



**The Quoted  
Companies Alliance**

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## **Review of the Role and Effectiveness of Non-Executive Directors: A Consultation Paper**

This letter and the attached appendices are written by the Corporate Governance Committee of the Quoted Companies Alliance (“QCA”) in response to the Consultation Paper issued under your name on 7 June 2002.

### ***Quoted Companies Alliance and its Corporate Governance Committee***

The Quoted Companies Alliance represents the interests of the smaller quoted companies defined as those outside the FTSE 350 (with a market capitalisation currently up to £340m). A fuller description of the role of the QCA is set out in Appendix C.

The Corporate Governance Committee of the QCA has two main objectives – to promote the principles and benefits of good corporate governance to the QCA’s corporate members and to ensure that the voice of its members is heard in debates about corporate governance. The detailed objectives of the Committee are set out in Appendix B to this letter.

We are determined supporters of the principles underlying the Combined Code and have published a guide to the application of the Code to smaller companies which has, I believe, been well received by both boards and investors.

### ***Views collected from members***

We welcome the opportunity to share the views of the Committee and our membership with you and thank you for acknowledging that the position of the smaller listed company is different. The views set out in this letter include results from telephone conversations and meetings with, and written responses from, both executive and non-executive directors of a range of smaller quoted companies.

### ***Structure of the submission***

The main points which we wish to make on the role and effectiveness of non-executive directors are set out in this letter with more detailed responses to the specific questions you posed set out in Appendix A.

### **Summary of main points**

#### ***Non-executives contribute but must not become just “policemen”***

It is clear that no two boards are the same and no two have the same balance or mode of operation. There was however a broad consensus on a number of issues including the very

positive role that good non-executive directors play and a disquiet that the “policeman” role for non-executives could become too dominant a role.

### ***Unitary board suits the UK’s corporate culture***

There was universal support for the concept of a unitary board comprising directors (whether they have a management role or not) operating as a single team with the key objective of securing the company’s successful future.

### ***Concern that a climate of blame will restrict non-executive numbers...***

Concern was expressed by a number of members that the increasing level of litigation against or criticism of non-executives when a business goes wrong (as some inevitably will), makes the role less and less appealing. This risk/reward imbalance could well cause the supply of suitable non-executives to dry up.

### ***...this could be a major issue in already troubled companies...***

It will be a particular problem for troubled companies in the recruitment of directors and even more so in the case of non-executives who would receive no plaudits for a successful recovery.

### ***...need to ensure that blame is proportional to role***

We suggest that, to ensure the future supply of high calibre individuals prepared to accept non-executive roles, the liability for decisions by individual directors (executive and non-executive) must take account of their role on the board and their expertise.

### ***The supportive and “policeman” roles must be balanced***

A number of members expressed concern that the twin non-executive roles of providing a wider view and of being the “policeman” were in danger of becoming out of balance. If being a “policeman” were to become the key expected role for non-executives, there is a significant risk that the board would cease to act as a team and that the executives would no longer respect the benefit of the experience and external view provided by the non-executives. With the generally smaller board of a smaller quoted company, such alienation of the two groups would be detrimental in all ways. In current circumstances, it was generally felt that, with an effective chairman and directors having mutual respect, the two roles were not being divisive.

### ***Roles must not be defined too tightly and beware checklists***

The role of a non-executive director was, it was widely felt, difficult to define precisely and that, as a result, attempts to do so in any detail were liable to produce checklists to be adhered to regardless of the underlying principle. Too precise a codification of the role would, we believe, damage the very positive role which is played by non-executives. We would oppose any legislation which sought to impose specific duties on any category of directors.

### ***For smaller companies diversity exists but commercial ability is vital***

The responses we received evidenced no need to widen the pool of non-executives but equally did not discourage a widening of the pool. In making appointments, boards generally identify the particular characteristics required of the non-executive in advance. These usually include commercial experience, preferably at plc board level, and at least basic financial literacy.

## ***Non-executives must add value as well as independence***

In addition, boards generally seek a particular attribute which will add value to the board and thus the company. This might be knowledge of the specific industry, a knowledge of financing through City experience and connections or a skill which the company cannot justify acquiring on a full time basis.

