX and at other companies that we are independent and we are seen as independent despite the length of time we have been on the board. But so much does depend on the individual and on their relationships. That is the key. The balance of the board, its age, its experience, its knowledge. If that balance is good and alive, then it will work. And that is something you cannot define in codes of conduct. You need to be clear whether you are independent or not, and if you are independent, the time you have been on the board is not relevant.”***

**Respondent 32**

***“When you say commitment, I presume you mean involvement. I think, to some extent, this is a function of the type of individual. I was not impressed with one or two of the lobby groups who have said that if you have been a director for more than 10 years then, ipso facto, you are no longer independent. That was levelled at me at XXX when I had completed ten years. We got round it by saying that the company had been reconstituted eight years ago. But independence is a state of mind and the length of time you are involved does not come into it. If you are brought up with principles, for example, if you are trained in a profession or, say, in the services, for example, where they have certain standards of personal behaviour, then they don't leave these standards behind when they go to work.”***

**Respondent 13**

***“Take the case of these very tiresome people, PIRC. Their attitude is completely over the top. According to PIRC, the Chairman of the Federal Reserve Board in the USA is totally unfit for office because he is over 70! It is absolute nonsense. They say that anyone over 70 cannot be independent, which is absolute nonsense. They then go to the extent of advising shareholders to vote against the appointment of anyone who is over 70. They presume that if you have been around for long time you are going to***

*change your character, you are going to 'go native'. But a lot of older people, including myself, tend to get more cantankerous as they get older. The whole idea that you can have blanket regulations, which cover all situations has to be a nonsense. Obviously one wants to refresh the stock of non-executive directors by having new and younger people coming in, but PIRC say that you can only do 3 stints of three years each and then you must go out. But I would query whether even nine years is long enough to get a proper appreciation of the business. For the first three years you are still learning, for the second three years you are advancing and your most valuable contribution comes during the third three years, and is likely to follow with a fourth, if PIRC will allow you.*

*At the AGM of XXX last month, I said that if I was given the chance to speak, I would make some very rude remarks about PIRC, and the effect of this was that I was discouraged by my colleagues! Their attitude is political correctness carried to extremes. There is an old hymn which talks about the Almighty being 'slow to chide and swift to bless', well PIRC is exactly the opposite!"* Respondent 22

However, it was important not to be financially dependent on the company.

*"You can be independent in the sense that you are not reliant on that company for your total income. For example, there are people who will stand on their hands in order to avoid losing their job, but they are absolutely useless in the end of the day, and I have had to live with one of two of those in my experience."* Respondent 08

*"... it is important that the non-executive director should be able to walk away without a moment's regret. If he is earning something like £60,000, then it is substantial, and that is in his mind before he starts saying, 'Well, if you boys think like that, then it is goodbye'. I find the balance to be achieved is very, very difficult. I like the amount of money that I am paid, because it is a nice sum, but I never felt that my life style was dependent upon it. This was partly because I had quite a large portfolio, but this is now being frowned upon."* Respondent 09

One or two participants challenged the premise behind the question, believing that they had to be committed in order to contribute effectively.

*"I think this independence question is completely wrong-headed. First of all, you are a director who is equally responsible. How then can you be independent of the company? You are responsible for what happens within that company and all directors*

*are responsible. You are involved. Inevitably, you want that company to perform well. Now as a non-executive director you have a broad experience and you can give advice to the other directors because you are in that position. You do not have to be told that you are independent.”*

Respondent 10

*“I have never thought that a non-executive director was totally independent. After all, you have committed yourself to the company. Your responsibility is to the board, and to the success of that company, so I have always stood aside from the sense that you are completely independent.”*

Respondent 08

*“If you had total independence, quite frankly the thing would not work. If the executives and the non-executives work totally at arms length and at daggers drawn, it would not be good for the company. Nevertheless, one has to keep an independent mind, appreciating that one is working towards common objectives.”*

Respondent 22

It was obvious that the interviewees regarded independence as a very important personal quality or competence, (or perhaps as a *threshold competence*, see the discussion of the responses to **Question 7c** above), rather than as state to be determined by demographic checklists on the lines of those proposed by PIRC (Pensions & Investment Research Consultants, 1998). The author asked Sir Adrian Cadbury whether it might also be true to say that the definition of independence in the Code is also mechanistic rather than competence based (see Appendix attached).

Sir Adrian replied that he did not agree with that interpretation. The Code had said “*The majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement*”. Issues might be brought before the board in which a particular non-executive director had an interest but that did not mean that he was not an independent director. His or her position could be safeguarded by dropping out of the discussion of that particular issue. What the Cadbury Committee had in mind when they drew up that second part of the definition were those company advisers like bankers and lawyers who might have a professional interest in the company and could not be said to

be independent in that sense. They were not thinking of other types of relationships like cross-shareholdings, which is one of the issues listed in the PIRC definitions.

But Sir Adrian thought it was inevitable that people would then start drawing up these lists and he agreed with the view that PIRC's list was too mechanistic. He agreed with the respondents and saw independence as a subjective quality. He questioned how the quality could be tested by the selection process. The answer was to look at reputation. Sir Adrian had put forward an idea, which he categorised as 'slightly fanciful', that all directors coming up for nomination should make themselves available on the internet for interview; shareholders could see them personally and ask them questions.

The respondents very strongly rejected the implications behind **Question 8**. The respondents saw independence as a personal attribute or competence without which non-executive directors would find it impossible to meet the demands placed upon them. The majority view was that since independence was a personal attribute, or a 'state of mind' as the respondents themselves preferred to describe it, so it could not be diminished or threatened in any way.

**Question 9 : Are we moving towards a situation where we have professional non-executive directors?**

About 70% of the participants thought that it would be undesirable if the new corporate governance framework led to the growth of a professional cadre of non-executive directors.

*“In so far as it happens, I see it as undesirable because if you need a portfolio of four directorships to support your way of life, then you will be dependent on all four of them. The crucial thing is not to be dependent on the income. That means wholly or partly dependent. Any form of dependence takes away independence.”*

Respondent 35

*“I have actually had ten years of being a professional non-executive director and I can say that it has been thoroughly enjoyable. But I actually don’t believe that this is the answer. An awful lot of people were brought in in the early days, like myself, because they had financial expertise and qualifications and that was seen as a sort of basis for a sound independent non-executive director qualification. I think that has changed very much and I think that it is right that it has changed. Nowadays the emphasis is much more on people who have had good and ongoing broad managerial experience. You have got to find the right people, and they have got to make the time available. They are likely to be in full-time employment.”*

Respondent 14

*“You may be right in hinting that this might be the way the wind is blowing, but I hope not. A lot of people are either retiring earlier than they used to or being retired at an early age, and for those people just to put their names down as potential non-executive directors is not the right answer. They have actually got to have something to offer, they have got to be of some good to the company, not just because they have retired early.”*

Respondent 15

Those holding the minority view were relaxed about the prospect.

*“I do not have any fundamentalist view, provided the person concerned is capable and has a sufficiently disciplined approach, intellectual and psychological approach, actually to behave with integrity and loyalty to one organisation. To take an analogy, you are getting to a situation where the non-executive director might almost be like a partner in a law firm, who acts for several clients. Part of the trick is to persuade each client of his unqualified devotion to that client’s business, to the exclusion of all else. Solicitors manage that and other professional people manage it perfectly well. They can compartmentalise their lives sufficiently well, and I see no reason in principle why non-executive directors should not do the same. But you have to draw the line, of course. You can spread yourself too thin.”*

Respondent 31

*“On some of the boards I have seen that, yes. I think there is a role for both the professional non-executive director and the person who has a full-time job, the person for whom the non-executive directorship is simply part of his wider range of interests. There are different experiences which they can offer. They each have something to offer.”*

Respondent 11

The principal arguments put forward against having professional non-executive directors with wide portfolios of directorships are set out below.

