

## REVIEW of the ROLE and EFFECTIVENESS of NON-EXECUTIVE DIRECTORS

Comments from Mr. G. M. Bagot, FFA, ASA.

My background is that of a partner in Wood, Mackenzie & Co. and a director of one of its successors, The WM Company. Latterly I have been an independent investment consultant. I am also retained by my profession to monitor all their interests in FTSE International's range of Equity and Bond Indices, both UK and Global. In addition, I am a non-executive director of two private companies and a public company, Tribune Trust plc.

My short and personally topical comments are as follows, and would apply to a longer standing, publicly quoted company, not a private company where the principal investors are the management or originating family: -

1. I believe the title "non-executive" should be dropped. It appears that all directors are essentially the same with similar responsibilities. There is a difference between Executive Directors (ED's) who I define as those also employed by the company in a senior role such as finance, marketing or production. The other group are Independent Directors (ID's) whose role is to assist and direct the company through the board and board meetings. They bring to the board and the company, expertise and knowledge of other and varied fields, markets, production, management, etc.
2. The Audit committee of the Board should be made up of Independent Directors with the possibility of the Executive Director (finance) also being on this committee. The Audit committee should appoint the external auditors, review their role and change as and when necessary. The external auditors should be answerable through the Audit committee to the main board, and to the shareholders through the chairman of the Audit committee.
3. The company may also appoint the same auditors for consultancy or project work, provided there is a different partner in charge and only with approval of the Audit committee. Otherwise the company should appoint a different firm altogether for such consultancy or project work.
4. There should be no constraint in retaining external auditors for any finite period. Rather, after a period of say 5 years, the Audit committee must make a case to shareholders and the wider public for the retention of the auditors for future years(s).
5. Similarly for directors, whether Executive or Independent, after some finite period, say 9 (according to PIRC), or if older than 70 years, then a clear reason for retention should be made.

6. Directors should be paid the "market rate" for the job, increasing overall at the same rate as the workforce. Just as in the workforce, some may get a larger increase, some smaller, each year. I do not believe that options should be offered to directors in any form other than specified below in 7. I am far from convinced, and high profile cases confirm this, that directors are not influenced by their own specific option packages when advising shareholders on corporate actions affecting their company. (see also further related comments in 8 below)
7. If directors believe that the company and its shares are going to perform particularly well into the future, I would allow them to forego all or part of their payment for shares, provided they elected to do so in advance. For example, if a director was paid £60,000 per year, then he or she could elect, once per year, and advised to the Stock Exchange etc, for shares to be bought, at the rate of £5,000 per month. If the director selected correctly, the purchase of shares in lieu of salary would be beneficial. I realise that there are Income Tax and National Insurance considerations here, but these should not be insurmountable.
8. Other than through the acquisition of shares as in 7 just above, Directors should NOT own shares in their companies. I am not convinced that asking directors to align their interests with shareholders by holding the company's stock is correct. See my comments to John Plender of the FT in the attached e-mail. The directors of a company are not just answerable to shareholders however much they may feel that is the case or the law seems to say. Morally that is not justifiable. There is no value in a company if there are no customers, poor products, poorly trained and/or unmotivated workforce, no suppliers of raw materials. The duty of directors is to consider *all* the expectations of these interested parties. To be beholden to just shareholders is not giving due recognition to the role of these other parties. Recent and not so recent events have shown that too many directors have put their interests in line only with their financial rewards, never mind other shareholders, customers and employees. To bar them from holding shares should at least mean that their long-term interests are best served by considering all parties in the running of a successful company.
9. Many companies now have performance targets, such as growth in earnings, improvements in margins, head count control etc. Some of these are internal measures, some are used for explaining targets to shareholders. I would wish the ID's to vet all such measures, comment on them, amend them, introduce new ones as they deem appropriate for the company.