

Higgs Consultation Paper by Rhidian Jones

By way of background, I am making this submission because I have unusually broad experience in the boardroom during the whole of my working life over the past 35 years. This has comprised:-

15 years as a non-executive director – my current appointments are Deputy Chairman of Britannia Building Society, where I chair the Remuneration Committee, and serve on the Audit, Defence and Nomination committees, and Senior NED at Serco Group Plc, where I chair the Audit Committee, and serve on the Defence, Nomination, Training and Remuneration committees, as well as three trusteeships of registered charities, providing coverage of the not for profit sector;

10 years as a company secretary – including seven years as Assistant Secretary of Granada Group, which was a senior finance and property role involving daily interaction with the main board directors of that company; and

25 years as a corporate lawyer, having trained at Herbert Smith and recently retired in May of this year as Head of the Corporate Department at Nabarro Nathanson, during which time I have advised directors extensively on their duties arising from boardroom conflicts as well as M & A transactions and other matters such as insolvency.

My professional qualifications as both Chartered Secretary and Solicitor have provided a solid foundation for my long standing interest in questions of corporate governance, long before that became fashionable. However, these comments are the fruits of practical experience, and for the most part eschew reference to statutory or other legal authorities. These can naturally be furnished if this or any other amplification is required.

I have no particular agenda but if I were asked to identify my overriding concerns, it would be that :

first, in order to promote good corporate governance emphasis should be placed on the encouragement of effective boards, for which there is, in my experience, necessarily a diversity of models, rather than a universal prescription, which may be followed in a box-ticking sense but without conviction; and

secondly, NEDs are part of the solution and not part of the problem, and it is undesirable to focus on their effectiveness as opposed to reviewing board functionality in the round.

My comments are set out below by reference to the questions raised in the consultation paper. They are my personal comments, and should not be attributed to any entity with which I have been connected, whether now or in the past.

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?

In early chartered companies the appointment of a board or court was a recognition by the members that responsibility for the conduct of the affairs of the company, and stewardship of its resources, had

perforce to be delegated to a smaller group if chaos, or worse, stasis, were to be avoided. Such a body

was there to ensure the company pursued the purpose for which it was formed, and to raise capital and engage staff, starting with a Governor or General Manager, often not a board member, so as to achieve the fulfillment of that purpose. (The idea that boards should include more than one executive director is a comparatively recent one. The Table A in force until CA 85, and dating from CA 08, referred only to delegation of powers to one or more Managing Directors, which is the origin of that title signifying originally the only executive director and not the chief executive.)

The modern board, in addition to those responsibilities, is expected to set strategic objectives, to approve a business plan, monitor performance against it, and ensure the company achieves its objectives in compliance with the laws governing its activities and in a socially responsible manner having regard to accountabilities not merely to shareholders but to many other stakeholders, not least, employees, customers and the local community.

The board also has an important ceremonial role to assist in communicating the desired culture of the company, and the visible endorsement by the board of policies and initiatives is an essential tool of change management in the modern company.

The Chairman is often said to be there to run the board while the Chief Executive runs the business, which is easier said than achieved in many cases. This is not merely because of officious intermeddling or clash of personality, for it is possible even for persons of goodwill to have honest disagreement over the boundaries of roles, and the precise dividing line between strategy and tactics. Where the Chairman is executive, and previously held a management job in the business, it is appropriate to lay down very clear guidelines, and perhaps even arrange for them to be policed by an external executive coach, during a transitional period. Whilst an NED can help in diagnosis and prescription, the executives will probably open up more to an external coach, and the NED's independence will not become compromised by being perceived as having taken one side or the other.

The Chairman should be the primary point of contact for the NEDs, other than in relation to merely administrative matters, which are likely to be the province of the Company Secretary, or that person's PA. He should also appraise them, and be appraised by them or some of them, where no NED is Deputy Chairman or Senior NED, and there may be safety in numbers.

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?

NEDs should bring to the board, in the classic language: independence of judgment, knowledge of the outside world and constructive challenge of accepted thinking. Today these are seen as being applied in two aspects of the role, the strategic contribution to the business and monitoring the performance of the business and the executive team. As ever with boards, it is not always easy to distinguish between the two aspects. For example, if the NEDs on the Audit Committee are evaluating business risk, and the company's response to it, they may well be contributing strategic input as to avoidance of business

sectors which are too risky for their rewards,
from

making comparative suggestions as to best practice

their outside experience, and making judgments on the effectiveness of the executive team by their response to the matters at issue.