First, boards required balance; there was a need for a spectrum of non-executive directors with different things to offer :

*“There are such people. No. I think you need every sort. It is a matter of judgement whether they are going to do the job well but in the end this is tested by how well they perform around the table. It follows that the board should be equally fearless in dispensing with a non-executive director who proves to be not good at his job. But I don't think we need to go to professionals. I think people should come from all walks of life. What I do fear, is that the perpetration for of the current wisdom, which is that a non-executive director will be of most value if he has been an industrialist, I think that is nonsense. Yes, having been an industrialist he will be someone who will understand what the chief executive is trying to do them, but industrialists do not have a monopoly of the state of mind which you and I have been discussing. You need to search in other domains as well.”*

Respondent 26

*“No, I don't. Just as I don't like full-time professional politicians. This is because I think their value lies in the breadth of experience you get from other fields. This brings most to the role. I am a director of quite a wide range of companies and I find it quite extraordinary the way which the experience gained in one company is transferable to another. You do not set about deliberately saying ‘how do I apply this?’, but you do find that the situation arising in one company does have a parallel in your experience in a completely different field, and perhaps in a completely different country.”*

Respondent 19

Second, boards needed non-executive directors who could offer specific contributions :

*“No, I don't think I can see any such trend. Companies choose non-executive directors basically because of their experience in the related fields. They usually bring a specific contribution with them.”*

Respondent 30

*“ ...what is going to happen is that we are going to develop specialist non-executive directors. You will have, for example, non-executive directors who will only serve on audit committees and ones that will only do the Turnbull type of overview. I suspect that that is what may happen. The choice will be related to their personal backgrounds. I cannot see any other way in which it is going to be resolved. And I*

*fear that this is going to create a professional non-executive director cadre.”*

Respondent 19

Third, it was essential to keep contact with the executive world; professional non-executive directors got stale and experience was a wasting asset:

*“No, I don't because I think you lose some of the spontaneity and the experience. Those sort of people become stale and out of touch quite quickly and the essence of the job is having a broad experience which is brought to specific situations. The best non-executive directors tend to be those who are at the top of their own businesses, a chief executive or a very recently retired chief executive. My feeling is that if you get a professional I think they could become slightly pompous and lose their independence.”*

Respondent 02

Finally, and echoing an argument already covered earlier, it was felt that if the non-executive director relied on the financial incentives, independence could be threatened :

*“I am not so sure about that although I suppose you could argue that I'm making a living out of it, at least adding to my income. I don't need to work but I do it for the fun of it. I would go totally mad if I didn't. You have to do something, even if it is less demanding. But I don't think I would welcome the idea of a wholly professional non-executive board. I think if you had directors who were only dependent upon their fees I suspect that you would not get the same level of independence. As far as I am concerned the chairman of the companies on which I sit has my resignation to use any time he wants it. I think that is very important.”*

Respondent 23

The minority view was based mainly on two arguments. First, professionals would have the time to give proper attention to the job requirements :

*“Well, in fact I am really in that category. I think you reach the stage, later in life, when you can do that. When I was a chief executive running a major business, I had precious little time to give to any other enterprise. Later in life you are still mentally quite alert and I think I have made my best contributions as a non-executive director since I passed the age of 60. There are two reasons for that. The first is that you can actually give more time to the job and the second is that because you are on a number of boards, you can bring best practice information to all of them.”*

Respondent 08

Second, in direct contradiction of the view that the knowledge gained through experience would leach away, an opinion was expressed that multiple directorships could actually lead to cross-fertilisation of best board practice :

*“... that was based on what I had learned in the other companies. I sat on six audit committees. There was no doubt at all that I was bringing my experience in one company to another. It was extraordinarily useful.”*

Respondent 09

The academic discussion of the professionalisation of the role of the non-executive director, which has been conducted mainly in the US, has been discussed above. Sir Adrian Cadbury suggested that one of the main arguments against the idea was that it could lead to a loss of identification with the client board. This was linked to the question of involvement. Non-executive directors should be people who believed in the business of the companies on whose boards they served and who wanted to help to make that business succeed. Impartial, professional appointees would be more likely to act as consultants rather than as directors (see Appendix attached).

The general view was that it was unlikely that the Combined Code's requirements would lead to a growth in the cadre of professional non-executive directors.

**Question 10 : What is your view of the proposal for the appointment of a senior non-executive director? Will problems arise from the Code's requirement for this appointment?**

Opinions about the value of the role of senior non-executive director were evenly divided, with a very slight majority of the participants being in favour of the appointment.

The arguments of those who were against could be categorised under three heads. The most frequently expressed view was that the appointment could be superfluous where separation of the posts Chairman and CEO was already in place :

*“I’m strongly opposed to this appointment. If there is a non-executive it is an inherent duplication. Now if there is not a non-executive chairman, then in my view the company ought to have one. That is my position. I do not regard this as a sensible proposal. It would not have been in the report if I had been drafting it. I would be much firmer on saying that you must separate the chief executive role from the chairman’s role.”*

Respondent 17

*“I think it can be very difficult. I can envisage a situation where it can be very difficult. I think it might work where you have still got companies which are run by a chairman who is also the chief executive. But where you have got an independent non-executive chairman and a separate chief executive I think it is absolute nonsense really. I can’t remember who introduced this one. I think it was Hampel. I cannot understand what it is trying to achieve unless it comes back to the point I made about the chairman and chief executive.”*

Respondent 23

*“Well, I think there has been some muddled thinking. I think it is driven by this preoccupation, which is a correct preoccupation, with the combined roles. I think that the Code’s attitude to the combined role is correct. But if you do have the roles of Chairmen and Chief Executive combined then you do need something like a senior non-executive director. These are the only circumstances in which the role could be useful.”*

Respondent 28

Others thought that the appointment could be divisive, that it was an unnecessary diversion which could challenge board authority :

*“Well, I think it is a bit of a nonsense, to be perfectly frank. The only environment in which it is relevant is where you have a combined chairman and chief executive. Then I think there might be a case for a senior non-executive director. But the thought that I, as non-executive chairman, might be regarded as not independent appals me. I think it is a nonsense. I think this can be divisive between the senior non-executive director and the chairman for a start. What is the role of the chairman if he is not going to be the senior non-executive director?”*

Respondent 28

*“I can see the theoretical advantages. When there is a crisis, you will know who to contact. But for most companies, there is not normally a crisis and I think the appointment cuts across the idea of equality of responsibility. Also, I think it is*

*hierarchical, in that if people follow up on it they will tend to take the senior most important person. It used to be a noble lord, but nowadays it might be the person who has been a chief executive, and I think on balance it is not a good idea ... They all looked at me, because I happened to be the oldest and I said no, it is ridiculous, it is a sort of militaristic approach, 'senior officer present', you know, everyone else shuts up while he speaks. ... We will report that we have discussed it and come to the conclusion that we are not going to make this appointment. To summarise, I think the main objections to it are two. The first is that it is hierarchical, and let's face it younger, junior men and women often make just as great a contribution as the old and bold, there is no correlation with age. The second is that it chips away at the objective which should be pre-eminent which is maximising the value of the shares in the market because of the dialogue between the chief executive/chairman and those who represent the market."*

Respondent 13

*"Well, it is undermining the role of the non-executive chairman. It is superfluous or rather, it is either superfluous, or it implies that the existing chairman is not up to the job."*

Respondent 17

A final group suspected that they could see the hidden hand of the institutions. They believed the proposal was just a sop to institutional pressure :

*"I don't know why they wanted this appointment. It seems to me to be just another idea coming from the institutions."*

Respondent 27

*"I think it is probably, and I'm being a bit provocative, some idle City man who thinks that it would be much easier if he was able to ring up Jim or Bob and know who to speak to or establish a relationship with. The other objection is that it dilutes the main dialogue with should be between the executive or the chairman with the market."*

Respondent 13

Those in favour included one or two who had been converted after the requirement had been introduced by the Code :

*"It is not a job that you will want to have on the board until you have actually made the appointment. When you have experience of the appointment and you find yourself in a situation where the appointment has not been made, you wish you had one."*

Respondent 26

The main arguments of those who supported the proposal were, first, that it helped to form a consensus among non-executive directors by creating a focal point, around which the non-executive directors could congregate.

*“ ...it is a good idea because it takes the politics away from the other non-executive directors. There is a clear leader who can put his point of view and we all have the opportunity of accepting or rejecting it. Where you have five non-executive directors, all fairly out-going business people, it is sometimes quite difficult to get a consensus of opinion. It is just like a chairman, someone who says let's look at it both ways. I think the senior non-executive director is the one who does the most work, generally speaking because he is at the chairman or the chief executive's beck and call. Before decisions are made he can be approached and the matters discussed with him. He can be asked whether he has knowledge of anything similar being done by others and he can be asked whether he can find out in the marketplace what has gone on in similar circumstances and whether this will be acceptable. I think it is a good role.”*

Respondent 24

*“ ...it provides a focus if there is an issue, rather than have people making their penny's worth in an uncoordinated way. If there is a senior non-executive director, who can act as the focus for opinion and reflect that in a coherent way, I think that is a good thing. So if shareholders are concerned about the management of the business and want to make those concerns known, then having a senior non-executive director actually gives them a focus for those concerns.”*

Respondent 11

*“Well, I am all in favour of it because I have had experience of it in one of the companies. It was his job to gather his colleagues together, it was up to him to fix the date with his colleagues and it was his job to arrange the company review to which I referred earlier. In the other two companies all the other non-executive directors were mostly on a par. But my experience in the first company taught me that it was a very useful appointment. I think the director concerned was paid a little more than the others but he did have this extra responsibility. He was able to speak for them in the board meeting.”*

Respondent 15

Second, that it recognised status, with the representative emerging naturally.