## ***Personal chemistry is important***

In keeping with the need for the board to act as a team, the personal chemistry between a potential non-executive and the other board members was regarded as important and often a new board member would already be known to a director or to a close contact of a director.

## ***Same principles for smaller companies: practicality varies application***

You asked specifically whether the position was different for smaller listed companies. We believe that there is no difference in principle, but that there are noticeable practical differences. These are largely matters of degree, but are important and include:

- non-executives are more likely to have a mentoring role and to be in more regular communication with the executives
- non-executives are more likely to be invited to assist an executive in a one-off project (maybe an acquisition)
- non-executives (in part because of being smaller in number) may be expected to have a greater degree of flexibility in their schedules to be able to accommodate issues arising at short notice
- non-executives must have a greater degree of interest in the business of the company.

The QCA has published a guide to the Combined Code specifically for smaller quoted companies which deals with some of the practical aspects of applying the Code to smaller quoted companies. A copy of this is enclosed.

## ***The board is a team and a non-executive must get more than money***

Finally, two comments by directors struck a particular resonance with other views and emphasised that boards regarded themselves as a team:

“If you get to a vote, then you have lost the plot.”

“A board has got to be fun – a non-executive has got to get something out of the role. If the executives perpetually resent the non-executive’s views, then the non-executive has got to get out.”

## **Conclusion**

We believe that you have raised a number of pertinent questions over the roles of directors and not just of non-executives. We believe that this has provoked an interesting debate which suggests that the situation quo is not substantially flawed. It has also focused thoughts on the extension of the pool of potential non-executives although we believe that for the smaller quoted company there is a generally adequate pool available.

We share your and the Government’s view that legislation is inappropriate in this area and that, where change or improvement is needed, this is best achieved through the establishment and promotion of principles.

We believe that this committee is uniquely well placed to reflect the views of smaller quoted companies in general. We would be delighted to discuss further with you any of the points made or discuss any other matters which you consider might be particularly relevant to our membership and your further considerations.

C J Yates  
*Chairman,*  
*Corporate Governance Committee*

## Detailed comments on specific questions raised

### A: Role

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

**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, as stewards of the shareholders, to act in the best interests of the company. In practice, the role is to ensure that the company is properly managed and that that management is subject to appropriate control in seeking to achieve the company's aims and objectives as agreed by the board. The role also includes assessing the risks and rewards applying to the Company's businesses and strategies to ensure they are appropriately balanced.

The role of the Chairman is critical to the proper functioning of the board as a team. He must lead and control the board's discussions (whether formal at board meetings or informal in other circumstances) and ensure that the views of all directors are considered with appropriate weight. He must supervise the information flow to and involvement of the non-executive directors for adequacy and to make sure it is not excessive. He must also promote plans for management and board succession.

The Chairman's role in relation to the non-executives is to ensure that they have the information necessary to play a full part in board discussions, to ensure that they do play that part and are heard and to ensure that the each non-executive is contributing satisfactorily to the board's performance.

**2. What should be the key roles of non-executive directors on the board and what should be the balance between the different components? Within a board, should all non-executive directors be expected to fulfil each of the different roles?**

The key role of the non-executives in the boardroom is to provide external objectivity. This objectivity can be split in two – firstly the provision of support, a ready ear and a wider commercial view to the executives and secondly leading the board, through the relevant committees, in the consideration of matters where the executives have a real or perceived conflict of interest. In smaller quoted companies, the specific skill-set or experience of a non-executive may provide a valuable additional resource which can be called on to support the executives in appropriate circumstances. An additional and valuable by-product often sought from a non-executive is access to a wider network of contacts whose views can be tapped.

The balance between the two main roles is important and may well vary with the size of the company – the smaller the company, the greater the proportion of the role which is likely to be devoted to support. It is one of the Chairman's duties to ensure that this balance is right and that the non-executives' dealing with matters such as remuneration and audit do not destroy the respect of the executives for the non-executives which enables the support role to be valuable.

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

In general terms this is the current position on well run boards.

