

RESPONSE OF JOHN HODGES

Review of the role of non-executive directors

Issues for consideration

A: Role

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

Possible issues for comment:

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

The role of the Board is:

- To set strategy.
- To appoint and, if necessary, replace management.
- To counsel management
- To set the Board as an example of Corporate behaviour.
- To establish accountability.
- To consider implications outside the narrow company confines, eg shareholder views, treatment of employees, world events.

The role of the Chairman is fundamental. If the Chairman and Chief Executive are both executives they hold a considerable amount of power. In this situation I believe that the majority of the Board should be non-executive directors to balance the power base within the company. However, I have seen the US scenario where the same person held the Chairman and CEO positions and all other directors were non-executive directors. In this situation there was no counterbalance to the one executive's detailed knowledge.

So:

- There should be a mix of executives and non-executives on the board.
- One person should not hold the Chairman and CEO positions.
- If the Chairman and Chief Executive are both executives the majority of the Board should be non-executive directors.

2. What should be the key roles of non-executive directors on the board and what should be the balance between the different components?

I think the roles should be upholding the responsibilities noted in 1 above.

Within a board, should all non-executive directors be expected to fulfil each of the different roles?

No. Each individual brings his or her own expertise and experience and should apply it accordingly.

3. How does this compare to the present position?

Similar but with varying degrees of diligence.

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

For whatever roles non-executive directors need to be independent and **seen** to be independent. Perhaps called "independent directors".

Currently non-executive directors have only their power of persuasion, their vote or the ability to resign if they do not agree with management.

Their vote would hold more sway if the changes noted in 1 above were made.

If they resigned there should be very widespread mandatory reporting procedures so that it was clear why they resigned and this should not be held to their detriment in future.

They should be financially independent. On reflection I think this means not only another source of income. It means that they should be banned from holding shares in companies where they are non-executive directors, just as I believe auditors in the USA are. Significant shareholdings can influence one's judgement on reporting or even investigating bad news that might depress the share price. I have seen this danger and believe it should be avoided by stopping temptation.

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?

No specific comments.

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?

I am sure it must vary considerably from company to company. An aggressive growth company will probably need many meetings and a lot of work. Others may be very routine.

Are there any implications for the number of non-executive posts that one person can sensibly take on?

I feel very strongly that this is the case. We have over fifteen meetings a year. To travel and attend takes the best part of a day. Preparation takes at least half a day a meeting. Add a few odd meetings and this is 25 days. That is 11% of a working year.

I believe that to discharge one's duties as a director one should see more of the business than the HQ reception and the Board Room. Doing the job properly could easily take 20% of one's working time. Thus, non-executive directors should be limited to two public companies, which could occupy nearly half one's time.

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

Yes, if the Chairman and CEO are executives.

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?

No specific comments.

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?

Possible issues for comment:

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?

I believe that every Board should have some non-executive directors who are knowledgeable about the sector in which the company operates. I think the day of the Great British Amateur in management should be over. My experience tells me that this is not the case. It may well be the opposite.

10. What personal qualities and attributes are needed?

Independence.

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.

I think a mix of skills to match that of management could be appropriate. Thus, operations, finance, legal, industry sector etc.

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?

It is not easy. We were offered a selection from the "cosy club" that brokers and specialised headhunters provide. It seemed that if you appointed the head hunters to find non-executive directors for you they would place you in other companies.

Recruitment should work as with executive recruitment. Set a job specification with skill sets etc and then search and interview as with an executive. Why not use assessment centres instead of lunch?

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?

Limiting the numbers of positions any non-executive director held would force companies to widen the pool.

International representation runs into the natural barrier of time availability.

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?

I do not think the levels of pay are appropriate for the positions.

I calculate that the executives at the company where I am a non-executive director are paid more per hour basic salary than I and my fellows am for the hours worked. The executives also have cars, benefits, bonuses, stock options, LTIPS etc which add multiples of their salary. Yet we are supposed to monitor and mentor them!

I do it because I enjoy it. I would not do it as an economic job.

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

I think this is difficult to justify. One should take responsibility if one takes the position. But, to repeat answer 14, one should be properly paid.

C: Structures and accountability

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

Possible issues for comment:

*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?*

See answer 4 above.

*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?*

No specific comments.

*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?*

I think the role should be changed. The Finance Director of a company has a great influence over the selection and management of the audit process. He also has the immense power of patronage in awarding multi-million pound consultancy deals to the audit firm. This is too much power in one person's hands however the audit profession protest.

I think the auditors should be appointed and report directly to the Audit Committee in practice and theory. The FD should not be involved in the process.

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

Nothing specific.

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?

I think these should be in place. I see little point in recording votes. In my experience there are few votes.

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

Yes.

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?*

In the Board where I sit, we do challenge and, at times, refute or stop executive decisions. If there was always a non-executive majority this would be easier.

If non-executives resigned there should be very widespread mandatory reporting procedures so that it was clear why they resigned and this should not be held to their detriment in future.

D: Relationships with shareholders and others

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

Possible issues for comment:

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

There is no relationship in the Company where I am a director.

I like the idea but can't immediately think how it might work.

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

The Chairman could do more. This position holds a lot of power. An alliance between Chairman and CEO to arrange matters can be very difficult to counteract. Board Meetings can easily be "fixed" beforehand if the other non-execs are not determined to make their views heard.

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

It should not be too "cosy" but it should be based on more knowledge of the business than I believe is currently the practice. Thus, non-executive directors should have some relationship with senior management to understand and influence the ethos of the company.

26. How can Company Secretaries support effective performance by non-executive directors?

No specific comment.

E: Support

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

Possible issues for comment:

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

As a non-executive director one sometimes needs to be firm that you do want information. Executives often think it is their proprietary material.

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

I attended a course. None of my fellow non-executive directors did. Opportunities are limited.

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

It can't get any worse. It does not exist as far as I have seen. I asked to visit company locations and management. It was not suggested by the Board. None of my fellow non-executive directors did so.

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

No.

The whole non-executive process is amateur. It seems as though directors resent thinking they might need training for a new job. It casts aspersions on their managerial virility. The world's greatest athletes continue training. Not your great British director.

F: Smaller listed companies

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

Possible issues for comment:

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

There is far more mentoring involved. At times the Board Meeting becomes an executive meeting where issues are thrashed out and actions determined.

G: International context

What can we learn from international experience?

Possible issues for comment:

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

I have experience of the US model at one multi-billion dollar company. The Chairman and CEO was one person. The rest of the Board were non-execs. They were there through the Chairman's patronage and acted like it. None of them had enough knowledge to challenge him. The company's performance for years was woeful.

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?

Not to my experience. Better to significantly improve our model.

John Hodges
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