Not surprisingly, management puts a higher value on the business input, and so should the NEDs. In the unitary board responsibility is indivisible, and if the NEDs are seen by their executive colleagues as a group of risk-averse, negative narks, who have nothing positive to contribute, they will be ignored by the executives, who will conduct their real business elsewhere, outwith the boardroom. As we have seen, the out of touch and off the pace continental supervisory board is no model of corporate governance. NEDs who are well informed, engaged with the business, and perceived by their executive colleagues as making a useful contribution, will be accorded more respect by them when they are attending to their monitoring and compliance duties.

For that reason all NEDs should contribute to both aspects of the role, and serve on relevant committees. Clearly, however, not all will, nor should, have the same skill set, and a well structured board will have a skill plan to ensure all relevant roles are covered with directors having the requisite experience, for example in finance, marketing, legal or production engineering as may be relevant, and that succession plans are made to cover this aspect. Succession planning for NEDs is now practised by the better boards. NEDs can also mentor marzipan layer executives as part of their role. This opens up knowledge of candidates for board succession, and encourages those more junior executives that they are visible on the board's radar. NEDs can also have portfolios on a rotating basis, to aid their understanding of the business. To create a separate and distinct class of NEDs as quasi auditors in the boardroom would be ineffective as a control, do serious damage to the integrity of the board, and be a deeply unsatisfying job for someone to undertake, save for those misguided persons, most of whom have never served on a board, who think this aspect of the role is the sole raison d'être of the NED.

3. How does this compare to the present position?

The better boards will follow all or most of the practices referred to in the previous answer. Those who do not should do so wherever practicable. Lord Young's trenchant attack on the relevance of NEDs at this year's IoD conference, reflects a prevalent view of many executive directors. NEDs must work hard and be in post for sufficient time to know their business, and earn the respect of the executives. Whilst this means that too frequent rotation should be avoided, giving rise to longer terms of office for NEDs than are being stipulated by some commentators, this can be achieved without compromising their independence.

It is no accident that Marconi's dramatic and ill-judged change of strategic direction was accompanied by a clear out of long serving NEDs. In consequence the board lost at a stroke a lot of experience of the business as well as a potential constraining factor on the excesses of the new management. It is very difficult to take a strong position on strategic questions as a new appointee without being at risk of being made to look foolish.

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

Independence is an attitude of mind, and a matter of character, rather than perceived compliance with a formula. A robust readiness to speak one's mind, combined with a sound knowledge of the business, may be as necessary to oppose an ill conceived proposal as to question a rather racy accounting treatment. For the reasons stated in the previous answer, in my view, shorter terms of NEDs, and the quicker they therefore rotate, will reduce their effectiveness in either aspect of the role. Moreover, I am aware of NEDs, whose freshness of appointment was such as to be compliant with the strictest independence requirements, but who were in a very real sense financially dependent on the NED fee, and therefore unable to exercise truly independent judgment.

It is perhaps instructive in this context that the Combined Code leaves the question of independence to the board, who are required to identify independent directors in the annual report, and that the mechanistic rules are seldom followed in practice by institutional shareholders, who tend to abstain from voting as a mark of their displeasure rather than to vote against, save in the gravest of causes celebres. (There are, however, signs that this is beginning to change particularly in relation to matters of board remuneration).

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 obvious candidates for potential conflict are remuneration and contracts in which the executive director is interested, for example an MBO, but the potential also exists in changes in strategic direction and acquisitions and disposals, which may bear upon the career of one or more executive directors, in terms of personal employment threats or opportunities. The latter provide the greatest difficulty in practice when it is sometimes necessary to "aim off" for bias when one concludes a particular proposal has been coloured by personal interest, conscious or more often unconscious.

As regards the former category, the weakness of traditional company law that disclosure is sufficient to enable the person conflicted to participate in the decision has been mitigated by a variety of procedures. Approximately half of the Combined Code deals with remuneration and the Remuneration Committee, the Takeover Code requires any public to private bid by an MBO team to be handled by a committee of disinterested directors which in practice usually means the NEDs, and CA 85 S 320 requires substantial contracts with directors, of all companies public or private, to be subject to affirmative shareholder resolution.

