



**Response to Consultation Paper on Review of the role  
and effectiveness of non-executive directors published  
by Derek Higgs on 7<sup>th</sup> June 2002.**

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This document gives our response to some of the five key areas for discussion that are presented in the consultation paper. It also answers some questions put specifically to TMP by Derek Higgs and offers some additional information giving an international perspective.

### **Key Areas for General Consultation**

- A What role should non-executive directors perform, and how does this compare to the present position?
- B What knowledge, skills and attributes are needed, and what can be done to attract, recruit and appoint the best people to non-executive roles?
- C Do existing structures and procedures facilitate effective performance by non-executive directors?
- D Do existing relationships with shareholders or others need to be strengthened?
- E How can non-executive directors best be supported to perform their role?

### **Specific Questions put to TMP**

- 1 How are potential candidates for non-executive roles identified and approached?
- 2 How easy is it to recruit NEDs with the right skills and attributes? What about the availability of women and ethnic minority candidates? Do you think there is scope for an increase in international or academic representation on boards?
- 3 What is the relationship between headhunters and boards/nomination committees. Do you feel that you get clear guidance on the kind of individual a board is looking to recruit?

## Key Areas for General Consultation

### Section A -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 to review and approve strategy and budgets and to monitor the effective execution of strategy. The board is responsible to the shareholders for the successful development of the company and for maximising value for all shareholders. The role of the Chairman is to provide a secure and effective forum for the above. He is the bridge between the execs and the NEDs. He runs the board, not the company; the Chief Executive runs the company, not the board.*

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?

*There should be a separation of duties, with a head of audit, head of remuneration and, ideally, a head of nominations committee. For smaller boards the Chairman should be head of the nominations committee. While all NEDS should not be expected to sit on each of the 3 main sub-committees, and it is helpful that they do not, there should be a sensible flow of information between them and it should be the duty of the Company Secretary to ensure that this is the case. The head of the audit committee should be an independent director with a background in finance.*

3. How does this compare to the present position?

*In many cases some NEDs sit on all the key committees, although the chairman is usually different for each.*

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

*It is vital that the head of the audit committee is not only independent, but also seen to be so internally and externally. The heads of the remuneration and nomination committees need to be able to understand the business in the context of the market in which it operates. It is preferable that the head of the remuneration committee is independent, as this is an area which is coming under considerable public and shareholder scrutiny.*

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 Chairman should spend at least one day a week in a small business and 2-3 days a week for a FTSE 100 company. A CEO of a FTSE 50 company should take on no more than one NED position, a FTSE 100 CEO no more than two, and top limit on NED positions should be five.*

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

*Yes, with the expectation that this senior NED would normally succeed the Chairman. The senior NED should act as a point of contact for shareholders and directors who have concerns about the Chairman.*

**Section B – 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 NEDs to perform the role effectively, and how is this likely to change over the next 10 years? Are some skills essential and if so, what are they?

*A board should contain a mix of experience. For example a CEO or divisional director from relevant business, a finance director and then either marketing, FMCG, heavy industry background as appropriate to company and customer base. For some companies geographical experience is relevant. Companies with highly specialised/technical focus may need to balance the desire for a technical/sector expert against the need for all NEDs to be able to contribute to broad business issues, including company law, corporate governance and financial accounting. The increasing need for the Chair of the Audit Committee to understand fully and challenge the work of the auditors is likely to increase the demand for candidates in this role to have detailed financial training and expertise and a background as a Finance Director or a qualified accountant.*

10. What personal qualities and attributes are needed?

*Influencing skills are vital, an independence of mind, an ability to know when to speak and when to let others speak.*

11. What sort of mix of experience and attributes is desirable on a Board?

*See above.*

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?

*Within a relatively small pool, the challenge is to find candidates who not only have the right skills and attributes, but are able to commit sufficient time and do not have any professional conflict of interest. Challenges also include fit with other board personalities and other board meeting dates. There is a trend for companies to limit the number of external directorships that their executives may hold. Individuals with a portfolio of non-executive roles are becoming aware that they are unlikely to be able to make sufficient time commitment to more than 4 or 5 companies.*

*Some skill sets are easier to recruit than others. It is moderately easy to identify and recruit candidates with fairly common business skills and experience, such as general management, marketing, profit and loss responsibility, change management, or financial qualifications. There are more challenges to recruitment when either a very specific combination of skills or particular technical expertise is required.*

*Board roles in FTSE 100, blue chip companies are generally considered the most attractive. However, a significant number of candidates are interested in smaller companies where there is the potential for a flotation and the candidate stands to gain professional experience or gain financially, and where the contribution of individual non executive directors can be seen more directly.*

