

## **Response of James L Gunderson (Jim Gunderson)**

### **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?**

In listed companies today, the role of the board is to select and evaluate the CEO, delegate the appropriate authority to the CEO to manage the company, oversee the management of the company, evaluate and decide upon transactions or changes in the company that would have a fundamental affect on it, and nominate board candidates to the shareholder for election.

#### **What is the role of the Chairman?**

The role of the Chairman is to ensure the proper functioning of the board, ensure that the board carries out its responsibilities, and manage the balance between the Board's oversight role and management's operational role

#### **How does [the Chairman's role] relate to the non-executive directors?**

The Chairman's role is to ensure there is active facilitation of non-executive director involvement in board deliberations and decisions (directly and through support and direction of the Secretary). The non-executive directors are dependent on management to supply all necessary information about the workings and performance of the company, and to provide candid and balanced proposals and recommendations to the Board. The Chairman must ensure this is happening.

#### **2. What should be the key roles of non-executive directors on the board?**

One role of the non-executive directors is to contribute to the alignment of management incentives to shareholder incentives. Another is to ensure the integrity of the company's financial reporting. These roles require independence in the broadest sense.

Oversight of the performance of the company and evaluation and decision making regarding strategic transactions and fundamental changes requires an intimate knowledge of the company and the industries it operates in, particularly how performance is measured and how transactions are evaluated in its industries.

Selection of a CEO may require a degree of familiarity and experience with the candidates.

**What should be the balance between the different components? Within a board, should all non-executive directors be expected to fulfill each of the different roles?**

There should be a balance of totally independent non-executive directors, independent directors from within the industry (e.g. from customers, suppliers, bankers, etc) who have no direct relationship with the company or its CEO, but travel in the same circles, and non-executive directors with enough relationship with the CEO to help with communication, trust, etc.

**3. How does this compare to the present position?**

Many CEO's with significant influence over their boards will prefer entirely independent directors who are totally dependent on them for understanding of the company and its industry — in those cases the balance is over-weighted toward total independence.

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

As suggested above, some non-executive directors should have knowledge of the industry and familiarity with the CEO outside the board room, which may require some compromise with respect to independence.

**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?**

Executive compensation, incentives and perquisites create the most intense conflicts of interest, and non-executive directors should be determining them for the CEO and playing a leading role in determining the principles to be applied and verifying they are being applied to the other senior executives. Strategic transactions that tend to increase the empire of the managers (and increase one of the elements used to determine their compensation — company size) also create significant potential conflicts of interest.

**What can be done to help non-executive directors to be effective in relation to these conflicts?**

A greater portion of board meetings should be dedicated to reviewing the potential conflicts and alternative approaches available to align management incentives with shareholder interests, and the board should retain its own management consultant to assist in evaluating strategic transactions rather than depend on bankers who receive fees based on transactions being done.

**6. What time commitment is needed for the role of Chairman and for nonexecutive director roles, and how far does this vary between different companies?**

The time commitment of the Chairman is significant — perhaps 15 - 25% of a full time job. The time commitment of the Chairman of a key committee (audit, compensation, nomination) is somewhere in between that of a Chairman of the Board and other non-executive directors. The time commitment of a non-executive director depends a bit on their role. Companies benefit from having active CEOs among their non-executive board members, but normally must expect a limited time commitment. Retired CEOs and academics might be expected to put in more time.

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

Yes, particularly for active CEOs, who should not have more than 2 non-executive director posts. Retired CEOs and academics could probably manage more — perhaps up to 4.

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

Only where the Chairman is the CEO or is otherwise not truly independent (e.g. if the Chairman is the former CEO).

**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?**

The same duties should apply. The key difference between executive and non-executive decision making at the board level is that the executive directors, as part of the management team, have often already raised problems and discussed issues related to a proposed strategy and have decided as a team to go forward and propose a course of action to the board. The executive director will feel his commitment to that management decision-making process during board deliberations, and may not volunteer to the Board every concern he originally had and discussed at that level, but his duty at the board level is the same and if his judgment changes due to the board discussion, he must act accordingly. Similarly the non-executive directors are aware of his position within the management team, and if they want to hear all of the concerns raised at that level of deliberation, they need to ask.