*“The tendency I have seen is that senior non-executive directors are usually those with the longest experience with the company. It is almost a recognition of their status within the board.”*

Respondent 25

***“I think it is one of those things that just happens. Insofar as there is a reason to discuss something among the non-executive directors, and you do not want to discuss it with the chairman, normally there is an individual who can be seen to be approachable, whether it is the deputy chairman, or the oldest hand on the board. So, I think the appointment naturally emerges, and it is not necessarily the same person every time. Separate occasions might need difference skills and different people.”***

**Respondent 06**

Third, there were those who thought of it as a mechanism for handling crises, a fall back position which acted as a contact point for shareholders, when things were going wrong.

***“It is a useful method for communicating, say, with an institution that is worried about something. They then know who to go to. On the whole I think it is a positive move.”***

**Respondent 22**

***“I am very much in favour of the concept, for two or three reasons. These are mainly from my own experience where I have had to be in the role of being of the senior non-executive director on perhaps five different occasions. Three of those occasions were in a formal position and twice where there was not a senior non-executive director and it fell to me to take on the role. All these occasions related to dealing with crises. It was usually to do with succession rather than anything else. I found the role was easier to carry out if you were identified.”***

**Respondent 02**

***“In the case of XXX, I have been appointed as the senior non-executive director for the past couple of years. I have to say that, so far the institutional investors have left me, mercifully, alone. To be honest, I am not sure whether this is a good thing or not. I can see that if things are not going well and the board has concerns, and the directors can see that the concerns are not being met by the chairman and the managing director, there could be value in having a final court of appeal, a fall back position.”***

**Respondent 32**

Some of the participants saw the paradoxical nature of the appointment. If the board needed to put it to use, then it was probably an indicator that something was seriously wrong for which more drastic corrective action would be needed.

*“We talk on the telephone from time to time if we have one or two issues we need to address, but we do not have separate meetings. I think this could be divisive. I have not encountered any problems, but you have to remember that this is a relatively new creature, as it were. I think it could be much abused. I think that the institutional investors should relate to the company through the chairman or the managing director, but there is no harm in having a safety conduit in place. But you have to recognise that if they feel so strongly and it has to be used then everyone has to realise that the issue is really serious and you better do something about it.”*

Respondent 32

*“Our view is that so long as you have a good board with a number of truly independent people then it will emerge which of them needs to take the lead should there be a problem with the chairman. We had a full debate on the question at XXX in front of the chairman. We've all agreed that it was wrong to give one person that responsibility. We were of the opinion that it tended to challenge the authority of the chairman. The chairman already takes on the responsibility of having informal, off the record, chats with each non-executive director to make sure that they were saying what they really thought and that they were not holding back on opinions that they were not ready to express in the full board meeting. ...I think it is that some chairmen had been found wanting in demanding situations. Instead of allowing such matters to be sorted out by those who are suffering from the situation, this idea has come up of having someone else who could be represent the non-executive views. If you need to have such an appointment, then you have the wrong chairman, in my view. At XXX we are very happy to have a lead from an individual non-executive director when it comes to individual subjects. We do not believe that to have one of them singled out, other than the chairman, is appropriate. That is what the chairman is for. He is the key man who has to pull everybody together. That is our view and I fully agree with it.”*

Respondent 18

*“First of all, the person to whom the institutional investors should be expressing disquiet is the chairman. So we are actually only dealing with the position when the chairman himself is under attack. At that moment, you find that they have got to talk to someone who was actually appointed by the chairman, who has obviously become very close to the chairman. If I was in that position I have always wondered why the institutions don't say, ‘We want to talk to the whole board and get their opinions’. It seems to me that this appointment is self-defeating. You are saying to this senior non-executive director, you have got to carry the black spot in. I have carried the black spot in myself on occasions when the chairman had to go, but I was not the person who would normally have been designated as the senior non-executive director. But I was the person who was actually sufficiently concerned to become the ring-leader. You need a different person for different circumstances. The board tends to produce its own black spot bringer when the chips are down. Designating him in advance is not exactly helpful.”*

Respondent 09

Sir Adrian Cadbury (see Appendix attached) pointed out that his Committee had envisaged that this appointment would only be required where the posts of chairmen and chief executive were combined. The Cadbury Report said “*Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognised senior member*”. The Hampel Committee then proposed that the appointment should be made even where the posts were separate. Sir Adrian expressed the view that the decision of the Hampel Committee was questionable.

Subsequently Hermes had taken up this idea and said it was an excellent proposal, the Code having laid down that the senior non-executive director should be available for consultation. Hermes’ suggestion was “*Establishing direct channels of communication as a matter of routine should enable difficult issues to be aired before a crisis develops*” (Hermes Investment Management Limited, 1998). Sir Adrian thought that that suggestion could lead to divisions. The fact that someone was identified to whom outsiders could turn in a formally recognised way was sensible. Sir Adrian was fearful that if the institutions were to press down the route proposed by Hermes, then opinions might change and the appointment could become controversial.

There was some support for the view that the Combined Code’s requirement that boards nominate a senior non-executive director would create divisiveness within boards, but the majority view was that divisiveness was only likely to result where there was separation of the posts of chairman and CEO. If there was duality, then the post of senior non-executive director was seen as having a potential for enhancing board performance rather than being divisive.

**Question 11 : Does the fact that the balance in board composition is progressively moving in favour of non-executive directors diminish the advantages of the unitary board structure? Might the changes lead to two-tier boards?**

Nearly 80% of the participants did not believe that the unitary board was under any immediate threat. However the minority of participants who did believe that the changes in corporate governance were leading to a two tier system saw this prospect as a clear and present danger.

*“I do think that that is a danger. I think the business should not be whipped by the institutions or the newspapers. I favour the unitary board. Under no circumstances can you have two boards. It just does not make any sense at all.”* Respondent 24

*“In so many of my replies to your questions, that has been my concern. I believe that the unitary board structure is imperfect, but it is the best that there is. I am very clear about that. I believe very strongly that the European system with a supervisory board, and I saw that at first-hand during my time with XXX, does not allow the directors to get involved in the business at all. Then you really do have a gap in your information flow. ... One of the dilemmas about the unitary board, but still it is one of its strengths, is that you have all the executives present and although, in practice, they do not like to speak up against the chief executive, nevertheless they have a platform to do so. Therefore when you get to really critical decisions, for example where the executives have got together and only narrowly agreed to put forward a proposal, if the board were not informed that this was a very narrow decision of the executive, you do not have the ability properly to assess the decision. It is not an easy, or a pretty, process at times but on narrowly based decisions I have often seen, quite rightly, executive colleagues break ranks. They have listened to what the elders and betters, represented by the non-executive directors, are saying and they have had the confidence to speak up.*

*... I am concerned that the pendulum has passed halfway towards the non-unitary position. I think this is has been a by-product of the governance process. Whether the initiators were wise enough to see this I'm not so sure. I'm sure that the Cadbury process certainly set out to give different roles to the non-executive directors and the executive directors and that it did not understand the essential point that the responsibilities were the same. Perhaps they did not understand how the changes might*

*polarise things. ... I find that almost all the non-executives I talk to would share my views to a greater or lesser extent. They see the issues.*”

Respondent 10

*“...there is a danger there. We might be getting a two tier board through the back door rather than through the front door. It is the way in which the institutions are acting which creates this division and the key has to be that if you are the chairman of a board committee you ensure that your committee is not in a confrontational situation with management.”*

Respondent 02

Those, in the majority, who did not see a threat were much more sanguine about the current situation.