The best way of dealing with both categories is for the company to have a company-wide ethics policy which requires alertness to the possibility of conflicts of interest arising, and a duty to disclose. Such a

policy will apply equally to the executive directors, and significant matters can be entrusted to an NED committee to progress.

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?

As a general rule, taking into account preparation, travel and attendance at board and committee meetings, and allowing for some involvement in projects, an NED appointment will take 2/3 days per month in a “steady state” business. The Chairman’s role in such a business is likely to take twice as much time, say 4/6 days per month. Of course all companies are not the same, and become unsteady from time to time. When that happens, for example, if a chief executive is to be dismissed and a new one recruited, or if there is a major deal or takeover bid by or for the company, the role for the Chairman, or relevant NED, can be more than full time. In addition, in order for NEDs to understand the business, it is the practice to arrange a programme of induction and continuing site visits to the company’s operations. This is sensible, and can often be effectively combined with board meetings. Participation in strategy off-site meetings by the NEDs is also becoming common.

My perception of the differing demands of larger and smaller companies is that these are inversely proportionate to size. FTSE 100 NEDs usually attend a monthly board which seldom takes more than half a day and committees fixed around that commitment, and are relatively remote from the business, with little contact between meetings. Whereas in smaller companies NEDs are often seen as business advisers as well as directors and have a greater day to day involvement, perhaps requiring participation in a project team where they have relevant skills, or mentoring a junior manager for the same reason. In consequence, they may receive two or three telephone calls or emails a day, some of course for information only. Whilst there is an obvious risk that such involvement will compromise independence, in my view, that risk is outweighed by the benefits of knowing more about and being engaged in the business. As well as being more satisfying for the NED, it is more difficult to pull the wool over NEDs’ eyes if they have their own networks of information within the organisation. Experienced NEDs can play this wider role without prejudicing their independence or interfering in normal reporting structures.

Having regard to the foregoing, and the need to allot time to keep abreast of professional developments, a “plural” NED with no full-time job can, in my opinion, do justice to no more than five appointments, one of which could be as Chairman. Full time executives could only do a maximum of two, and preferably one. However, I believe it is neither desirable nor practicable to impose such a limit, whether by legislation or guideline. It should be left to the good sense of nomination committees, who are alive to the issue.

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

The role is of course already enshrined in the Combined Code as the person “to whom concerns can be

conveyed “. The code does not make clear the type of concerns nor by whom they are likely to be

conveyed, and nor does Hampel in paragraph 3.18, but the implication is that investors need a separate channel to the board when their concerns involve either the chairman or the chief executive personally. It is to be hoped that this would be a rare occurrence, but in addition to that narrow function there are other useful tasks for the SID, as the senior NED is now somewhat inelegantly being called

I have experience of meeting representatives of substantial institutional shareholders at their request on a one to one basis to go through the company’s governance processes as a matter of regular routine and not to meet any specific concern. Those representatives are usually different from the fund managers who meet the CEO or FD at analysts’ presentations, and their interests are more long term and have an emphasis on governance rather than financial performance. It would clearly be a potential source of conflict on the board for the SID to have a significant internal role, which might be thought to usurp that of the chairman, but at the chairman’s request I have arranged consultations of both executive and non-executive colleagues and performed internal communication tasks on governance and risk management, where it was felt the SID role added weight to the message.

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?

It is not surprising that this is the case because it is a re-statement of existing law, which of course is based on the unitary board concept, making no such distinction. I am content with this and believe that to attempt any such distinction would be difficult, divisive and damaging to corporate governance in the UK. I welcome the Government’s plan to publish a plain English version, as I fear that one has to be a lawyer to comprehend the draft text. I have produced my own plain English version, couched as nine positive commandments for directors, which I use when I lecture on directors’ duties. I disapprove of the proposed reduction of the principles to seven by the removal of the two relating to insolvency. Whilst I accept that directors in specific business sectors are subject to additional duties under, for example, consumer credit or financial services legislation, all directors are subject to insolvency rules. It is therefore wrong in my opinion to distinguish insolvency law from company law. Moreover, the most frequently asked questions I am asked about directors’ duties are about the judgment of when to continue and when to stop trading

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?

Good NEDs should have a sound understanding of business, the capacity to see strategy in the round, the ability to get on with their colleagues and the company’s other employees, the knack of absorbing

quickly a lot of complicated information and still seeing the wood rather than the trees, a realisation that it is only possible to participate in executive management when invited to do so, and preferably some

specific skill which will be valuable to the company. The one skill which is essential is to ensure you are perceived by your executive colleagues as bringing value to the board mix, and being positive rather than negative, otherwise the board will be unhappy and ineffective, and you personally will not last long as a member of it.