**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?**

Most of the key skills non-executive directors need are fairly well understood. The deficit I see is with respect to matters on which the board defers too much to management. If the board is to oversee strategic planning, there must be at least one non-executive director familiar with the best practices of the time, which might be strategic scenario planning or game theory one day, and system dynamics, agent-based models or real options analysis another day. They must also be familiar with the current approaches to valuing and comparing alternatives, such as internal rate of return or economic value added. If the board is to oversee performance, there must be someone knowledgeable about current approaches to measuring performance, which might be balanced scorecard or a single objective function/economic profit approach one day and innovation theory based the next.

**10. What personal qualities and attributes are needed?**

Blind spots on boards are often caused by the combination of arrogance and insecurity which prevents the basic questions from being asked. Non-executive directors need the diplomatic skills to extract honest views from senior executives without requiring them to defy the CEO.

**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.**

The ideal mix would incorporate active and retired CEOs, relevant professionals (e.g. lawyers, bankers, management consultants or auditors that are sufficiently independent of the company and the CEO), and possibly academics (experts on management theory, economics, geopolitics, 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?

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?

**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?**

Good corporate governance is of such importance to society that the service of non-executive directors on boards is akin to public service. Non-executive directors basing their decision on serving primarily on the remuneration probably don't have the attitude one is looking for.

Some share component is healthy, but share options are not — the distort incentives too much toward the short term rather than aligning interests with those of the long term shareholder.

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

#### **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?**

Yes, the fact that the Code refers to relationships which could materially interfere with the exercise of independent judgment creates uncertainty as to how serious it has to be to be material. Does it permit a director to be considered independent if he or she is the CEO of another company with this company's CEO on its board? I would hope not.

17. Do the recommended structures for board committees facilitate governance and an effective contribution by non-executive directors?

The Combined Code would seem to permit a nominating committee with no independent directors, with the chairman being a former CEO Chairman. That would portend rather weak governance.

Are board meeting procedures working effectively? Do you have comments on board size?

**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?**

There should be some reference to qualification of audit committee members and the independence of the audit committee chair. Independence should include no prior relationship with the firm's external auditor.

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

The Combined Code would seem to permit a nominating committee with no independent directors, with the chairman being a former CEO Chairman. That would portend rather weak governance.

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?

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?

**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?**

It is not enough to sit back and have executive management present the methods to be used and then how the proposal or performance musters up under the analysis — it is the board's duty to assess and validate the very processes and measures being used. They are in no position to do that without the use of consultants or a more candid communication relationship with the individual senior executives with the expertise, experience and internal knowledge. Some companies are expanding "executive sessions" among non-executive directors to include regular private discussions with the CFO, the chief legal officer, and other relevant senior executives to increase the opportunities for those executives' own doubts to be heard outside the shadow of the CEO.

**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?

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?

**25. What should be the relationship between non-executive directors and executive directors, and with senior management?**

There should be as many opportunities for informal communication in small groups as possible. Non-executive directors should have opportunities to communicate to the professional senior executives (CFO, chief legal officer) that they are counting not only on their loyalty to the company and its CEO, but on their professional integrity and commitment to the company as a whole.

What should their relationship be with the Chairman and the Chief Executive?  
What should their relationship be with key advisers to the company?

**26. How can Company Secretaries support effective performance by nonexecutive directors?**

An important new development is the creation of board intranets and links into corporate executive information systems, which facilitate involvement of nonexecutive directors between meetings and increase the pressure on management to be open and honest.

**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?**

There is an inherent problem with a situation where non-executive directors are meant to be evaluating the performance of management based on information selected, organized and presented by management, with few alternative sources of information available to non-executive directors. With the advent of data base information systems and secure intranets, non-executive directors should be afforded complete access to corporate management information systems — not so much to use (non-executive directors don't have time), but rather to keep

management honest and open. The possibility that a non-executive director might browse through the database would be enough.

**In practice, are information flows and communication channels sufficiently open and unrestricted?**

With the increased responsibility placed on non-executive directors to actively monitor and assess the performance of management, pressure has built on the management side to present information in a favorable light. Board meeting presentations are prepared almost like sales presentations.

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

Traditional corporate governance consulting and training focuses too exclusively on board processes and not enough on the interface between the board and management.

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

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?

**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?

**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?

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?**

The UK might benefit from more precise definitions of independence and greater emphasis on qualification of audit committee members, as found in the US.