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

Independence is a state of mind which it is critical that all directors demonstrate in board discussions. Independence is not, we believe, susceptible to proper definition solely by reference to length of service or relationship with directors or shareholders. Notwithstanding this, it is accepted that a non-executive's judgements are more likely to lose the necessary objectivity if there is a close relationship with an executive director or major shareholder and as their length of service dulls the freshness required of a non-executive's enquiring mind. Equally, it is accepted that an external observer (such as an investor) is unable to judge a director's state of mind and must rely on defined measures in his assessment: boards (which may regard themselves as better placed to judge the state of mind of a director) must bear this in mind sympathetically.

With this difficulty of definition, it is important that the board is satisfied that the non-executives demonstrate adequate independence, that the non-executives are prepared and able to justify the views they have reached and that shareholders and others who might doubt independence are able to satisfy themselves of such independence. It is also important that the director has the ability to recognise the existence of a conflict of interest and an external perception that such a conflict might exist. A good director will be able to recognise this and, if it does not require his abstention, be aware of the concern.

We support the Combined Code's objective that the Remuneration Committee should comprise solely of independent non-executive directors and that the Audit Committee should comprise non-executive directors of whom a majority are independent. As our guide to the Combined Code for the smaller quoted company explains, we believe that it is important to recognise that practicality may preclude a committee of three which meets these criteria for smaller quoted companies.

**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?**

The main conflicts which may arise are where an executive's personal interests (in terms of remuneration or retention of position) may influence his decisions against the best interests of the company. The two most common situations are clearly executive remuneration and relations with the auditors (and other key advisers whose advice might influence the performance measurement and future of an executive). In these situations, best practice is already well established and continues to develop with committees comprising independent non-executives responsible for dealing with an agreed remit for the board.

In respect of other matters, it is important for the non-executives to maintain their objectivity and ability to question both proposals and motives critically.

In all circumstances, the biggest issues for a non-executive will be the ability to have access to sufficient information to identify on a timely basis a real problem or a suspicion and to decide how to react in the company's best interests.

In relation to such situations, it is important that a non-executive is not in a position where he cannot debate the issue with another party. To achieve this, it is crucial that there is more than one independent non-executive director and that each director has the right to communicate directly (without consultation with the board) with the company's advisers or an independent firm where appropriate at the expense of the company. Clearly this right is a last resort and use of it would probably demonstrate that the board team was not functioning properly and a resignation (whether by the non-executive or another director) was almost inevitable.

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

The time commitment required for the proper performance of the role of Chairman or of a non-executive director is impossible to define for a specific company and varies substantially from company to company. The obligations of being a director require that the director devote such time as may be necessary to that role. The time commitment will cover routinely not only the formal and regular board and committee meetings but also regular communication, ad hoc meetings to deal with non-routine matters and time devoted to understanding the business and the industry in which it operates. In the event of a serious issue arising, a significantly greater time commitment may be required, often at very short notice.

As Chairman, even with no full time executive role, the time commitment will be more significant than for a non-executive. For an active trading business, it is likely that the Chairman would be in regular contact (maybe daily) by telephone or e-mail with the executives and would meet them pretty well every week. He would also be in regular contact with the non-executives, again probably every week. If the company or executives have particular problems from time to time or there is a greater degree of activity, this commitment could need to increase substantially.

There are certainly implications from this for the number of roles which can be effectively and sensibly be undertaken. It is not, however, possible to be prescriptive about a maximum – to chair two major international companies might be excessive depending on their circumstances whereas to sit on the boards of ten investment trusts might be entirely manageable. It must be for the non-executive to judge whether or not he is able to undertake a position and for his chairmen and colleagues to judge whether he is effective in his performance and act accordingly. It may be helpful for shareholders in any assessment they might wish to undertake to see a fuller description of each director's outside activities within the annual report.

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

Within the context of the smaller quoted company, we believe that there is only a limited role for a “senior independent” non-executive director which is dealing with situations where the Chairman's position itself causes concern.