Perhaps the most important ability in the next decade will be to live with ceaseless change, and ensure that the management team can do so as well. It may be the NEDs' job to find replacements for a burned out management team

10. What personal qualities and attributes are needed?

There is no magic formula or background. One of the best NEDs I ever served with left school at 16 and did an apprenticeship as a bricklayer. In consequence there was nothing he did not know about the building trade, and he also had superb judgment and a great way with people. Resilience to pressure however subtle, and the capacity to listen, analyse and respond in debate are invaluable.

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.

This is entirely dependent on the business of the company. What is important is that the Nominations Committee analyses the required skill-set, and aims to make appointments to fill those roles according to a planned and transparent process. Many will have multiple skills. It does not matter if in the event a candidate is selected who does not fit the person specification perfectly, provided the selection process is rigorous, and the absent skill can be sought in the next search, What is important is that the board members get on with each other. There is nothing worse than a board of all the talents who are at each other's throats. NEDs with specific skills can fill gaps or supplement inexperience amongst the executives.

As a lawyer director I was personally involved in building an increased profile for the compliance function at Britannia BS in the wake of regulatory shortfalls. Following findings of potential pensions mis-selling by the field sales force I was asked by the board to play a leading role in ensuring the organisation had an all-pervading compliance culture. Together with the Chief Executive I recruited a new Group Compliance Officer, also a solicitor, helped her to build an effective team, created a new Compliance Committee which I chaired, and spoke at internal conferences and other events in support of the re-invigorated compliance mission. This initiative has proved successful and resulted in a clean bill of health from the society's regulators in relation to on-going compliance matters.

This was one among many projects which I have undertaken at Britannia. Apart from service on the usual committees I have also been involved in working parties on defence of mutuality, re-shaping the board agenda, member communications and monitoring arrears performance. Other NEDs have had a similar involvement in different projects utilising their individual skills. Like them I also spend time visiting the branches and supporting and mentoring staff.

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?

It is never easy to recruit the ideal candidates, because although the pool of would-be NEDs is large, those who are really suitable are limited in number, and as always a good predictor of success is to have been an effective one somewhere else already. Busy CEOs, whilst seen as ideal in theory, have other pressures on their time, other concerns at the forefront of their minds, a low boredom threshold, and an inability to stand back from the executive role in many cases. There are of course exceptions. Professionals, with a positive attitude to business risk, and preferably with practical business experience, may be a source of good NEDs, as also would be former company secretaries, with the requisite skill-set and extensive boardroom experience. The Equitable Life debacle, and consequent litigation, will not make it any easier.

Recruitment and appointment mechanisms are now more structured and transparent, and in most cases involve well briefed search consultants.

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?

Diversity is clearly desirable both on grounds of equality of opportunity and to ensure that the board truly reflects the company's customer base and the community within which it operates. Most boards will include these desiderata as part of the brief for the Nominations Committee. The pool of qualified and experienced candidates to address these issues of diversity is even more limited than that for well qualified NEDs generally. Whilst it would be a breach of good governance to recruit an unsuitable candidate merely on grounds of diversity, most boards will positively discriminate for diversity reasons when choosing between two otherwise equal candidates.

The question of international representation is a difficult one. Clearly for those businesses with an international dimension whether in terms of markets or technology, this will be sensible. However, I am

aware from personal experience that the travel time involved can be a problem for a busy US CEO at his

or her peak. Video conferencing helps, and I have attended several board meetings successfully involving Australia and the US, but like all such uses of that medium it only really works when the participants know each other well, which implies some physical meetings will always be necessary.

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?

At present, I do not believe that the rewards are inadequate. However, given the growing demands on NEDs both as business contributors and participants in compliance processes, and against the background of the Equitable Life proceedings, it will inevitably be necessary to increase the NED pay levels.

I have no objection to those NEDs who have other means of meeting their grocery bills electing to be paid in shares. However, I do not believe they should be eligible for options or bonuses, because of the obvious conflict of interest in their key role in policing executive director remuneration. The optics would also be unfortunate.

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

Provided a board behaves sensibly and conducts its affairs with due diligence, I do not believe the risks are unacceptable, although one cannot rule out having to defend claims for breach of duty, which are likely to increase as the compensation culture in the UK catches up with the US.

