

FROM SIR RICHARD GREENBURY

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Non-Executive Directors Review  
Department of Trade & Industry  
Room 2142  
1 Victoria Street  
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Dear Derek

Thank you for a most enjoyable lunch and stimulating conversation. I promised to let you have my thoughts in writing so here they are.

1. The horrendous problems that have emerged in so many American companies have been largely caused by their excessive (many would say greedy) remuneration 'culture', and to a lesser extent Board structures. The first is not within your brief but nevertheless you are in a position to point out that since my committee investigated remuneration in 1995, bonuses and share option schemes, even here in the UK, are too frequently not justified by performance, and often unacceptably high. This needs looking at again. focussed on (as 2017)
2. In respect of Board structures my experience of the American system is negative. They are dominated by 'outside' directors (sometimes 80-90%) who do not have the time to get to know and understand very large complex businesses, and all too often become embroiled in the many Board sub-committees, so losing their independence.

In recent years, through my Philips Supervisory Board experience, I have become very impressed with the two tier system favoured in Holland and most of the Continent. I believe it is now time for the UK to consider this approach again, particularly in respect of the large, complex multi-nationals which have emerged these past 20 years through globalisation

However, the UK Unitary Board system has stood the test of time well, and the role, number and effectiveness of Non-Executive Directors has grown strongly since I joined the British Gas Board 26 years ago. The only significant disappointment of recent years is that separating the roles of Non-Executive Chairman and CEO has all too often failed to deliver – Marconi is probably the biggest disaster in UK corporate history, but there are many other examples such as BT, Reuters, Granada, Carlton etc. This approach is dangerously dependent upon the abilities and relationship of just two people, with large companies particularly vulnerable.

I know you feel otherwise but what is wrong with an Executive Chairman (no CEO required) supported by one or more Deputy Chairman and/or a Managing Director all of whom know the business well, backed by strong Non-Executive Directors including a heavyweight senior Non-Executive Director. This structure has served the UK well and still fits comfortably with Cadbury who recommended "that there should be a clearly accepted division of responsibilities which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision". Incidentally having read Cadbury again before writing to you, I am convinced his is still the definitive report on corporate governance.

### 3. Question A – Role of Non-Executive Directors

If one accepts that the Board is responsible to the shareholders and employees for running the business successfully both on a day to day basis and strategically in its longer term interests, then clearly the key roles of the Non-Executive Directors must be performance, strategy, succession planning, and the proper conduct of the business.

To do this effectively they need to be restricted to two or maximum three Non-Executive Directorships if in full time occupation (none of which should be as Chairman), and no more than two Chairmanships even if retired from full time work. These are 'tough' rules but necessary in the present and future climate as the demands and expectations on Non-Executive Directors continue to increase.

An important special role for the senior Non-Executive Director is, from time to time, a quiet informal chat (one to one) with the Chairman or CEO on matters which might be causing concern to the Board.

There should be no distinction between the legal duties or responsibilities of any member of the Board.

### 4. Question B

Essential skills required are experience which leads to sound judgement, financial basics, and a good feel for people. Personal qualities are integrity and courage. The mix of the NED's should be from a variety of disciplines and industries.

I don't believe pay levels have been a problem up to now (particularly for Non-Executive Directors with full time jobs) but it is becoming an issue in respect of Non-Executive Chairman due to increasing pressure and accountability. I do not believe Non-Executive Directors should be given share options or own shares as they become wedded to the share price performance and lose independence. On the other hand, insurance provision is becoming essential, especially for those involved in an American company.

Recruitment is easy as all the head hunters have long lists of available Non-Executive Director candidates but, they are all too often "selling" their clients and therefore the company finishes up with the wrong advice and appointment. Thorough interviewing by the

Nomination Committee can help but, ultimately, personal knowledge often proves to be a better basis for the appointment.

One way to widen the pool of Non-Executive Directors would be to scrap the practice of expecting directors to ask for shareholders approval to continue after the age of 70. Many companies and individuals will not go through this procedure (which is generally attacked by the press), and there are still large numbers of 'heavyweight' retired CEOs etc. who are still physically and mentally young, have much to offer in their late 60's and 70's, and importantly the time on their hands to do so.

Finally, there should be greater international representation on UK Boards but how do you attract bearing in mind travel and time constraints and, if American, inadequate remuneration.

In respect of question B11 I gave you the Zeneca example of how the NED's handled John Mayo's ambitions resulting in his resignation. An even better example is Philip's Supervisory Board rejecting the proposal from the CEO and Management Board (in Summer 2000 at the height of the Technology boom) that we should acquire one of our major competitors in the semi-conductor market for some €20-25 billion. Our good instincts and experience of how such booms eventually collapse were well founded and two years later our semi-conductor business is losing money and shutting down capacity as are all our competitors. The role of Non-Executive Directors in mergers and acquisitions is of paramount importance as the executives generally 'get the hots for the deal' and lose objectivity on what they should pay for the company.

#### 5. Question C

By and large I share the view that there are now more than enough rules, self regulation and codes of practice in place – the major problem is that together they are too inflexible to respond to variable company cultures, their size and required Board structures, and sub-committee effectiveness. There is an old Hebrew saying 'The fish rots from the head down'. Ultimately there is no antidote for greed (Enron), incompetence (Marconi) or a crook like Maxwell.

Setting objectives and performance reviews (personal and corporate) can largely be pursued via the one year operating budget and 3-5 year strategic plan – but again, can be manipulated by a capable CEO, or thrown off course by circumstances beyond control or prediction. That is why good instincts are worth more than any rules or financial analysis.

However, there is one positive recommendation I wish to make – auditors should not be consultants to the same company on any subject. Philips have recently made a strong statement on this subject and I will forward you a copy when I have one to hand.

#### 6. Question D

Shareholder relationships are one of the major responsibilities of the Chairman, Deputy Chairman, CEO and Finance Director. All others can only play minor support roles.

Relaxed yet positive and questioning relationships between the Board members are dependent on the Chairman and will vary individually. In this connection I believe strongly that the Non-Executive Directors should have good friendly relationships with him, thus enabling them to be able to talk quietly to him outside of the boardroom, as well as argue with him inside it.

I speak from experience of having worked for Denis Rooke, Brian Pitman, Marcus Sieff and one or two others of their ilk.

**7. Question E**

All Board meeting papers must arrive the weekend before the meeting so that there is sufficient time to read and evaluate their recommendations. Fundamental decisions should not be taken on the basis of papers presented on the day of the Board meeting which is sometimes attempted. It is extremely useful that really important business information (cash flow, weekly sales etc) is copied to Non-Executive Directors on a regular basis.

I believe the Chairman should encourage, possibly insist, that Non-Executive Directors visit all parts of the business outside of the boardroom, to meet senior management (potential Board appointments) and to get a feel for the business.

**8. Question F**

Smaller companies need to be more flexible, quicker on their feet, and generally have much smaller Boards who do not have the back-up resources of larger companies. Therefore sub-committee structures and numbers are more difficult to balance and pursue best practice. Successful CEOs often resent Non-Executive Director's advice, and Non-Executive Directors can make the mistake of getting too involved in the day to day management of the business. All this requires careful and sensitive handling.

I believe the Non-Executive Director's position and relationship to the Board is still settling down in smaller listed companies, but that should not be a reason for best corporate practice being different. As long as there are public shareholders the rules must be the same.

**9. Question G**

Covered comprehensively on page [1] in answers listed as 1 and 2.

**Richard Greenbury**