**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?**

We consider that there cannot be a difference of duties between the executives and non-executives as a matter of statute, unless there is to be a change from the unitary

board structure currently adopted in the United Kingdom. Each director must be responsible for the Board's decisions and responsibilities. We would however welcome an acknowledgement that the degree of culpability of a particular director for a board's decisions must be assessed in the context of that director's role, thus obviating the need for non-executives to become "shadow" executives questioning each executive decision.

## **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?***

**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?**

The key attributes identified in our discussions (apart from the obvious pre-requisites of honesty and integrity) have been commercial ability and awareness (not necessarily evidenced by running a business), management experience (preferably on a small to medium sized plc board), financial literacy and independence of thought (allied to the ability to communicate that thought process effectively). These skills are seen as essential and are unlikely to change over the coming years – they are the basic skills which will not change.

Other skills, knowledge and experience were identified as highly desirable within the board, but not necessarily required of all directors. Such other matters included awareness of legal developments, awareness of quoted company regulation, a sufficient understanding of accounting matters to challenge effectively the finance director and the auditor, sufficient knowledge to handle remuneration matters and pensions knowledge. The nature of these desirable characteristics will change over the next ten years along with the issues which the board has to deal with.

A number of people observed that the talents which make an executive successful are different from those which will make a successful non-executive director (who must leave execution to others).

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

The personal qualities and attributes identified included independence of thought and the strength of character to speak out on an issue and argue a point effectively without ceasing to be a member of a team. In addition, the ability to take an intelligent interest not just in the company but in the industry in which it operates was seen as very helpful, together with enthusiasm for the role.

**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 desired mix is hard to identify precisely and there can be no magic formula. It is one of the required skills of the Chairman and the nominations committee to identify the skills that are missing and the personalities required to produce a balanced board which can act as a team with mutual respect.

Examples of the contribution of a non-executive director to the performance of a company are more readily identified than that to corporate governance (where the best successful actions are generally those which prevent public problems). Examples of performance benefits include access to the network of contacts of a non-executive enabling a contract to be concluded or a log-jam in another organisation to be overcome by conversations at a different level within the other organisation and access to analytic skills of the currency markets where a raw material is priced in dollars. Further examples come from the application of the skills of a non-executive to a suitable situation which is outside the company's day-to day business (such as property experience being applied to property transactions by a manufacturing company).

**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?**

With limited exceptions, the directors with whom we discussed this matter had not found it unduly difficult to identify suitable non-executive directors. The sources used included search consultants, lists run by the likes of 3i plc, investment banks, accountants and, of course, PRONED and the network of contacts of each of the directors. The exceptions cited related particularly to the identification of people with suitable skills to deal with remuneration issues.

**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?**

The response from the membership was that there was neither a need to widen nor an objection to widening the pool for the smaller quoted company. In this sector there was a low incidence of cross directorships and of very high multiple directorships – the matters which appear to have caused concern about the size of pool. The main constraint on the greater diversity of the pool for the smaller quoted company is, we believe, the perception that commercial ability and awareness were essential attributes – outside the world of business these are harder to demonstrate. Finally, we believe that greater international representation on the boards of UK companies is appropriate where that experience is beneficial to the board. It would deepen the UK's understanding of other systems of corporate management and governance – information which must be beneficial to UK industry as a whole. From the perspective of the smaller quoted company with its generally smaller board and resource, this marginal benefit would only make sense if the non-executive brought another attribute to the board (such as a close knowledge of a market in which the group operated or was seeking to operate).

We are aware that, at the margin, people are put off from accepting directorships of certain companies (and in some cases from accepting any directorships at all) by the need to disclose their home addresses on the public record. This provision of law would seem to have little benefit and its removal would be welcomed.

**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?**

In terms of the form of remuneration, we continue to believe that remuneration in share options is inappropriate to non-executives but would encourage directors to

consider taking a proportion of their remuneration in shares (or possibly more appropriately, given the neutral tax position, reinvesting part of their net cash remuneration in buying shares). This was, however, seen to be a very marginal issue and not something on which we would express a strong view either way.

The levels of pay which a company is prepared to pay and the commitment it expects in return for this are clearly matters which will determine whether or not someone is prepared to accept appointment as a non-executive director. We believe, however, that in the current climate a much more influential factor in the availability of good non-executive directors is the risk element of the risk/reward balance. The increased expectations of non-executive directors and the increased likelihood that they will bear much of the criticism for any corporate failures inevitably causes good candidates to opt for the safest roles only or to stick to a purely executive role where they will have greater awareness of issues causing problems.