The cost of successfully defending such proceedings is of course what Directors and Officers Insurance policies cover, because the company cannot fund wrongdoing against it. Such policies should be taken out by the company for all directors, because on the unitary board, they are all equally liable, subject to additional liability for those with professional qualifications who should have known better. This is also in practice the cheapest way of obtaining cover, which is underwritten on a specific company basis.

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?

My personal experience is that the Code is working well in relation to the boards on which I serve., which are compliant not only according to the letter but also in spirit. My concern is that is not always the case elsewhere, and companies claiming compliance are ticking the boxes and not embracing the

principles of good corporate governance with enthusiasm. Nevertheless, I do not believe this position would be improved by more rigorous legislative prescription, and the concept of a code does permit derogation in appropriate cases provide it can be justified.

The one third rule for NEDs is sensible so as to avoid the possible feeling of isolation, or even in the worst case to prevent positive attempts at marginalisation, but the question of whether NEDs should constitute the majority is a difficult one. As I have said above , the nineteenth century model in the UK was for a board consisting almost exclusively of NEDs, and the model of a majority of NEDs persists to this day in the US, where it did nothing to prevent the recent corporate scandals there. In the UK we have a majority model in building societies which are required to adopt this by their regulator.

My personal experience is that there is little tangible distinction between the cultures of the Britannia BS and Serco boards, which are both collegiate and open, freely sharing information and welcoming NED contributions. I do , however, accept that in some boards the NEDs can be kept on the fringes, and it would be difficult to do that if they were a majority. One positive benefit of having more NEDs is to provide the executives with a resource pool of expertise which they can and do call on frequently. Britannia's NEDs have , and were consciously sought for, expertise in: accounting and finance, banking and treasury matters, business strategy, corporate finance, governance and law, economics, industrial relations, residential property markets, retail operations and systems procurement. This expertise is not there to second guess management, nor to replace external consultants, but to provide a reality check for all board members when addressing complex questions.

The accountancy profession has spent much time, without final success, in an attempt to define independence for the purposes of audit independence. As indicated above, I believe that any attempt to define further NED independence would be counter-productive, and the matter should be left to the judgment of boards. In particular, a mechanical disqualification solely on grounds of length of service would be inappropriate and potentially damaging to governance in UK boardrooms, potentially destroying board glue, continuity, culture and collective wisdom , all of which are important factors in the success of boards. Of course, there should be no automatic re-appointment, but whether an individual continues to deliver robust, independent value should be a matter for decision by the board itself, being in possession of knowledge of all the relevant circumstances, rather than the application of a rigid formula.

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 structures are sound, provided that it is understood that different businesses may require further

committees to address their specific concerns, for example , compliance or health and safety, always premised on the basis that the committees report back to the board, which assumes collective

responsibility. The effectiveness of the committee will, of course, depend on its chairman, and the support of the company secretary.

As a former professional company secretary I have been involved as a NED in devising effective board meeting structures. The agenda should be primarily forward rather than backward looking, and should leave sufficient time for strategic matters, rather than formulaic approvals of proposals, which should instead be the subject of appropriate delegated powers to management . Above all, the meeting procedures should be kept under review, and NEDs encouraged to provide input on improvement in format and processes.

My personal experience is that boards should not exceed 12 members, to ensure effective dispatch of business, whilst allowing a proper opportunity for involvement and contribution, and preferably be closer to seven members. If NED majorities are encouraged this will lead to bigger boards.

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?

The name has become somewhat misleading because, in practice, the remit of Audit Committees has developed to cover corporate assurance, compliance and risk management in the round, as well as financial and treasury matters. This is entirely appropriate, but requires more time and expertise on the part of the NEDs.

I believe Audit Committees which are applying best practice are working effectively, and steps should be taken to disseminate such practice, rather than to add further blanket prescriptions. In this context, the Government has announced that it is conducting a review of auditing and the effectiveness of Audit Committees in the wake of the Enron and other financial scandals, from the fruits of which we may anticipate the issue of further guidelines in any event. These may well take the form of an expansion of the existing Code provisions.

