

Non-Executives Directors – Derek Higgs

Quite independently of your review, I have been thinking for some time about the role of non-executive directors, and it seems to me that it can really be split into three separate sections:

1. Advisory
2. Watch-doggy/Compliance
3. Executive handling of certain key functions (notably the hiring and firing of the Chief Executive).

None of this is new. What is becoming increasingly apparent however is the inherent conflict between in particular the second and the other two functions. Not only does watch-doggy militate against a completely open relationship with the executives but it also creates problems for the non-executives themselves. How do you know whether or not you are properly informed? Of course, this can apply equally to executive directors at some companies! But the difficulty of being sure that you have the right amount of information at your disposal is a well-rehearsed one, (not just in the business world). At the end of the day, you need to be with people that you trust.

However, this response does not any more seem to me to be adequate for the requirements of professional investors and importantly public opinion (which of course has an important effect on the confidence of markets generally and in particular retail investors).

So if we need more regulation, how do we provide a framework without making the role even more unattractive, unfulfillable, or even more conflicted with the other elements?

I would strongly propose to move the watch-dog role out of the Board altogether (but see the penultimate paragraph), so that non-executives can relax a bit more and hopefully perform roles 1 and 3 even more effectively.

What is needed is an independent body with wide-ranging powers which should be exercised on a random basis, and which would function somewhat as a **roving supra-audit commission**. This should be staffed by the great and the good (or better still, the wise and the crafty) at the top level, to be drawn from the broadest constituency, to include company directors, fund managers, civil servants, tax, accounting and legal professionals, actuaries, trustees etc. etc. - and in every case, past and present.

They will be supported by a substantial permanent staff, including lawyers, accountants and other relevant professionals (e.g. valuers in the case of property companies), many on secondments. They should be able to call on a particular company and to inspect all of its documentary records, to interview its staff (and ex-staff) and professional advisors and so on. They would “descend” on a company for a period of time, to be limited except in special circumstances so that disruption is avoided, and in general no more often than, say, once in every three years for the biggest companies. Companies should be selected on a random basis but every company should be inspected on a regular (but not too frequent) basis so that “inspections” in themselves should not attract undue publicity.

The costs of the body should be met by investors, to whom it should ultimately be accountable. Of course, investors will look to have the cost of this reimbursed by the returns on their investments, but in the long-term I am sure that it would more than provide value for money. (Although it may be tempting to say that companies should pay for their own regulation, I do think that the example of this way round of doing things provided by the rating agencies shows that this can lead to corruption, or to slack disciplines at the regulatory "agency" itself as they become out-of-touch with their own investor constituency).

Should the investigation provide evidence of any sort of negligence or wrongdoing, this would be passed on to the relevant existing authority, whether SFO, FSA, Law Society, RICS, DTI or FRRP. Similarly, any failure to produce documents or staff (including ex-staff) would immediately be reported to the supervisory body.

In general, it would be hoped that the threat of this sort of investigation would be much more powerful than any threat from a single or even united Board of non-executives, and ensure that companies maintain best practice on a consistent basis.

Although this may conjure up rather Gotham City-type images, we should remember that we are not dealing here with individual liberty. The powers that this roving commission would enjoy would be effectively exercised by mutual consent, and would anyway be restricted to investigation, close scrutiny and report, rather than extending to the imposition of fines or other sorts of sanctions. This would remain the preserve of the existing regulatory and legal framework.

We should however make it clear that while the principal responsibility for this sort of compliance/watch-doggery would be taken from non-executive directors and given to this body, that will not relieve them of their general responsibilities as directors (any more than it would reduce the responsibilities of the executive directors). On the other hand, I do think it will make their role more attractive. This should increase the number of potential candidates, and the range of skills available, with benefits all round. Further, by removing an area with constant potential for conflict and mutual suspicion, it should help non-executives directors to be more naturally the friend of the executive management and therefore (a) in a much better position to advise on future strategy etc., (which is where I believe they can add most value), and (b) improve the overall functioning of the Board.

It is also vital to manage public expectations. Firstly, it should be made clear that while we want to catch the next Enron and WorldCom before they happen, investors in Marconi had their eyes wide open. Secondly, there is the thorny subject of the press. I am not going to pronounce on that here. We are all well aware of the libertarian arguments. But it is an attractive thought that the roving commission should also be able to investigate the business press, in great secrecy and privacy of course, but with the aim of checking the diligence and accuracy that journalists have used in sourcing their stories. Confidence in companies needs to be nurtured as well as tested, and the press has a vital role to play.

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