We believe that the greatest contribution that this consultation can make to the available pool of non-executive directors is to address the risk adopted by non-executives, not by eliminating it but by ensuring it is proportional to their role.

We would also note that, were the remuneration of non-executives to increase significantly with an increase in the expected time commitment, the source of income might be perceived externally to have become so significant to the director that his objectivity was impaired.

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

As regards the risks, please see the comments on the previous question. As regards insurance cover for non-executives, we believe this to be essential and would question the judgement of any director prepared to accept a non-executive appointment without appropriate insurance cover.

## **C: Structures and accountability**

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

**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?**

The experience of QCA members in general is that the Combined Code, the balance between executives and non-executives and the role of independent directors is working reasonably well in practice within the confines appropriate for smaller companies on which we have already expressed our views. As with all matters, best practice continues to evolve at the margin and this is helped by use of principles rather than the rigidity of statute.

Our views on the definition of independence are expressed above under item 4 – we do not believe further definition is possible or appropriate. It would, however, be helpful if those who wished to apply checks to the boards' views on independence were able

to co-ordinate the checks they apply to enable non-compliance to be justified (where appropriate) to just one standard.

**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?**

The experience of members commenting to us is that the structure is working well, that the non-executives are able to make their commercial contribution as well as perform the independent review functions without impairing the board's team functioning. The size of boards is generally only an issue if they become too large. This is rarely an issue for the boards of smaller quoted companies.

**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?**

Our experience is that audit committees are functioning satisfactorily in practice. The only issues of composition appear to be the need to have an accountant within the Audit Committee (which is not generally a problem) and, from time to time with the smaller boards, having enough independent non-executive directors to form an appropriately balanced committee.

We are aware of the current consultations which are on-going lead by the DTI and the Treasury which are considering the role of the Audit Committee in the appointment of auditors and their appointment to undertake non-audit services. This committees' views on this are that the appointment of auditors is a matter for the shareholders ultimately and that any interim decision to be taken by the board must be one for the board as a whole. We would concur that the Audit Committee should have a role in the review and selection process but would oppose any requirement that an appointment had to be made by the Audit Committee. We would similarly concur that the Audit Committee should have a role in any selection process which might lead to the auditors being selected to undertake non-audit work. We would expect that the Chairman of the Audit Committee would be able to justify any of these decisions if asked to by shareholders.

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

We believe that, in general, these are operating well and that the practicalities are developing satisfactorily although in some cases there were insufficient independent non-executive directors to fill the Remuneration Committee. We would however observe that provision of a range of norms by remuneration consultants has the effect of inflating the norm because no board likes to acknowledge that one of its directors might be below the average of his peers and thus be paid below the average.

**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?**

There was no clear theme which emerged on this – in general the boards of smaller quoted companies are sufficiently small that it is obvious if any of the directors are failing to fulfil the role of director properly. Most of the remuneration committees set objectives for the executives and achievement against these is reviewed periodically. Good practice suggests that performance review for each director is a process which should be undertaken (probably by the Chairman) on a regular basis and not just at the

time of renewing a director's term of office. The activity of the board as a whole is to be judged by results and by shareholders.

**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?**

The law has just changed on the reporting of directors' remuneration and this is likely to lead to a discussion of performance by the Remuneration Committee. At this stage, we believe it is appropriate to allow practice to develop rather than force further disclosure immediately.

The board should function as a team, taking collective responsibility for its actions, and it would be divisive to report separately on the performance (including such matters as attendance) of non-executive directors. There may be opportunities for some companies to increase the information provided to shareholders concerning the skills and experience of non-executive directors to highlight the additional capabilities that they bring to the board.

We believe that the performance of the board as a whole (and thus of the non-executives) is already adequately reflected in the total annual report of the company published each year.