*“The European system? There could be a danger in this. I think, on the whole, the unitary system has had more benefits than it has had disadvantages. You have to recognise that the American system is spreading over here, which is to have more non-executive directors. Whether this means better performance or not as an open question. ... I think the unitary board system is robust and strong in this country and not under any immediate threat.”*

Respondent 32

*“No, I think that is not likely to happen. I do not think it is the trend. I think we are finding a way of making the unitary board work better. I am definitely of that opinion and indeed I think that is the trend overseas as well. ... I think the unitary board is alive and well in this country. I think it has definite advantages over these other systems.”*

Respondent 35

*“You mean more towards the German system. Or the American. I have always been against those models and continue to be against them. The directors of the business should be the people taking the prime responsibility and who report to the shareholders for the performance of the business. I believe that the British system, where we have a healthy engagement between the executives and the non-executive directors, is the best way of achieving that responsibility. I'm not a fan of having a sort of advisory council who are pontificating over reports which are presented to them historically and have not been involved in any debate on where the businesses is going. What are they doing? There are just sitting there are like Pontius Pilate in judgement on what they believe is right. I believe that this does not lead to the healthy interchange which the current board structure has developed. All the trends over the last few years towards bringing on more and more professional non-executive directors to give balance to the board is absolutely right. It is down to leadership from both executive and non-executive directors to make sure that the board is not split. I do not see any particular*

*evidence in the companies with which I'm involved that this split is happening at the present time."*

Respondent 20

*"Whether the other system is better or not, I have no idea. Every country has its own way of handling problems. But I do not believe that we are necessarily threatened. I know that some people do think this and I appreciate why they think it. But I believe that we can still preserve the unitary board. Maybe either system could work but the unitary board is a system we have had bound in our law for a long time and I doubt if the other system produces markedly better results. ... It is interesting, isn't it, that people in other countries, like Holland, often say what a wonderful system the unitary board is. Whereas we sit here and say what a wonderful thing the two-tier board is. The other man's grass!"*

Respondent 09

In their responses, the participants identified a number of advantages inherent in the unitary board system.

First, as a single forum, it allowed flexibility and informality. Since directors were all equal there tended to be non-divisive, healthy engagement.

*"All directors should be equal around the table. That is what the board of directors is all about. It is about a group of people coming together, making decisions on behalf of the company."*

Respondent 24

*"Again, this is an excellent question, but I don't think we are moving towards the two-tier board structure like the continental model. I just think that the executive have to realise that they can't get their way on things without proving it and that if they push and get their own way on a decision against sceptical non-executive directors and it goes wrong, then they are in trouble."*

Respondent 26

*"The view I have formed now is that you should have enough non-executive directors so that they have sufficient strength to act properly. So just having a chairman and chief executive is not right, but equally you don't want a baronial structure where every part of the group is represented on the board, because all they do is argue for their own corner. As in so many of these things, it should be a careful blend according to the business you are in."*

Respondent 08

Second, it had given rise to a robust, proven system. Improved performance followed, because small groups were better able to perform, while large groups tended to play politics.

***“Funnily enough I did go through a period of thinking that it was quite a good idea, the idea of having two boards. I remember in one of the companies where we had management problems a few years ago and we had to sack quite a number of the directors, I was finding myself arguing in favour of this separation of the non-executive directors. I think however that the final experience was that we actually achieved what we wanted to achieve. We, the non-executives did succeed in sacking the chief executive and the finance director and I think this would have been somehow more difficult and it certainly would have been more divisive if we had not all been there in the same room pulling together.”***

Respondent 23

***“So I think that, in a way, emphasises the merits of the unitary board, that there are critical minds at work with the executive in the decision-making process. You would not get that in a supervisory board structure, where so much of the decision-making process is taking place one level down. So I think the unitary board is still strong and we are not moving away from it.”***

Respondent 26

***“I think this is a danger, yes. But if we do go in that direction it will not help the performance of a company. Everyone would start playing games. The downside would be that the larger the group the more people would start playing politics. This is the big downside of very large boards.”***

Respondent 03

***“I feel that the unitary board is something that is very, very strong. All non-executive directors are aware of the need to retain it. You remember that there was such opposition to the idea that the remuneration committee should report direct to the shareholders. Now that was opposition that came from the non-executive directors. They said this is absolutely wrong. We are members of a board and the board is fully accountable for everything, the board has to report to the shareholders. The remuneration committee should not do so. There was a real anxiety to preserve the unitary board.”***

Respondent 09

Third, as a result of the corporate governance changes flowing from the Cadbury nexus, the committee system had strengthened unitary board and outside interests were better represented.

***“Our traditional system has changed a lot, some banks and insurance companies used to follow the American model, I don't think intentionally, you had the good and the great and then the chief executive and the actuary and nobody else. They were on duty and deferential all the time. Noble Lords and retired army officers. But I do not believe that the unitary system is inherently any better unless it is because of the overall numbers and because of the committee system which has developed following Cadbury where in fact the non-executives are in the majority.”***

**Respondent 13**

***“...the balance should be more towards the non-executives. I have no doubt about my views on this. There should be a majority of non-executive directors. Having said that, if they ever grouped in that way it would be very rarely, for example, to sort out some major problem and the important thing would be to get that problem talked about early enough to get an immediate impact. One of the things I have noticed is that people are involved within community work and the plus of that is that they bring a different dimension to the risk management side. I have been impressed with that. The surveys show that the customer, the citizen, is asking for more social involvement on the part of its company rather ahead of other issues. I think this is why Turnbull is so important.”***

**Respondent 21**

The disadvantages inherent in the UK model of the unitary board system were also identified in the discussion. There was a need to preserve a good balance. Too many non-executive directors might stifle the executives, or give a free hand to the ambitious CEO.

***“Management must be involved even if they are not voting. At XXX where I am the chairman of the audit committee the executives are pretty well all present when we have a meeting of the committee and will answer as appropriate. They will leave the meeting if some secret discussion is necessary but we try to ensure that there is not a confrontation. There is a risk that if you keep them out, they feel that they are second-class citizens.”***

**Respondent 02**

***“...there is a great deal of merit in our unitary board system. I think it is a well proven model. But I can see that if you just have one or two executives and half a dozen non-executives then potentially you are playing into the hands of the power hungry chief executive again. Whereas if he has other people around the table who are as familiar, if not more familiar, with the company's business than he is, then that potential misuse of power is not that great.”***

**Respondent 28**

Some thought that the power base of the executive committee meant that, for all practical purposes, the unitary board actually already had two tiers.

***“In fact, I think the truth of the matter is that there has always been a two-tier board in any company. There are always board-type tasks which are carried out either just by the executives, or by the executives and a small caucus of non-executive directors. Whether that is a formal structure or not, it is a fact of life. I think that is always there. There are non-executive directors who are ‘in’ with the executives and ones that are not and that does not necessarily mean that they are more less independent. They are just people who are on the same wavelength as the executives and they tend to consult more with them. I don’t know whether those have been helpful comments. I would hate to see such a change happen formally. I think there are great merits in our existing system.”***

Respondent 19

Others thought that boards should be given the option to choose which system they adopted.

***“I’m against the unitary board or rather I am not totally against the unitary board but I am in favour of allowing companies to have a two tier structure, if they wish it. I have spoken about this over the years. Why can’t companies have the option? I have never served on a substantial board where there was not, in reality, two chambers. There would always be a forum where the chairmen would meet with the executive directors, probably weekly, certainly more often than the board meets, and I have never served on a major board where the non-executive directors did not caucus separately, with the chairman and sometimes with the chief executive on a regular basis. ... I think there should be a supervisory board and an executive board and you should define it by separating the responsibilities of the directors. The difficulty at law in this country is that all directors are equally liable. There is no separation at law between the executive and the non-executive. This leads to executives failing to function as directors and to non-executive directors failing to be able to operate properly as directors because they are not in full possession of the facts. ...I think you would have to recognise different levels of responsibility for the two chambers.”***

Respondent 17

There were other views expressed by the participants which had direct bearing on the current debate on possible changes to UK company law. Some of those views are grouped below under various heads.

1. The attitude of the UK government, and of the institutions

The UK government was thought to be biding its time until proposing a move towards a continental two-tier system, and there was a feeling that it ought not to interfere. There was also a suspicion that the UK institutions were pressing for change, but that they had no track record which might justify their involvement.

***“I think there could be (government pressure in that direction). Yes. I think there will be a number of pressure points coming from the DTI on a number of issues. I think that probably in this parliament they don't think that it is worth the candle and they will keep their powder dry and see how things shape up and see how we...conduct ourselves.***

Respondent 34

***“Anything is possible under this government with the type of nanny state administration which they believe in. But hopefully in their next term we might be able to convince them that there is balance to be achieved.”***

Respondent 20

***“The two-tier board would be a nightmare. The institutions are pushing this and they can't run a company. None of the people who are proposing this sort of thing have got any track record. ... But I do know that when a government starts interfering in business that is even worse. I am completely at one with Hampel over this. I think for all the right reasons you have got to put in controls and procedures but you can go over the top.”***

Respondent 24

2. The American model

The American model was a unitary system. There had been abuses in the US. Also, higher salaries were paid than were usual in the UK and Americans were not so status-conscious.

