

Sir Michael Pickard

**Review of the Role and Effectiveness
of Non-Executive Directors
Response to Consultation Paper dated 7 June 2002**

Issues for Consideration

A: Role

A well-balanced Board with a part-time Chairman and full-time Chief Executive, good financial disciplines and information, improves the strategic decision-making of the company and controls over-confidence by a successful executive in the same way as it would encourage change in executives who are not performing.

The non-executives should know why they have been elected to the board. The Chairman should have a clear view on what he is expecting from each of the non-executives, and a regular channel of communication should be open for views to be expressed both inside and outside the boardroom. The Chief Executive should feel able to use the knowledge of non-executives where it is appropriate and in the normal way the non-executives would relate to the Chairman in the management of the board.

All non-executive directors should carry pari passu responsibility with the executive directors (in a legal sense), but equally it should be recognised that a director appointed for his technical skills in production or sales should be able to rely on other directors for financial analysis or financial speciality, for example, in insurance on actuarial assessments or vice versa. It should be the responsibility of the Chairman to see that the non-executive directors represent a balance of knowledge and personal strengths that is both a protection to the Chairman and a balance to the executive team.

The concept of independent non-executive directors is less important than the clarity of their contribution and the strength of their own personalities. If shareholders or investors have concerns they should push the Chairman to explain the make-up of the Board rather than attempt to enter into direct dialogue with other non-executives.

The role of part-time or non-executive Chairman demands very different time commitments depending on the complexity of the company, the administrative skills of the organisation and the all-round strength of the executive team. From personal experience it can vary from two days a week down to two days a month. Both non-executive Chairmen and non-executive directors can successfully manage a wide portfolio if they themselves are well organised, with their own secretarial resources and possibly with their own chauffeur. I personally was able to handle eight separate appointments at the same time as a result of having strong secretarial support and a chauffeur, which allows the reading of papers during travel periods. I estimate that if I had not had that support, the maximum number of roles that I could have fulfilled would have been closer to five. There should be no legislative limits. Chairmen of Boards know when a non-executive director has taken on too much and Chairmen should take action accordingly.

B: Attracting and appointing non-executives

The key skills for a non-executive director and a non-executive Chairman would normally be based on a successful executive background, a good fiscal understanding of reports and accounts, and importantly good interpersonal skills in order to translate their experience effectively round the boardroom table. In future these same skills will be required but it is likely to be essential to comprehend the technical changes that have taken place in recent years to help reinforce strategic investment for the future. Most non-executive directors find it difficult to exercise judgement in this area, as has been proven in the changes in telephonic, computer and internet skills, and disastrous decisions have followed that lack of knowledge.

I believe that whilst younger non-executives who are fulfilling executive roles elsewhere are useful, the best non-executives are those in the age group 55-70 who give the right balance of time to the roles and where personal ambitions do not conflict with the non-executive role.

I have never found it difficult to recruit non-executive directors. I always believe as a Chairman you succeed best by identifying the people, approaching them direct and explaining why you consider them to be appropriate for the intended role. I do not believe that all non-executive roles should be advertised. The best Boards have been carefully selected by able Chairmen and able Nomination Committees so that not only is the contribution defined, but also the style of the person is in keeping with the style of the company itself.

Similarly I have not found remuneration to be a huge issue with non-executive directors. I believe that the pay should be limited to fees and that all non-executive directors should have a personal investment in the company relative to their own wealth. They should not have any share options and they should not be on bonuses. They should, however, be paid for additional responsibilities such as chairing committees, and the company should feel free to make an added payment to non-executive directors for excessive time spend on particular issues, which are normally obvious and easily explicable.

All non-executive directors should be covered for non-fraudulent liabilities where they have acted in good faith.

C: Structures and accountability

I believe the Combined Code is working in practice in the companies where I have been involved and I do not believe further definitions of independence are required.

The recommended structures for Board Committees, particularly in respect of Audit, Remuneration and Nominations, do work well. The problem with Remuneration Committees is largely driven by a desire of companies to benchmark executive remuneration in above median quartiles and hence there is a self-fulfilling continuous upward spiral. The remuneration advisory companies are the biggest inflationary salary producers in the market.

Audit Committees have improved the formal relationship with auditors and have diminished the power of the executive to “push profits” to the limit of the definition but there is a danger that both Audit Committees and auditors have become so strategic that they overlook a number of basic checks that used to be an automatic part of the auditor’s task.

