

Response from the Institute of Business Ethics

Review of the role and effectiveness of non-executive directors

Section A

The board of a company exists to provide strategic direction to the company and to assess the risks associated with such a strategy. Each director has a role to play in challenging the strategy and monitoring the risks. The assumption by many is that it is only the non-executives who have this role - this is not so. It is the prime difference between 'managing' and 'directing' at board level. Non-executives can approach the role however with a degree of clarity due to their independence which may be lacking in the executive members of the board. Hence the importance of their role.

The role is to challenge, monitor, advise and support the executive team. In doing so they should look to the relationships the company has with its extended stakeholder group (shareholders, employees, customers, suppliers, the community, media and NGOs) to ensure the company behaves consistently with its stated aims and values. In other words, whilst not acting as policemen but acting in part as the moral and public conscience in ensuring expectations of others of the company are appropriately handled.

In great part non-executives already fulfil this role but perhaps in an ad hoc rather than formal way. Legislation is **not** required to change this but tighter best practice guidelines would assist - both the company and individual in the role.

Independence can be as much a frame of mind as a guideline definition and all directors should be encouraged to think independently. As to a guideline, the non-executive could be termed independent if they never worked for the company, or in its sector, was recruited from a third party search, and is not dependent for their livelihood on the director's fees paid to them from the company. A director can be independent and provide expertise but if playing the role of the expert and providing specific advice then this should probably not be conducted via the boardroom. The non-executive could be part of the monitoring team of external advice.

One cannot be prescriptive about time that non-executives should take over each post. Suffice it to say it should be appropriate to the task and role defined by the company. This means it is difficult to

suggest what number of posts an individual might reasonably and responsibly hold: an executive of a FTSE100 company could probably only cope with one other non-executive role; a portfolio non-executive could hold say 3 FTSE 100 roles plus two others, or say maybe 7 others with non FTSE involvement. The number and balance should be monitored by the respective chairman of the boards the individual sits on and the individual themselves. It is to be hoped that the individual will be experienced and self-aware enough not to over extend themselves by taking on too much.

The board hierarchy places much emphasis on the role of the Chairman therefore it may be (but not a statutory requirement) appropriate for companies to appoint a senior non-executive director but the board should decide. If there is a problem in the board typically one becomes self-appointed anyway.

Directors' duties in law should ***not*** distinguish between executives and non-executives.

Section B

To attract good people to the role of a non-executive director that role needs to be seen as worthwhile with an opportunity to contribute. It should not be too rule-bound but guideline-bound. This would help the individual by providing clarity.

The key skills are a combination of technical and personal skills. Technically the non-executive must understand a director's responsibilities in law as well as the board's; be aware of the role of the board and of a director; understand strategy; understand key issues such as finance - at a 'finance for non-financial managers' level. Personal attributes must include moral courage and integrity (to stand up to a robust Chairman if need be); steadfastness; ability to challenge and question; and to be analytical.

It would be helpful for all directors to be trained for instance to attain the Institute of Director's Chartered Director status. This would lead to greater confidence in board directors in general. The board should give more information to shareholders on the skills and qualifications of its directors. Certainly there should be more board training undertaken.

Greater diversity and widening the pool of directors will only happen if the existing director base, choosing new colleagues, is prepared for this to happen. In choosing a new director a job role specification should be drawn up and put to a third party to identify candidates. Whilst it is important to have previous board

experience before becoming a non-executive it need not necessarily have been in a FTSE100 company. Companies should encourage their subsidiary board level directors to become non-executives elsewhere as part of the individual's training and development.

Remuneration for the role should be appropriate to the responsibilities and time commitment given. A basic level plus extra for chairing a committee for instance is a good model. The level of remuneration should not rise to the point the non-executive becomes solely dependent on it for their livelihood otherwise they may lose that option to vote with their feet. That decision may be unduly influenced and they become compromised as an independent director as a consequence.

Rewards should be in cash, through the company pay roll scheme only.

Directors should have access to insurance cover at the cost of the company. Non-executives are at times reliant on the information given to them by executives. If there is a fraudulent executive there must be some cover to protect an innocent non-executive.

Section C

The balance in boards is generally working well, as is the governance structure. Audit, remuneration and nomination committees are appropriately structured if composed of all non-executive directors with appropriate executives in attendance when necessary.

The Audit Committee (or a Corporate Responsibility Committee) should be mindful of the company's reputation as one of the risks it reviews. This would entail a responsibility for monitoring (directly) the company's whistle blowing procedures. Regarding Nominations, these should have third party input and Remuneration Committees should have regard to relative pay within an organisation not just to external peer companies. Board review and self-assessment should be a regular part of the board's business, as should individual review by the chairman of directors. This could be a 360° process so the chairman is reviewed too. Some description of such processes could be explained to shareholders.

Section D

Shareholders will be aware of who the non-executives are and be prepared to approach them if necessary. However, the day-to-day relationship with shareholders and others should be by the executive team.

It is important that non-executives meet and get to know senior members of staff. This should be part of the induction process for a new director, and regularly monitored.

The Company Secretary acts as the linch pin between the non-executives and the company. It is crucial role and one that needs to be performed with utmost integrity.

Section E

Non-executives are primarily supported by the Company Secretary. However they need to ensure that are receiving the information (both quality and quantity) necessary to fulfil their role. Each director needs to given an induction programme, with refresher courses from time to time as the company changes.

Receiving guidance and feedback are two important elements of the individual's enjoyment of their job. Without either the director can only do the best they can and therefore not be as effective as they might otherwise be.

In giving information to non-executives the executive team need to act openly and transparently, the key being to build up mutual trust.

Section F

Smaller company issues are essentially no different from middle or large sized companies; it is a matter of degree. Oftentimes, the non-executive may have a greater role to play in a smaller company. The same factors apply though.

Section G

It would not be sensible for UK boards to move from a unitary board arrangement. There is some evidence of supervisory or two tier boards not working effectively. Similarly, to move to a position where the board is entirely composed of non-executives would be detrimental in terms of openness and transparency as the real business or the company would be divorced from setting its strategic direction in terms of responsibilities and accountabilities.

All in all the UK system with its strong (and growing) ethic of corporate governance is well placed and should not be disturbed lightly.