***“ ... I think we are moving in the direction of the American model. I think however we do have a greater strength here. In America the situation is rather different with the non-executive directors having share options, and they have fairly high salaries, some of them. I think the balance of salary, give or take a few thousand pounds, is about right in the UK. I know that there is not one of my companies that I could not quite happily walk away from without a personal problem of any sort. This helps your independence. So I think I would not want to see the remuneration pattern moved in***

*the direction of the Americans. On the other hand, I think the American model for the structure of the board is the correct way. ... I think you find that more and more presentations are given to the board by individual divisional heads. This means that they get exposure to the board, they get to know the directors, and they get a chance to say their piece and to answer questions as well. They do not have to be members of the board for this to happen. This seems to work extremely well.”*

Respondent 25

*“Yes, but of course the American model is also well proven. But you do get some extraordinarily powerful combined chairmen and chief executives. When it works, everybody praises it and says how good it is, but then there are many abuses there and I am not sure that this is a model which we can take as something we should aspire towards.”*

Respondent 28

*“Well, we may be going (towards the American system), but I hope we are not. How can you run a board without executive directors? You don't know what is going on. We talked about control a moment ago. How do you find out what is really going on? At least we have chit-chat with our executive directors. It is amazing what you learn and it is amazing how you can influence them. ... What happens if (the chief executive) is no good? We have seen one or two chief executives ousted recently, haven't we? How would you get him out? You would not know what was going on.”*

Respondent 12

*“In a sense you can look at the picture in a different way in America, where very few executives are on the board. They structure it differently. But there is a social difference between us and America. A lot of English managers aspire to be a director of a main board and they feel that they are failing or being overlooked if they are not appointed to the main board. Whereas in America they do not have that same hang up. You are the senior vice-president in an American Corporation and that is something you aspire to be. And something you are proud to be.”*

Respondent 02

### 3. The Continental models

Some participants noted that the continental systems were themselves under attack and questioned their performance records.

*“If we are moving towards the German system, I do not think it would be an improvement. I do know a bit about that. I am very sceptical about the need for a second, supervisory board. It has not worked in Germany. It has held them back because it gives rise, in that country, to cross-shareholdings. I know quite a lot about it*

*from the insurance industry because I did work at the Bar and I was specialising in commercial law, which is my background and I saw it probably better at first-hand than even businessmen would see it. It was a barrier to entry and it was a barrier to take-overs. The Mannesmann/Vodafone take-over was long overdue. I did a paper for the Bank of England on this 10 years ago and it is 10 years later that we have had the first hostile bid. And that, of course, went consensual in the end.”* Respondent 12

*“ ...I do not see a change taking place in the majority of companies. If there is an end-game in that direction, then I think it is going to come from the European Commission. I would be against a move towards a continental system. If we are going to have worker representatives I think it would be better simply to have a representative of the workers with whom the board could communicate rather than somebody actually on the board.”* Respondent 22

*“ ...the experience on the Continent of Europe has not been a shining example in favour of the two tier board system. In Germany, it seems to me that their corporate problems come from this division of responsibility between the two boards, the supervisory and management, and I think that very often supervisory boards have been shown to have very little teeth.”* Respondent 02

*“Personally I am totally against two tier boards. They are incredibly wasteful of time. You are seeing it in Germany and other places now. Their whole structure has become solidified and nothing moves. ... Well, there may be (company law changes on the way), but my view would be that it would be a retrograde step.”* Respondent 08

Finally, one participant took the view that, as we got closer to Europe, the Anglo-Saxon model would eventually prevail.

*“I do not see that the unitary board structure is under any kind of threat at all. In fact I think that it will become the dominant structure in Europe as a whole. I think that Europe will adopt the Anglo-Saxon model.”* Respondent 16

Sir Adrian Cadbury suggested that it was possible to for a UK board to set up whatever structure it thought appropriate. Company law in the past had said almost nothing about board structure so it would be possible to have a two-tier system, but it would not be the

kind of two-tier structure as recognised by European law. For example, a company could have an advisory board at one level and an executive board at another level.

For Sir Adrian, the most important point to emerge from these responses to **Question 11** was the identification of the need for constructive engagement between the executive and the non-executive members of the board. “*That sums up the huge advantage that the unitary board has*” (see Appendix attached).

There was little support for the idea that the increase in the number of non-executive directors would threaten the advantages of the unitary board structure and lead to a two-tier board system in the UK. The unitary board system was generally thought to be in robust health after the impact of the Cadbury nexus.

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**Interview with Sir Adrian Cadbury on 9<sup>th</sup> August 2000**

*AC : I have made some notes on your report, which I will go through with you, but I hope you will intervene and ask me questions whenever you want to.*

*With regard to the answers to Question 1, what I found encouraging was that over 70% of the respondents felt that board committees were necessary and that they had improved board effectiveness. I thought it was very interesting that the doubts about the process were that it was taking up a lot of time and that there was concern about meeting accounting requirements. It was interesting that the word used was 'accounting', rather than 'code' requirements. The implication was that this appeared to be acting against wealth creation.*

*The underlying question was whether committees were taking charge of the process. An answer to that is found in one of the responses to the second question. Somebody cited the case where the chairman felt that the nomination committee proposals had to go through. Now that, I think, is a very interesting point. Because this is where, I felt, Greenbury was quite wrong and the Combined Code got it right. Greenbury, if you remember, said that the remuneration committee should decide, that they would be the body who decided what the remuneration should be. Now in my view that was wrong. Okay, you might have a problem, and clearly the executive directors on the board have to declare an interest, but nevertheless in the end of the day it is the board that is responsible for pay. It is not the remuneration committee. I felt that was wrong and I was very pleased when it was put right in the Combined Code. It seems to me that that was perhaps what lay at the back of some of the answers to that first question. There should always be an understanding that these are committees of the board, that they are set up by the board, that the terms of reference are agreed by the board and that their recommendations go to the board. And provided you see them like that then it seems committees may add to effectiveness, looking back at a period when we virtually had nothing of that kind.*

**KG :** Yes, it's quite surprising that even within this group of major companies so many committees were created in that seven-year period which I was reviewing. Quite a number of the companies had none of the three main committees at the start of the period.

*AC :* That's right. In my own company, we had what we called a chairman's committee which was basically the non-executive directors and that committee dealt with matters like succession, nominations, those sort of questions. We did form audit committee but it was not all that long ago.

**KG :** What is your view about the point which is also made, that it has become a very time-consuming process?

*AC :* I entirely see that. But I think it is very difficult to see it a way round it. I think it ties up with a point that I would want to come back to in looking ahead to future developments. It seems to me that the fundamental change has been that the board is now the key-stone in the structure and I do not believe that that was true to the same extent previously. If that is true and the non-executive directors are going to accept their responsibility and be involved and want to make a contribution in various areas, then I do not think there is any way round this. I think what the committee system attempts to do is to deal with the potential problem, which is that you don't want to bog the board down in detail. But I still think you have got to be quite firm about the role of the committees and avoid two things. First, the committees have to avoid getting into too much detail and they must not cross the line between direction and management. Secondly, I think there is a danger, which some of the people concerned about it felt, that the committees would begin to play a bigger role in relation to the role of the board. This comes back to my point that they have to be seen as creatures of the board. They report to the board, so they must not be allowed to assume a life of their own. This is always an issue and always a danger, because it is much easier to get things done with a smaller group. It is a more congenial atmosphere.