**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?**

We believe that it is very important that the executives are left to execute the board's strategy and objectives and we would suggest that, in a well run company, the challenging should be of those actions which the executives propose to the board. In this regard, we believe that the non-executives are able to challenge proposals and to question them critically and that generally the information necessary for this is made available readily. The exposure of "serious problems" is not, naturally, a role for the non-executive directors – they are part of the unitary board team and not policemen. Clearly, however, they (together with non-board members and external advisors) are the only people who could be expected to take action in respect of a "serious problem" involving executive members of the board. They should, accordingly, be able to question matters critically, demand further information to enable them to further their review and be prepared to follow their questions through if the answers are unsatisfactory. They should also have good relationships with the non-board senior management so that, if a serious problem involving a board member (or members) is suspected, senior management has a communication channel around the executives.

## **D: Relationships with shareholders and others**

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

**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?**

In general for the smaller quoted companies, relationships with shareholders and other stakeholders are handled by one or more of the chairman, the chief executive and the finance director. We believe that this is in most circumstances appropriate. It was observed to us that there was a risk of, by accident, an inconsistent story emerging if relationships were handled by different directors and it was noted that the non-executives would not be as close to the detail of the business as the executives.

In special circumstances, however, we believe it would be appropriate (and necessary) for shareholders (whether institutional or otherwise) in particular to have a relationship directly with one or more of the non-executives. This would either be if the non-executive wished to discuss a particular issue or if the shareholder wanted to raise a particular point, maybe with the Chairman of the Audit or Remuneration Committee or if there was a concern about the Chairman's position. Such contact should definitely be available and in general can be easily arranged, normally with the Chairman or Chief Executive's knowledge.

**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?**

These are the features a good Chairman seeks to ensure occur and most companies seem to believe they have a good chairman, so non-executives are generally thought to be, and think that they are, effective.

**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?**

Non-executive directors must seek to ensure that they know the executives well and understand their strengths and weaknesses to assist them in identifying problems and providing support to the executives. Similarly, the executives should know the non-executives well enough to know who to contact for support when or if an issue arises. It is desirable that non-executives know, but less well, senior management as this is where the board's succession may well come from and it will ease the channel of communication if senior management needs to communicate directly with the non-executives. There should similarly be an acquaintance between the non-executives and the company's key advisers.

Overall, however, the Chairman should be the main channel of routine communication between the non-executives and both senior management and key advisers and should be responsible for promoting communication between the executives and the non-executives

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

As servants of the board and the company rather than of the executive, Company Secretaries have an important role but one which will vary from board to board. In many instances, they are critical to the dissemination of information on behalf of the Chairman and they should perform the role of ensuring board affairs are properly dealt with and recorded. It is however a role which should have limited proactivity.

## **E: Support**

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

- 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?**

Non-executives require a balance of information – they must not be swamped by excess detail and nor must important information be omitted. Controlling this process is the job of the Chairman who must respond to and judge requests for more information to ensure that the non-executive is not trying to redo the executive's job. In general with a functioning board, information flow is well handled and communication is sufficiently regular to ensure that any perceived deficiencies are dealt with promptly.

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

The views expressed supported and encouraged appropriate training. Training for being a director was generally seen as being the same for all directors and should include the executives but might exclude certain of the non-executives on the basis of previous experience and training in other roles. On a case by case basis, it was thought that certain specialist training was appropriate for non-executives in respect of duties such as the Audit and Remuneration Committees roles and possibly certain other specialist skills.

In addition, it was felt that the induction of a new director into the operations of the company was very important if he was to play an active part in the board discussions. This should involve meeting the senior management of all significant operations, seeing at first hand such operations and also spending time with the executive directors thereafter.

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

This was treated seriously by QCA members already as noted above.

- 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 clear view emerged on this question, although as noted above, we consider that the performance of all directors should be assessed against expectations on a regular basis.

## **F: Smaller listed companies**

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

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

We believe that the principles which apply to large companies should also apply to smaller quoted companies. There will however be practical differences between the approaches reflecting the different sizes, diversities of operation, geographic spread of

markets and resources reasonably available. We have already expressed our views on a number of these in our guide to the Combined Code for the smaller quoted company.

