

INDEPENDENT REMUNERATION SOLUTIONS

A. ROLE

1. The role of the board is to direct and control the company's strategy for the principal benefit of its shareholders, but the secondary benefit of its staff, clients, suppliers and maybe other stakeholder groups.
2. The key role of non-executive directors is to ensure that the board, as a whole, is operating in the interests of shareholders to produce the above outcome.
3. All non-executive directors do not need to fulfill each non-executive role; board sub-committees can and should be staffed with different non-executive members. On smaller companies, with two to three non-executives, each non-executive probably needs to be a member of each board sub-committee.
4. Non-executives need to be totally independent on board sub-committees, but on the main board itself, when they are operating as part of a cohesive body with hopefully a unanimous view on the issues, independence is less important.

In my experience, if a non-executive seriously disagrees with a strategic or governance issue, which the board plans to implement, they really only have the choice of resignation as obviously a majority vote would go against them. For lesser issues the director must ensure that the minutes note his negative vote.

5. The main point of conflict between independent and executive directors is likely to be remuneration. Because of our work we are very conscious of boards on which there is quite a significant disagreement about pay levels, but relatively few disagreements about reward systems, whether they are cash bonuses or longer term schemes based on shares or options.

If a non-executive really disagrees with a remuneration decision as a member or a non-member of the remuneration sub-committee, they need to record the fact in the minutes and with the Chairman of the board.

An issue at that stage is, should the director have the right to go to the principal institutional or other investors in the company and make their disagreement with the remuneration policy known. In our view they must inform that chairman of their intention, but should then raise the problem with shareholders.

6. The role of independent director is increasing in scope, particularly the chairman of sub-committees who need to devote more time to these appointments.

We are also very aware of the fact that many newly appointed independents and the chairmen of sub-committees, need to update their qualifications for these jobs and should consider training, whether internal or external. There is a very distinct antagonism among middle-aged, competent professional and business people to undergo training at that stage of their career.

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To acquire the necessary additional skill sets, directors need to be offered in-house familiarization and mentoring.

For instance, we think it is desirable for board sub-committees to have one meeting a year at which there are no agenda items, but advisors, whether auditors, remuneration consultants or other specialists, spend a day with the sub-committee updating them on what's happening to Remuneration/Auditing in the outside world. The committee can also discuss, without executives being present, how better to measure and improve performance, not just the statistics published in the annual accounts.

7. There is an obvious role for a senior non-executive (in companies with an executive chairman) as the focus of any disagreements between the executive and non-executive group. I think the description is very ugly and I would suggest that in companies with an executive chairman there should be an independent deputy chairman. This title is a much clearer statement of power and responsibility.
8. If UK companies are going to have a unitary board, I think that all directors have to carry the same collective risk. If you want to move to different responsibility levels in order to attract a wider group of people who are willing to serve as independent directors, you could move to the European supervisory and management board structure.

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B. ATTRACTING AND APPOINTING NON-EXECUTIVES

We have covered some of these issues in our answers to (A).

1. The skill sets and personalities needed by non-executives alter from company to company depending upon the professionalism, knowledge and personalities of the executive team.

Companies with an over-powerful chief executive, often in smaller groups an owner-manager, clearly need very strong non-executives who can repeatedly challenge the chairman when he or she appears to be putting their own views and interests above those of the other shareholders.

The difficulty is persuading the board to elect such characters when it is clearly likely to produce clashes which are in the long-term interests of shareholders, but in the short-term do not appear likely to help the board to operate in a harmonious way.

We feel very strongly that there are a lot of suitably qualified individuals who lack specific skill sets, particularly those who have served on divisional boards in big cap groups, who have no direct knowledge of financing, as all the money came from the holding company, or shareholder interface, as divisional boards do not get involved in these issues.

We have some concerns on the usefulness of those from outside the profit-making private sector on quoted company boards.

In my experience of working with such directors, there is some difficulty in getting them to understand that companies only survive if they make sales and generate their own income. Candidates from the public and the charity sector have often not had to worry about the income side of the business as it arrives automatically from taxation or donations, and spend too much time on the allocation of funds, rather than money making developments, become too tied up with the monitoring function and do not contribute enough on commercial strategy issues.