*Basically I was very encouraged by the responses because I feared that committees would be seen as something where one just went through the motions. 'Box ticking', to use that dreadful phrase of Hampel's, which has come into use, so I suppose we have to accept it.*

*With regard to Question 2, I was equally very pleased with the improved clarity about roles. I thought the answers given were very interesting, particularly about the way the board is composed and appointments to the board. Understandably I suppose, about 40% said that not too much has changed, that it was done still on the old system. That fits, but the trend seems to be in the right direction. The last survey I saw on this question, about three years ago, showed that about 50% of board appointments still seemed to be determined by the chairman. But I think that percentage has now dropped. One of your respondents talked about 90% now being determined objectively. In other words, in their experience, the system had turned right round. All I think we can say is that the trend seems to be in the right direction and I find that extremely encouraging.*

*We made two points in our code. The first was that appointments should be made through a formal process and that meant looking at who you had got and where the gaps were and so on, and, secondly, that the board as a whole should be involved. So we seem to be moving much more towards that now. The issue that they raise and that some are very worried about, is the shortage of people that might come forward. It is obviously very hard to give a factual answer to that. All I can say is that when I was Chairman of PRO NED we had far more potential candidates than we ever had demand for places. We had a register of about 800 and the maximum number of*

*requests that we received in one year was about 100. But we had been through 10,000 people in order to get to the 800. There are a lot of people who want to do this work who are not particularly suitable. So simply saying that there are people who would like to be non-executive directors is not really answering the point. But my feeling is that if you do make it a responsible and worthwhile job, where you can feel that you are playing a genuine part, I believe it is of interest to people who seriously wish to make contribution. The changing pattern of life, for example, the number of people who are retiring early, means that I do not believe that there is really a shortage. For example, look at the potential provided by women.*

**KG :** I found those comments very interesting. I have talked to Peter Waine and to Bernard Taylor about this. Peter is adamant that there is no shortage of suitable candidates and Bernard has said why isn't the net being cast wider to include women and people from ethnic minorities and perhaps also more young people should be brought into the process. Perhaps the focus is too narrow and they only look at males of 55 plus.

*AC :* I think that is true. I can see that if that is the kind of person you are looking for then it might be true that there is now a shortage. But provided you take a wider view and look ahead at what is expected of the board then I think that might include more than just the older white male.

**KG :** On other hand one has to accept that these respondents are saying that there potentially could be a shortfall and they seem to believe it strongly.

*AC :* I think from what I've learnt from the people have spoken to about this, that it is still often the case that the committee prepares a list of names, and the headhunters do this too, and then they say that most of these are very busy people. Of course, that naturally follows from the way the exercise has been carried out. They may say that they would not possibly have time to take on the job. That may be true, but if it is, it means that you're not looking in the right place.

**KG :** Perhaps the headhunters play it safe by looking only at known lists of candidates?

*AC :* Yes they do, but that's probably because that is what their clients expect. But I'm sure that will change. There is no doubt in my mind that there should not be a shortage of suitable candidates.

*Question 3 is very interesting. 40% thought that they were able to make a greater input to strategy but the majority really felt that not much had changed. I think that is quite understandable and there is very interesting point to be made. This is that other studies have shown that if you ask non-executive directors where they think they can contribute most then they nearly always say in the area of strategy. This is the area of interest to them. On the other hand, if you ask chief executives where they think that non-executive directors ought to be contributing, the answer is that they should confine*

*themselves to rather boring areas and they don't want them to be involved too deeply in the strategic area. So you have a potential area of mismatch of expectations from the different groups. But what I thought was good about the responses to the question was that the people were saying that we are not here to formulate strategy but that we are able to help in developing strategy and I think that is right. I think that in the development and the review of strategy there is an absolutely vital role to be played by the non-executive director. I think of it in terms of asking the right questions. Someone in their response uses the word 'probing' and I think that's good. I think that is probably the way it should be but there is a very interesting, slightly uneasy, feeling here of one party wanting to get more involved and the other wanting to keep them at arm's length.*

**KG :** Perhaps a weakness of the research I conducted, from a methodological point of view, is that I was looking at just one group, namely the non-executive directors, and I did not get the views of their executive colleagues or of their chairmen. I'm afraid the logistics of doing this make it very difficult. You can't get people to speak freely if you are then going to ask someone else to comment on their opinion.

**AC :** *You should not worry about that. It is more important for you to have got what you have managed to get. I have absolutely no doubt about that. Of course I understand the point you're making about the methodology, but we can get a feel for the other opinions through separate research. For example, I have seen some research with chief executives asking them some of these questions. You do not need to match the group within the same board and you must avoid the possibility that they will clam up.*

*To come back to the question of strategy it was interesting that the respondents threw into the answer the fact that they were certainly getting better financial control and they thought that they could do the job better because they were getting better information. This links back to the formality which has been introduced into the process by the code.*

*With regard to Question 4, I think it was understandable that in the debate on control versus advice, 50% felt that there was a shift towards more control, which I fully understand. There was a good comment, which said that 'influence' is a better word than control. I like that. That's what I would hope.*

**KG :** We can get hung up on words can't we? 'Control' is a pejorative word. 'Influence' is not so pejorative.

**AC :** *No. 'Influence', I think, is probably right. But nevertheless it is perfectly true that it has shifted the way in which they think. They now have to answer for their role. I think it is true that they would say that they now have greater responsibility in areas that would be seen as control, like financial management.*

*There are two interesting points in that same question. The first one, which is really nothing to do with the code, is that they are participating more in board activities. It was regarded as a natural process. I think there is a lot in that and I think that comes about from the fact that the role of the board is seen as being more significant and that, in turn, demands more participation. The second point was that the respondents said, yes, we are spending more time but we are spending more time on both control and on advice. I'm sure that is right. We are talking about a more demanding job in total and not so much of being pushed towards one aspect of the role or the other.*

**KG :** Coming back to the point that one of the respondents made that it was a natural process and that they were going to have to change whether the code said so or not, how far do you feel that you were swimming with the tide, as it were, that there was going to be this process anyway, that it was bound to happen. In other words, if you hadn't been around do you think that pressures from the media and social pressures might have produced these changes anyway?

*AC : We come back to that in the answers to Question 5. There you asked them what they thought had brought about the changes, what were the drivers for change. But going back to your point, the answer is yes, we were going with the tide. But at the same time I do feel surprised at the role which the code played in the process. I had genuinely anticipated that at the end of 1992, we had done a job, and we could all get back to doing something else. We thought that it was up to other people to pick it up. We looked particularly to the investors. We expected them to produce their votes now that we had played our part. It was a surprise to me, the momentum which the process then gathered. But for me that just emphasises the point about going with the tide. I believe the companies knew that something needed to be done. They weren't quite sure about the direction and we provided a steer at the time when they were looking for it. I think if you wish to give credit for the whole process it has to be to the Stock Exchange and the Financial Reporting Council who set the committee up. They had set it up because they were worried about the implications for London as a financial centre. There had been too many financial scandals. What was the point of having a company like Polly Peck formally audited when it then went down the drain! So there was an element of self-interest. I think the reason that I got involved internationally was that our report was the first written statement, it was the first document the people could refer to. I suppose that is not strictly true, because the Australians had already produced something, but ours was the first code that was formulated in a way that reviewed the issues, and put forward recommendations, setting out how they applied to boards and how they applied to investors. It approached the issues in an ordered and structured way.*

*However, there is no doubt that there was a tide at that particular point in time. It is interesting that we had a major investor on our committee and at the beginning he referred to it as 'your committee'. I had to point out to him that it was 'our committee'. Yes, he said, but I think I'll have to issue a minority report! But then, over time, he totally became involved in the work and became a very good member of the committee. So as an investor he had started from a position where he thought we were going to be*

*pushing things onto investors and he came round to understanding in the end that everybody was involved in the process together. So our work focused interests at a time when it was exactly right to be doing that. But I think the list of drivers that your respondents produced was great. Self-regulation, the need to put the house in order, scandals, social climate, institutions, improving efficiency, transparency, these are very good words to describe what was going on. As one of the respondents said "I think accountability and transparency are very good words. Responsibility is another ". That says it all.*

*The next question, Question 6, looked at whether non-executive directors can exercise the necessary vigilance. Very encouragingly, 80% of the respondents thought that they could. They expressed this view very confidently. Of all the answers to the questions you put to them, that, to me, was the most encouraging. Here we have the great majority of people saying, yes, we can do it. That gets us away from the box ticking, from any idea that they are doing it just to satisfy the rules, it gets us away from some of the cynicism which has been expressed elsewhere. These are the people who are actually doing the job. The answers to this question links through to Questions 7 and 8. These three questions are linked together. There is further encouragement in the fact that 80% of the respondents thought that the job was doable.*

*I was interested in the list of skills that they put forward as being necessary to do the job. I think availability was one of the points mentioned. This is an important point, in my view. I was actually interviewing some potential non-executive directors yesterday in London for a post. One of the points I was making about availability was that the job did not entail just one or two days a month. I had to point out that if a difficulty comes up you might be asked to spend the best part of your time for a fortnight on it. So you have to allow room for this. If you think back to the time when people boasted that they had a number of non-executive directorships, things have changed and today there is no spare time. Extra demands can arise at short notice.*

**KG :** I think the point that the respondent was making was that if someone is not available when they are needed then there is really no point in having them on the board at all.