In general, the board team is likely to be smaller and “tighter” at a smaller quoted company, the non-executives are likely to have been selected in part to complement the executive talents available on the board and there may be a greater emphasis on mentoring and strategic guidance. It is likely that the time commitment of non-executive directors will need to be more flexible at a smaller company.

We would further expect that the typical non-executive director of a smaller quoted company would have different personal characteristics (suited to the particular situation he is taking on) reflecting this. In addition, it is likely that a greater degree of tact allied to firmness will be necessary when dealing with a management which has (directly or through family interests) effective voting control of the company and when dealing with a person combining the roles of Chairman and chief executive.

If it were proposed that the role of non-executives be codified (which we believe would be inappropriate) then such codification must allow for these practical differences.

## **G: International context**

### ***What can we learn from international experience?***

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

Nobody’s system is perfect so there must be an opportunity to consider other cultures’ approaches to corporate governance. It would be equally wrong to believe that a corporate governance regime that worked in a different country would automatically work in this country. We believe that the culture of applying principles rather than rules to corporate governance will work best in this country and across the broadest range of companies.

#### **33. Do other models of corporate governance or different boardroom roles or dynamics contribute more to company performance?**

We are not aware of any clear evidence on this matter.

#### **34. Would it be beneficial to bring UK practice more in line with that in any other countries? If so, why and how?**

We believe that overall UK practice is, for the moment, not far off the best for the corporate culture of this country. Corporate governance is however evolving at a relatively fast pace around the world and there must be continuous review to ensure the best fit is maintained.

**Objectives of the Corporate Governance Committee of the Quoted Companies Alliance**

- To represent QCA members in the Corporate Governance debate, seeking to ensure that smaller quoted companies have the flexibility to implement Corporate Governance principles in an effective manner appropriate to their particular circumstances; and.
- To raise awareness among the QCA corporate membership of the spirit, and not simply the form, of corporate governance.

### The Role of the Quoted Companies Alliance (QCA)

#### 1. What is the QCA?

A not-for-profit association funded by its membership, the QCA represents the interests of SQCs, their advisers and investors. It was founded in 1992.

The QCA has over 300 members. 60% of these are smaller companies quoted on the stock market, or companies with aspirations to join. 40% are drawn from the full range of professional advisory firms whose business is either wholly or significantly derived from servicing smaller companies.

#### 2. SQC Definition

The Quoted Companies Alliance definition of Smaller Quoted Companies (SQCs) is:

- all fully listed companies – excluding the top 350, ie, with market cap of £340m
- plus companies quoted on AIM
- plus companies quoted OFEX

#### 3. SQCs Contribute to the Economy:

- there are approximately 2,000 SQCs
- they represent around 85% of the total of quoted companies by number
- they employ 2 million people
- this figure represents around 10% of total private sector employment
- every 5% growth in the SQC sector could reduce UK unemployment by a further 100,000
- They generate:
  - corporation tax paid of £2.0 billion pa
  - income tax paid of £5.0 billion pa
  - social security paid of £2.0 billion pa

The tax figures exclude business rates, VAT and other indirect taxes.

#### 4. QCA's Aims

As the only organisation dedicated solely to the particular interests of the SQC sector, the QCA has three primary goals:

### ***Identification***

To create a distinct identify for the SQC sector, and demonstrate its value to the stock markets and the economy.

### ***Representation***

To pro-actively pursue and represent the interests and requirements of the SQC sector to enable it to increase its contribution and ensure that its specific needs are addressed.

### ***Affiliation***

To build a strong and vocal collective body of support from within the SQC sector, among corporate directors and securities industry leaders.

5. The QCA is governed by an elected Executive Committee, and undertakes its work through a number of highly focussed, multi-disciplinary committees and working groups of members who concentrate on specific areas of concern, in particular:
  - taxation
  - introduction of, or changes to, legislation affecting SQCs
  - corporate governance
  - share schemes for employees
  - trading, settlement and custody of shares
  - structure and regulation of stock markets for SQCs; Financial Services Authority (FSA) consultation
  - political liaison – briefing and influencing Westminster and Whitehall, the City and Brussels
  - accounting standards proposals from the Accounting Standards Board
  - company law reform

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