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

Similarly, I believe that these committees which are applying best practice are working effectively, and steps should be taken to disseminate best practice , rather than to add further blanket prescriptions. As stated above, approximately half the Combined Code deals with remuneration and the Remuneration

Committee, to which must now be added the requirements being introduced for a non-binding shareholder vote on executive remuneration, which include further detailed prescriptions for the

Remuneration Committee. We need an holistic vision of best practice for joined-up governance in this area not a sticking plaster approach to reform reacting to perceived excesses, which may fail to consider all the implications.

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?

The performance of the board as a whole in a general sense is tested by the performance of the company, because if the board is dysfunctional, its failure to perform will after a time-lag, inevitably impact on company performance. In a specific sense standards and objectives for the board should form part of the Chairman's appraisal process, since he has the greatest opportunity to remedy any shortfall. Whilst it is in theory possible to devise criteria for external evaluation of board performance, they are in practice somewhat artificial and superficial, and are unlikely to add much to the prospect of achieving good governance, if the will to do so is absent. Clearly standards can be set for processes such as information distribution or content of investment proposals, which all good boards do already, and NEDs as well as executives should be appraised. Board contribution should be included in executive directors' appraisals, and the Chairman should be appraised by the Deputy Chairman or SID. At Britannia I do this annually on a formal basis, having taken soundings from all the other directors, and can communicate any comments or suggestions for improvement on a non-attributable basis, so people are free to speak their mind to me in the knowledge that their comments will be passed on anonymously. At Serco as SID I have six-monthly meetings with the Chairman at which board performance and any possible improvements are a standing agenda item.

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?

Naturally more can always be done, but there is a danger of missing the point here. The board is just one of many functioning components of a successful business. Provided it appears to be working, and what is more important is continuing to deliver the results, the best approach would be: if it ain't broke don't fix it!

In my view it would be inappropriate to report on board functionality beyond what is required at present, principally because the only objective KPIs, such as number of meetings, director attendance, and hours worked by NEDs would be very superficial and misleading, and any subjective evaluation would be

likely to be anodyne. What board is going to state that having considered their procedures and processes, they have concluded that they do not do things very well?

By the same token it would not be appropriate to publish performance evaluations for the NEDs, anymore than it would be to publish the outcome of the appraisals of the executives, other than to the extent targets and objectives are comprised within bonus schemes. Anyone who has run appraisal schemes where the grades awarded are published knows that that this leads to a bland “satisfactory” for everyone. Serious attempts to coach individuals for performance improvement require confidentiality. Surely even NEDs have some human rights? If a poor appointment is made it can be dealt with at much less cost and with a very much lower public relations impact than an executive appointment, unless the Nominations Committee suffers a succession of failures, which would probably mean there was something else more seriously wrong on the board in question.

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?

The short answer is yes of course, provided the NED has the necessary information and knowledge of the business. This can be achieved without compromising independence. I am content that in Britannia and Serco I am well informed without being a cheer-leader for management and its policies. From time to time we disagree and say so, or have doubts and express them. These reservations have been listened to and reflected in improved proposals or processes.

NEDs are members of the board, and derive their authority and legitimacy from that fact. They are not quasi-auditors or freelance whistleblowers. They should therefore be chary of contemplating a crusade against their board colleagues. I am fortunate to have served on the boards of extremely ethical companies, but I have thought of what I would do if I uncovered something which smelled. My first approach would be to the Chairman, and the next step would depend on his response. If I found this was unsatisfactory, I would get the external auditors on side. If the matter was sufficiently serious, I would expect both of us to threaten resignation unless satisfactorily resolved. Whilst resignation of an NED may be acceptable a simultaneous resignation of the auditors would not. Of course, in practice, really big issues are likely to arise but rarely, and in resolving lesser but nevertheless important concerns, an NED must be prepared to battle it out, and if necessary, walk away alone, facing the fact that he is unlikely to be at the top of any search consultants want list thereafter. There are unfortunately no prizes to be won in such a situation, but there is nothing more he can do.

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?

Save for the SID role referred to above, NEDs have no continuing relationship with shareholders, other

than to sit next to them at lunch after the AGM, and nor should they on an independent basis. Investor relations is a matter of great importance, which requires planning and co-ordinated communications, and can involve the CEO and the FD in meeting and presenting to hundreds of analysts and investors over a year. In the case of Serco I have monitored the questions raised at these meetings, and I have been informed there have never been any on corporate governance. As SID I am always willing to meet any shareholder but have only been asked to do so on a handful of occasions, and then only as a matter of good practice and not in the light of any specific issues. NEDs are members of a unitary board and are not representatives of institutional shareholders. It would therefore be wrong to strengthen the relationship other than as part of a co-ordinated investor relations programme, and then only to satisfy an express demand. The SID procedure is naturally in place if anyone has any specific issues.