**AC :** Yes, that's right. There is absolutely no point. This led onto Question 8 and I think some of the comments here are also very sound. There seemed to be a lot of common ground about independence, how important it was and how it was a state of mind.

**KG :** Yes I found this interesting because it takes us away from the rather mechanistic definitions which have been devised by some interested parties like PIRC. Perhaps it might also be true to say that the definition of independence in the code is also rather mechanistic?

**AC :** No, I don't agree with that interpretation. The Code says "The majority of non-executive directors should be independent of management and free from any business

*or other relationship which could materially interfere with the exercise of their independent judgement". There are of course sometimes issues in which you do have an interest but that does not necessarily mean that you are not an independent director. What it means is for that particular issue you drop out of the discussion. What we particularly had in mind when we drew up that second part of the definition were those company advisers like bankers and lawyers who might have a professional interest in the company and could not be said to be independent in that sense. We were certainly not thinking of other types of relationships like cross-shareholdings, which is one of the issues listed in the PIRC definitions.*

**KG :** But I think the respondents saw independence as a personal quality rather than as conformity with an objective list of requirements.

*AC :* We had to take the view that we thought that it was up to the board to decide who was independent of management and we had to avoid potential conflicts of interest. In my view I think this gets us away from having mechanistic lists and looks at attitudes. But I think it was almost inevitable and bound to happen that people would then start drawing up these lists. I'll come back to this point when I start looking ahead to the future. I agree with your view that PIRC's list is too mechanistic. Like your respondents, I do see this quality as a subjective one. Bob Monks and I have both spoken about this in debates. I remember Bob saying that he had one brother who would do more or less whatever Bob would ask him and another brother who would always be totally independent. This reminded me of my own brother. I have absolutely no doubt whatever about his independence of mind.

*So I have also supported a subjective interpretation of this quality. But how can you test for it? The answer is that you have to look at reputation. An idea I put forward at one of the Henley conferences was that all directors coming up for nomination should make themselves available on the internet for interview. You would have a chance to see them personally and ask them questions. It was slightly fanciful, but maybe we will move in that kind of direction in the future.*

*That leads us on to Question 9, the question about professional non-executive directors. 70% of the respondents thought that was undesirable. There have been people who have advocated this in order to get independent views on subjects like remuneration. They have proposed that there should be a group of people who do nothing but this kind of job. I don't think any of us really liked that idea.*

**KG :** A paper was published some time ago in America by two lawyers, Gilson and Kraakman, who argued the case for better governance on the basis of the development of a cadre of professional non-executive directors.

*AC :* There is another writer in America, also a lawyer, who has gone further than that and who has suggested that professional people should be appointed who would in turn be responsible for the appointment of directors who would put a board in place for a company.

**KG :** What you lose of course it is the experience which comes from having executives serving as non-executives of a board.

*AC :* Also you lose the identification with a particular board. This is linked to the question of involvement. You do require people who believe in the business and want to help make it succeed. Such impartial appointments would be too much like having consultants. They would stand back and not really be committed. Going back to the interviews I was conducting yesterday, one of the people described himself as being a professional non-executive director. What he meant was that he was no longer actively involved in business in executive capacity but he did have a number of non-executive directorships and it suited him.

**KG :** I suppose he had an independent source of income?

*AC :* Yes. It is of course difficult to make enough money out of a portfolio of non-executive directorships unless there is another income source. There is also the point that retired people cannot bring with them current experience of executive responsibility from other business and I think that weakens their position.

*Now to Question 10, on the senior non-executive director. I know this has not been a popular subject but I was quite surprised that you had a slight majority in favour of the idea.*

**KG :** Yes but most of those in favour only saw the idea as useful where there was duality. But in the Code this is a prescriptive requirement. You are required to appoint a senior non-executive director in all cases.

*AC :* Yes, but earlier on we had seen in our committee that this appointment would only be required where the posts of chairmen and chief executive were combined. What our committee said was “Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognised senior member”. It was Hampel who proposed that the appointment should be made even where the posts were separate. That was the questionable decision. I noted that subsequently Hermes took up this idea and said it was an excellent proposal, the Code having laid down that the senior non-executive director should be available for consultation. Hermes’ suggestion was “Establishing direct channels of communication as a matter of routine should enable difficult issues to be aired before a crisis develops”. I don't like that. It could lead to divisions. But to the extent that someone is identified to whom outsiders can turn in a formally recognised way, I think that's fine. I think the point is, however, that if the institutions press down this route then I think we will see opinions changing and that would certainly concern me.

**KG :** I thought an interesting point made by one of the respondents was that if you had got to that stage anyway, then you have got big problems.

**AC :** *That's right. That is the paradox. The respondent said it was a paradox. I agree with that.*

*The final question, Question 11 looks at the unitary board. It was very interesting that 80% of the respondents did not think that the unitary board was under any immediate threat. I think that's right.*

**KG :** It is perhaps worth noting that the Company Law Review Committee has said that it does not intend to recommend a move away from the unitary board at this stage.

**AC :** *Yes, but because company law in the past said almost nothing about board structure you could have a two-tier system but it would not be the kind of two-tier structure as recognised by European law. It has always been possible to structure your board in such a way that you could have an advisory board at one level and an executive board at another level.*

*The most important point for me coming out of the responses, was the identification of the need for constructive engagement between the executive and the non-executive members of the board. That sums up the huge advantage that the unitary board has. Someone else talked about interchange, which is really a variation on the same idea. We can come onto this when we talk about how boards might develop in the future.*

**KG :** Thank you. I am aware of the fact that I am imposing on your time. Perhaps we should move on now and have a look at how you see future developments in this area.

**AC :** *I would like to start with the point that the role of the board has changed. If we look back over ten years the board is now seen as answerable for the performance of the company. It is now seen to be accountable in a way which I do not believe was true in the past. In those earlier days performance was seen to be the responsibility of the chief executive or possibly the chairman. In other words it resided in a person rather than in the board as a whole. When M & S got into difficulties recently, people looked to the board. They did not think that the responsibility lay with any one person to sort it out. This links to the increased and increasing role of the institutions and we can come back to that point. The institutions clearly nowadays look at boards in ways they did not do before.*

*So that seems to be one change. The second change, which is allied to it, is that more is now expected of companies. That is to say, the range of issues which boards are expected to deal with has widened. Go back ten years and you would not have had issues like human rights and environmental concerns being raised at AGMs. You might say that ten years ago South Africa was a similar kind of issue. But there were differences. South Africa was a very special set of circumstances. It was an external issue. It was pushed onto the agenda by a small number of very vocal pressure groups. It was also a single issue. The sole objective was to get boards to disinvest. It is*

*different today. We now have the view that the board is the focal point for all these different kinds of issues confronting the company. There are many different kinds of stakeholder, representing different constituencies and the board is seen as the sole point at which these often conflicting interests have to be balanced. I expect to see this situation continuing. The board will maintain its position and what is pushed onto it for decision will increase. Expectations will continue to widen.*

*What are the implications of this for the composition of the board? I share the view that we will not move from the unitary board. The balance of non-executive directors to executive directors is changing. However, I would not expect this change to go as far as it has done in United States where all board members are non-executive, except for the person who holds the position of chairman and chief executive. In this country I expect the position to stabilise at around two thirds non-executive directors and one third executive.*

**KG :** You have probably seen that the new board at Glaxo SmithKline will have 14 members and 12 of them will be non-executive directors. Only the CEO and the CFO are going to be executives. But they are, of course, a very American orientated organisation.

*AC :* I think that will remain an exception. I do not believe companies in general are going to go as far as that. In my opinion, you should always have the chief executive and the chief financial officer on the board and, personally, I would like to see the human resources director also there. I realise this does not happen very often but it is a change that I would like to see.

**KG :** What your view about the pressures for change which might follow from closer association with the European Union? Might this lead us to change to our system?

*AC :* The legal responsibilities for the two boards in Europe are quite different. I think this situation of the involvement of employees on the supervisory board is illogical in anything other than a domestic company. A good example is Volkswagen. I think I am right in saying that 85% of its assets and 61% of its sales are outside Germany and yet the only employees represented on the board are German employees. This has two problems. The first is that they are there to represent the interests of the German workers and are not there to represent workers outside Germany. The Germans don't like discussing this, but it is a fact. That it is the legal position. So they have no interest whatsoever in, for example, the Brazilian employees of Volkswagen, and they certainly have no interest in moving production from Germany to Brazil. So you have a conflict of interest. Secondly, you also have a constitutional problem because the other members of the board are responsible for Volkswagen worldwide. So I think there are serious flaws in that kind of system. I'm not saying that employee involvement is the problem, the problem is the way you choose to address this in a constitution.