15. The issue of risk is being increasingly considered by candidates offered non-executive directorships. In the past year the Equitable situation in which the new board, on behalf of policy holders, is suing all the old board including the non-executive directors, is going to have a knock-on effect on the whole area of independent director risk. You may be able to insure your financial risk, but you can't insure your reputational risk if you are tainted by a case brought against a board on which you sit.

I would suggest that if, on any issue which is the subject of a shareholder or other suit, you resigned from the board, this should insulate you against subsequent legal attack.

At the moment a director who resigned or voted against a policy that created an action against the board, would still be liable with his or her colleagues.

This must be quite wrong and will inhibit good independent candidates from joining boards.

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C. STRUCTURES AND ACCOUNTABILITY

From what I see as a non-executive director and as a top level remuneration consultant, the actual structure of British boards with their sub-committees is working very well.

19. I return to my earlier comments when discussing the composition, duties and operation of remuneration committees.

The chairman of this committee often needs to increase his or her knowledge of the whole remuneration area and the various types of achievement targets that can be set for a management group. Committees need chairmen with experience in different groups and industries who welcome additional mentoring, whether in-house days with retained consultants or attendance of an external course.

In smaller companies we are seriously concerned that the collective skill of the remuneration committee is inadequate and, in an earlier letter, we suggested that the committee should be able to co-opt a remuneration expert or a businessman with the necessary skills with full voting rights although they would not be a non-executive member of the main board itself.

21. The review of the board's total performance is obviously an important issue which is becoming subject to increasing comment. Who is to do the monitoring? It would be very difficult for professional advisors to be totally honest in the case of an inadequate or weak board. It would also require a degree of skill that it would be difficult for any single professional advisor. If major shareholders are concerned with the performance of the board, I think the best solution is to insist upon the appointment of new candidates who can improve the collective outcome, but this is an area where the current legal structure of a board makes it extremely difficult for shareholders in a quoted company to exercise their rights.

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D. RELATIONSHIPS WITH SHAREHOLDERS AND OTHERS

23. This issue is bedeviled by trading rules and the reluctance of institutions to become insiders prohibited from dealing in the company's shares. It is also extremely difficult for a chairman to ensure the company is obeying the listing rules on the provision of information to the outside world if individual non-executive directors are talking to individual or collective shareholders and the chair(wo)man cannot monitor precisely what they are saying at any one time.

In an ideal world it is up to the chairman to have relaxed relations with shareholders and other external groups, however, if an individual non-executive director cannot get his views sufficiently attended to by the board and warns the chairman that they are going to take the issue to significant outside shareholders or the Association of British Insurers, they should be entitled to do so. I think the individual would have difficulty, if he wishes to give price sensitive information, in getting individual shareholders to provide a proper audience.

E. SUPPORT

I have covered many of these issues already.

29. Induction can be improved, not just for non-executives. A major problem with British companies is that executive directors appointed to the main board still operate as divisional mouthpieces as they have had no training on the wider issues affecting the whole company where their comments would be useful.

There is a paucity of high level courses suitable for directors of fully quoted companies where they will have the opportunity to network with people in a similar situation.

The business schools run mature executive programmes which would be suitable if the non-executives have one to three months free and can afford the sizeable fees.

I think that the Institute of Directors, the CBI and other organisations should encourage the establishment of more very high level courses for independent directors on which they will meet other independent director delegates as the course is particularly tailored to their needs and attendees are willing to reveal their difficulties and concerns in a way that wouldn't be possible with a wider and more disparate audience.

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F. SMALLER LISTED COMPANIES

I have already referred to the dangers of the owner-chairman in smaller companies simply railroading non-executives, most of whom are not strong enough to stand up to him or her. It does seem to me important that the shareholders in such groups do try to collectively insure that at least one non-executive director is genuinely independent. Too often on the AIM company boards you have professional advisors to the company or those who helped the AIM flotation, who are not sufficiently independent.

I would like to see a requirement for an AIM listing that an independent director must be elected from a slate prepared by shareholders and re-elected at the first annual general meeting after flotation has been achieved.

See C. 'Structures and Accountability' section 19.