I do not see how companies can provide information on the performance of non-executive directors. Any non-executive director who fails to make a proper contribution should be quietly removed from the Board and certainly not be put forward for re-election at the end of their three-year spell. Most companies review non-executive directors’ performance through the Nominations Committee at the time they come up for re-election but not in between.

Non-executive directors can successfully challenge executive decisions (or recommendations), but the balance of how often it is done is crucial to a smooth working Board. A non-executive who continuously challenges every recommendation can be as destructive as one who does not challenge any. This is why experience and judgement in the non-executive cadre is crucial.

D: Relationships with shareholders and others

I do not see how shareholders could successfully meet with non-executive directors on a regular basis. It is the task of the Chairman to represent the views of the non-executive directors alongside the Chief Executive and the Finance Director. I am surprised that shareholders do not seek to meet with

the Chairman on a regular basis. Many shareholders seem happy to meet only with the executive and in doing so expose themselves to reducing the influence of the non-executive on the Board.

The Chairman should certainly have direct relationships with the key advisers in addition to the Chief Executive, and best Board practice would normally include inviting senior advisers to attend sections of Board meetings.

Company Secretaries are extremely important in supporting effective performance by non-executive directors by:

- (i) providing information for meetings in good time and in a simply understood presentational form;
- (ii) being a source of additional discussion for non-executive directors who wish to seek further knowledge on delicate issues;
- (iii) seeing that meeting times are maintained, meetings have been given plenty of early warning and that communication with non-executive directors is easy and effective.

E: Support

Management information: some managers attempt to swamp non-executives with information, others give too little. It is the task of the non-executives to see that they are properly informed by requesting the appropriate amount of information.

Non-executive directors should maintain their best practice level by attending some of the many seminars that are available, where they meet other non-executives as well as discuss specific issues.

The biggest improvement in recent years has been the introduction of risk management reviews in companies, which has given non-executives a much better understanding of the critical risks and the important opportunities that face their companies.

The induction process for non-executive directors should be formally carried out. It should include meetings with all senior management and presentations on the issues that concern and excite senior management.

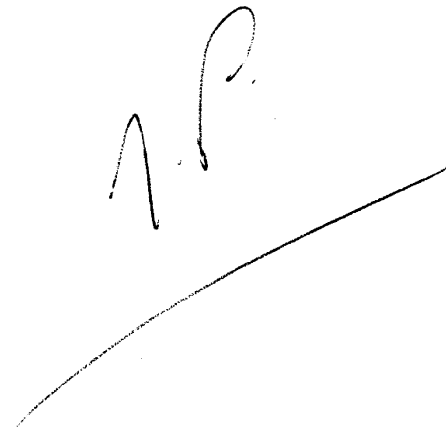
Non-executive directors do not get clear guidance on what is expected of them, nor do they get feedback on whether they are meeting expectations. The reason for that is simple. Non-executive directors must interpret the many roles that they are asked to fulfil for themselves and the Chairman should lead the non-executive role in a firm manner but not so firmly that non-executives are unable to put their own interpretations on both the role and on the major issues in the company.

F: Smaller listed companies

Both smaller listed companies and private companies need non-executive directors as key contributors to broaden the boardroom experience and to pass best practice into areas where there is no natural comparison. I believe non-executive directors frequently make a bigger contribution in smaller companies than in larger companies, for the simple reason that the huge and experienced administrative back-up of, for example, Shell, is something of a substitute for what a non-executive director contributes to a smaller company. I personally found when I was building a small company of which I was Chairman that two non-executive directors were a huge aid to success. They also give encouragement to management and staff in a small company that it is not a dictatorship.

G: International context

I believe that the UK system is better than either the American or European systems. In America there is far too much dominance from the President of the company and there is a history of Boards being dictated to by Executive Chairman or Executive Presidents. On the continent, the double-tier Board structure slows down the management process and gives too much power to vested interests such as unions. Recently in a company where I am a director it took eight months to change the management in a subsidiary in Germany which was losing a substantial amount of money, and this was entirely because of the bureaucracy of the double-tier Board structure. I believe we have the best systems if we work hard to maintain them and to improve the existing models.

Handwritten signature 'N.P.' and a long horizontal line.

8 July 2002