*The other aspect of the two-tier board, where the pressures are really coming on in Germany, is that actually it is very difficult to discuss strategy. Strategy is the province of the management board. If the supervisory board does not like the strategy, it can only do one thing in the end, and that is to fire the board. Now that is a very drastic step. I have actually faced that situation and we could not do it because it would have left the company absolutely trapped, so we continued with a situation that we knew was failing.*

*Another real problem is that in a period of rapid change, the supervisory board stands too far back. You saw this with Rover/BMW. The supervisory board at BMW was in a real fix. That was certainly part of the problem.*

*I accept that Blair might want to do a constitutional deal. But if you look at French companies, for example, it is not clear that the choice comes out for two-tier boards. I think there is just a majority on the French CAC of two-tier boards but it is certainly not a clear-cut choice in France. What I believe is that the two-tier board system will have to change and maybe what we will see is all of us moving perhaps slightly nearer together.*

*The final point I would make about the two-tier board is that it is very often not what it seems. There was a very interesting study of Lufthansa, when they were under competitive pressure from BA. They retained the formal constitution, but because nominations to the management board could only be made by the supervisory board, the chief executive formed other structures at the lower level, which the supervisory board could not interfere with. So you get back to the fact that systems are not always what they seem. I think we are in a period of change and I doubt whether we are going to be forced to sign up to the German system. To sum up, there will be change, but I'm not convinced that we are simply looking at two models as the alternatives open to us. We will not have to opt for one or the other.*

*Another development I can foresee will be that we will move towards virtual boards. Not every board member will have to turn up to board meetings once a month. Two years ago I did a video conference with a group in Brazil and I was impressed by how effective it was. The technology will change so fast in this area that I think you will be able to have board members in Japan or Latin America and at the same time retain the advantages of the unitary board system. It will change the way a board works.*

*A point which comes out of all this discussion is that the chairman's role will become more distinct. My reason for believing this is that, if I am right, there is going to be more focus on the board in the leadership of a company. Also, if it is the board that institutions will focus on if things are not going correctly, then I think the role of the chairman in making the board effective and the time and the skills required to do that, will differentiate the job even more sharply from that of the chief executive. That has been my feeling as to why it is not just a question of splitting the roles in order to balance the power, although that is obviously important. It is much more the fact that to make a board effective requires time, commitment and skills. I cannot see how you*

*can ask that of a chief executive who you are also asking to dash around the world, running the day-to-day business of the company.*

*I don't know how this might get resolved in America. I am open-minded on that. They are so committed to the idea of the dual role. But for us, this is a question of board assessment, board review and board performance. The chief executive can't do that. So I think this is another subject that is going to emerge.*

*Then there is the increasingly active role of the institutions. What interests me here is that where I believe the code did play a part was that the code did prepare the ground for this. We did address comments to the institutions. We said that institutional investors should disclose their policies on voting rights. What we said was “Given the weight of their votes, the way in which institutional shareholders use their power to influence the standards of corporate governance is of fundamental importance. Their readiness to do this turns upon the degree to which they see it as their responsibility as owners, and in the interest of those whose money they are investing, to bring about changes in companies when necessary, rather than selling their shares”. So in my view what the Code said, and this was of fundamental importance, was that we were not a committee trying to lay down rules and then arbitrate on those rules. We were saying that we have set up a series of principles and guidelines, that boards should use them to check where they stand and that investors should use them as their agenda for their meetings with boards. Soon after the report was published, I found myself being rung up by a company, and then almost immediately afterwards by the institution with which it was in disagreement and which did not know that the company had just rung me up. The company wanted to know whether what they had been asked to do was right and in accordance with our report and the institution was saying your report is going to be of no use if companies are going to behave like this. My reply to both of them was that it was up to them to sort it out between them. We were not here to sit in judgement. So what I feel we did do was to clear the ground for engagement between institutions particularly, but also investors in general, and boards. This if you like was the unseen role which the code began to play. But from our point of view, we had to step back from it and we could not become involved in disputes of this nature. We were determined to step back and we were not going to remain, despite the fact that a lot of people asked us to do this, as a permanent committee sitting in judgement. We were not going to become a referral body. Absolutely not. The responsibility was up to boards and shareholders to sort matters out between and they had to get together to do this. The good news on this front is that there does now seem to be a clearer view that active shareholders do create value. We have seen this in several recent reports.*

*Now moving on to the point about rules, I am concerned that out of all this has emerged a perhaps over-rigid approach. I think the way to use the rules which have been prepared by organisations like Hermes is to see them simply as guidelines and to be prepared to stand up and argue the case for exceptions. For example I have XXX my board. He is well over 70 and an absolutely wonderful man. I would have had no hesitation in arguing with anybody in public at the AGM or with individual*

*shareholders that XXX, regardless of his age, should continue as a director. I think companies should be robust in standing up for whatever they believe is right.*

**KG :** A similar view was expressed by some of the respondents who thought that the rules drawn up by PIRC could be applied too rigidly to the detriment of a company's board.

**AC :** *Yes it was. The way this has to go for the future is that boards should be more confident in their judgements and defend them. These 'rules' should be seen as guidelines, subject to interpretation.*

*The next point I want to make follows on from this. It is that the institutions will have to become more accountable to the people they serve. There could be interesting developments on this front in the future. Pension Funds are now being required to disclose their attitude towards social investment. Regulations have being brought in by the Department of Social Services which will make this obligatory. This comes back to the whole question of disclosure. If you have got to say what your position is, then you have to have a position in the first place. If you are going to have a position, then the people whose money you are dealing with are going to tell you what they think your position ought to be. I'm not saying that all members of the pension fund will want to be involved, of course they won't. But quite a few members of pension funds are concerned about the society into which they are retiring as well as about their pension and they are going to ask their pension fund to support the causes that they think are important to them. I'm absolutely convinced that this movement will grow. All the old arguments about the complexity of the business will begin to melt away, because the technology is now available to enable individuals to communicate, as members, directly with the managers of their funds through their screen. Of course it will not be many people and of course it will take time, but it will happen. I'm convinced about this.*

*The final point I would like to make about future developments in this particular area, and this comes back to my point about more being expected of companies, is that we are now going have this sequence of events. You ask pension funds to disclose an ethical dimension, they in turn then ask the question of companies and this widens the range of interests that companies have got to look after. Also it increases the pressure on pension funds to listen to their members.*

*Finally, I have two thoughts that arise from your research. One of the ways in which I think your research is important and invaluable is that it focuses on process, on the way the board actually works. My concern is that too much of the published work is on structure rather than process. Of course, structure is important but in the end it is a process that matters. It is a question of who is working in the structure and how they work within it. So I think it is research on the process aspects which adds value to a knowledge of boards. Such research is it at a premium and it is hard to obtain. I fully realise that. This is just another reason why it is particularly valuable.*

*The second thought takes us back to structure. I think it would be good if we had innovation in structure and if we encouraged creativity. We should get away from the thinking that there are just the two models we discussed earlier for the way in which the board of a company can be organised. I would like to encourage creativity in thinking about corporate forms. I worry about the fact that one of the concerns about the introduction of codes was that innovation and risk-taking might be stifled. This should not be the case provided we can find a way to have a range of corporate forms. The individual entrepreneur does not want a board, does not need a board. Provided that, if the public have been asked for their money, they understand exactly what it is there are putting their money into, I have no hangups about that. I don't want everybody to work to a similar system. So I would like to see a whole range of forms being offered appropriate for the needs of the individual entrepreneur through to the needs of the great corporate organisations, not feeling that we are constrained by the limited availability of any one model.*

**KG :** You might recall that one of the respondents actually proposed that people should have a choice between single and two-tier organisations.

**AC :** *Yes, I do remember that and I think that's absolutely right.*

**KG :** But you would have to have new legal structures, wouldn't you?

**AC :** *You would have to accept that many of these new organisations would perhaps not be public companies in the sense in which we know it, but would rather be businesses financed by risk-taking investors who accept that that is what they are doing and that they don't necessarily have the same legal protection that the present law would afford them.*

**KG :** Well thank you very much. You have been extremely helpful and I have taken much more of your time than I said I would.

**AC :** *Not at all. I found your research very interesting and I have enjoyed discussing it with you. I think it is the kind of research that companies can actually use, so I hope you will make an effort to have it published more widely.*

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**August 2000**