As regards other stakeholders, such as employees, pensioners or local politicians, NEDs can play a useful role in projecting a rounded picture of the company, and I have personally taken part in many meetings with such persons as an NED, but only on request of management and after making sure that what I was proposing to say was “on message”.

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?

In the case of the boards on which I serve, I am aware that the chairmen take active steps to ensure all the matters referred to in this question happen, although I am equally sure that there are some chairmen who not. Education and encouragement of best practice are what is required to deal with shortfalls in this respect.

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?

NEDs should have an open and co-operative relationship of mutual respect with the executive directors as colleagues on a unitary board, sharing equal responsibility for the direction of the company and the stewardship of its resources. Friendship will not prevent the exercise of independent judgment. In fact, it may make it easier to communicate some unpalatable truths, when that becomes necessary, as it assuredly will from time to time.

NEDs should be exposed to senior management, as has been stated above, for two reasons:

first, to be aware of executive talent below board level which may have potential for promotion one day, and thus possible candidates for management succession, (which would naturally have to be supplemented by a formal management resource audit) ; and

secondly to encourage junior managers that they are on the board's radar screen, and in the process help to inform the NEDs further about the company's business.

In any such contacts the NEDs should, however, be sensitive to the fact that they have no executive authority, save to the extent it may be given by management for specific purposes, and they must be careful not to confuse normal reporting relationships. So long as these principles are observed management will have no difficulty in permitting NEDs free contact with personnel throughout the company, and indeed will doubtless find it beneficial and therefore to be encouraged.

The Chairman should, as stated above, be the NEDs' main point of contact on substantive matters or the NEDs' own personal position, but the CEO and the NEDs, as board colleagues, should feel free to communicate directly at any time

As regards external advisers, while the NEDs would expect to have met them, and had a hand in selecting them, to a greater or lesser extent, the relationship should be managed by the executives. Exceptions to that would be the Chairman of the Audit Committee having a direct relationship with the Engagement Partner in the company' auditors, and indeed to participate in any beauty parade of auditors, and similarly for the Chairman of the Remuneration Committee and the remuneration consultants. All NEDs would expect to be consulted, and directly involved if they have relevant experience, in any change in principal advisers, such as investment bankers or brokers.

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

The Company Secretary serves the whole board, and particularly if he or she is a Chartered Secretary, and a trained corporate governance professional, will have a key part to play in ensuring the highest standards are attained. At a practical level. the Company Secretary or that person's PA will usually be responsible for all " pay and rations" questions for the NEDs, such as travel and expenses. As an ex-Company Secretary myself I have spent a lot of time as an NED mentoring company secretaries, and ensuring they are meeting the reasonable expectations of the NEDs. There are many small but important practical ways in which the life of the NED can be made easier, and the NED more effective in consequence. An example would be always contacting the NED before dispatching a bulky board pack to ensure there will be someone there to accept it, so the NED does not waste time chasing papers which would be better employed in studying them.

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?

The answer is enough but not too much. I have never been denied access to any information or anyone, to which or whom the executive directors would have been entitled to have access. The trick is to be provided with the right information in the right form at the right time without having to ask for it. Like all such desirable objects this cannot be achieved without application and experience, but having been responsible for the provision of board packs oneself does help. An equally important consideration is the use of modern technology. The Serco board pack is circulated in CD rom form, and for key documents a virtual boardroom has been constructed on a password-protected area of the company's intra-net. Emails are also a great way of keeping NEDs in touch, with, for example, information releases, press cuttings, market reports and broker circulars all being instantly available. I also find it appropriate to read at least one trade magazine, for example "The Mortgage Finance Gazette" by way of background, and Britannia subscribes to this for all its directors, including the NEDs.

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

Having two relevant professional qualifications, as Chartered Secretary and Solicitor, and always having undertaken the requisite continuing professional development, I find myself comfortable with meeting my own training needs and indeed lecture frequently on governance matters, but I also find the IoD facilities and the NED "Clubs" run by the leading accounting firms a helpful source of updating material and, perhaps more importantly, the opportunity to discuss matters of mutual concern with other NEDs. Britannia encourages participation in relevant courses and conferences, particularly those arranged by the trade association, The Building Societies' Association. Serco similarly has an active board Training Committee and has initiated the first company specific Chartered Director programme in association with the IoD as a development opportunity for subsidiary company directors, and with which I am personally involved as a supporter. Whilst I applaud this initiative and the Chartered Director programme generally, I should record that whilst I am not in favour of mandatory qualifications for directors, whether executive or non-executive, I believe NEDs should be encouraged to attend relevant courses, particularly former executive directors, because it is a different and sometimes difficult role.

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

Any training programme can always be improved, but I am a little concerned that at present induction programmes are in danger of getting out of hand. The executives are rightly proud of their company and want nothing more than to show it to the new NED in all its loveliness. The time commitment can be

extensive and if six months or so of induction is the norm it will be necessary to get many good years of service out of the NED concerned. This adds point to my view, expressed above, that there are negatives associated with too rapid rotation, where the NED concerned is doing a good job.

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?

Since Cadbury NEDs have been entitled to receive a formal letter of appointment, which should deal with such matters. Certainly in relation to both Britannia and Serco NED letters are to this day based on a draft which I furnished following Cadbury. Provided such a comprehensive letter of appointment exists, NEDs should have no illusions as to their obligations and entitlements. As to feedback that should be part of the normal appraisal process, when the appraiser should have taken soundings from other board members. Any good chairman will also give feedback on an interim basis, positive or negative, particularly in the case of new appointments. The effectiveness of board functions are too important to let things fester.

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

Clearly scale brings one closer to the real world. Directors of smaller companies are usually more concerned with meeting the monthly payroll than niceties of corporate governance. This is not to say that they should not be encouraged to aspire to higher standards, which is why the idea of a code of recommended conduct, from which derogations are permissible if justified on good grounds, of which size and board resources would be a good example, is preferable than two prescriptive standards, one of which is lower on the face of it.

A word on the very different role of the NED in smaller companies may be appropriate. As has been stated above, his role may be closer to that of adviser than that of policeman, at once more satisfying and more challenging. This needs to be understood when looking at how smaller company boards operate.

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

As the Weil, Gotshal comparative study of corporate governance codes in Europe commissioned by the

EC indicates there is a wide variety of standards on the continent, and as recent draft EC Directives also indicate, the UK is way ahead of other European countries in governance standards. The US in theory had high standards in the boardroom, but those were maintained by the threat of litigation rather

than conviction, and the contrast between theory and reality has recently been exposed. Accordingly, I personally doubt whether we have much to learn from elsewhere, other than that a lawyer in every boardroom makes everyone more comfortable, but may be a distraction from the real business opportunities.

One thing which can be learned with profit from America is the back-up and infrastructure available there to NEDs at the company's expense, which would repay closer study. If the Government sincerely wishes to improve governance through encouraging more professional and competent independent NEDs, perhaps it should pump-prime a College of Independent Directors, providing a sound base for the best practitioners, with shared facilities, information services, good IT, joint PAs, research assistants, meeting rooms, and common room facilities where mutual support and sharing of best practice can take place in congenial circumstances. The obvious partner for such a venture would be the IoD which already has city centre premises available for similar purposes in a number of locations throughout the UK.

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

According to the data available to me, there is no clear positive correlation between high standards of governance and high financial performance. Indeed, intuitively one can envisage there to be a negative correlation, as teasing fluff out of the corporate navel distracts the board from profit-generation. Of course, raising standards should contribute to strengthening of market position and therefore sustainable and growing earnings in the long term. This is also not to ignore the need to restore confidence in the integrity of the capitalist system as the best hope for improving living standards worldwide, in the light of recent US corporate scandals. In the circumstances, I do not believe we have much to learn from elsewhere on this.

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

See the previous answer.

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Directory: C:\tmp\work\R501110\KAREN\R501110
Template: C:\Documents and Settings\kanese.DEVELOPMENT\Application
Data\Microsoft\Templates\Normal.dot
Title: Higgs Consultation Paper by Rhidian Jones
Subject:
Author: Monica Jones
Keywords:
Comments:
Creation Date: 07/10/2002 11:06
Change Number: 2
Last Saved On: 07/10/2002 11:06
Last Saved By: camassey
Total Editing Time: 1 Minute
Last Printed On: 11/10/2002 10:06
As of Last Complete Printing
Number of Pages: 18
Number of Words: 7,748 (approx.)
Number of Characters: 44,166 (approx.)