*Candidates (and their employers) are increasingly aware of the potential dangers of being associated with a poorly managed or poorly performing company and are therefore being more selective about the roles they take on. Candidates are reducing the number of boards they want to serve on because of increased demands on their time and dedication to each board, and it is becoming increasingly common for active CEOs to be restricted by their own boards to serve on no more than one outside board. The existing, already small, pool is therefore becoming smaller.*

*Broadly, particularly for FTSE companies, the recruitment of non executive directors is led by the chairman with the full involvement and contribution from the chief executive and the nominations committee and the rest of the board kept informed. Boards are increasingly sensitive to the quality and reputation of the candidates' other boards.*

13. What could be done to widen the pool of potential non-executive directors and introduce greater diversity into appointments?

*Search firms have an important part to play in increasing the number and diversity of non-executive directors. We use a logical process to identify the best candidates in the market and are trained to select candidates objectively on the basis of skills and attributes. Traditionally there has been a heavy reliance on personal recommendations by existing board members and by company advisors. While this approach can provide some high calibre candidates, it often ignores the candidate specification and may compromise the independence of boards and restrict non-executive positions to a small and interrelated group of people*

*Thought should be given to developing the next generation of non-executive directors. This will involve companies being willing to take on non-executives who have not previously served as NEDs and may not sit as executives on main boards, and offering comprehensive training and guidance for new board members.*

*Candidates are increasingly demanding detailed company information prior to considering any opportunity, and this is likely to translate into increasing demands for training once they have been appointed. Few companies currently offer any form of training and most do not have a formal induction programme. A lack of adequate training and induction is one barrier to recruiting new directors without previous non-executive board experience.*

*We have identified a way to widen the pool of candidates available and to provide support to new non-executive directors that will allow them to contribute to board discussions earlier.*

14. Are the rewards for non-executive directors appropriate, both in terms of levels of pay and the form the remuneration takes? Are current pay levels a significant factor in whether good non-executive directors can be attracted?

*In general pay has not been a significant factor. However, as recent corporate events have highlighted the reality of liability and responsibility of non-executive directors, candidates are questioning risk/reward and we are seeing salaries begin to increase to reflect this. There is a minority of individuals who will only take on non-executive roles where they are able to make significant financial gain, eg through flotation.*

### **Specific Questions put to TMP**

1. How are potential candidates for non-executive roles identified and approached?

*Candidate specification is agreed with the Chairman. This specification may include professional experience, sector knowledge, technical skills and personal attributes.*

*Candidates are identified either by headhunters through sourcing of contacts, research into appropriate target sectors/companies and from existing personal knowledge/database of potential NEDs, or by the client company through recommendations by existing board members, company bankers, corporate advisors or shareholders. Recommendations can provide high quality candidates, however they often involve an element of self-interest. The background of candidates is researched to establish their suitability for the role. This may include informal referencing.*

*While it is useful for a headhunter to have a database of, and maintain ongoing relations with, potential candidates, he/she should avoid presenting the same small pool of candidates for each search. The headhunter is retained by a client company, not by an individual is seeking a NED position.*

*Traditionally, NED candidates have been approached and presented to the client in sequence, with the next candidate being presented only if the first is not successful. TMP takes an approach similar to that used for executive roles, presenting a selection of candidates simultaneously and thereby offering the client a clearer view of the market.*

2. How easy is it to recruit NEDs with the right skills and attributes? What about the availability of women and ethnic minority candidates? Do you think there is scope for an increase in international or academic representation on boards?

*The board has two key functions – offering technical/sector/market specific advice and ensuring effective corporate governance. Companies must consider carefully whether they can accommodate a director who cannot contribute to both of these functions, particularly if the board is small. This may be the case where a company has a very specialised focus and a director with the requisite technical experience is unlikely to have any corporate experience (e.g. Medical doctor).*

*In order to increase the pool of non-executives (including women and ethnic minorities), boards should be encouraged to consider appointing NEDs who have not previously held a non-executive position or do not sit on main boards. Within large corporate environments, executives who sit on divisional or management boards or on executive committees will often have sufficient understanding of business issues, company law, strategy, P&L accounts, performance and remuneration issues. Such candidates would need the support of the board to develop their skills as a NED. In general companies should put more emphasis on providing a formal induction programme and ongoing training for NEDs. We have also developed a way of bringing those new to this role up to speed.*

*There is scope, and indeed demand, for non-executives with international experience. Many UK companies have significant overseas interests, and those that are predominantly UK focussed may rely heavily on overseas sourcing, for example. International expertise may be gained from a non-executive director who is based in the relevant country, a director who lives in the UK but is a national of the relevant country, or a director who has significant previous experience operating in that country. Where candidates are based overseas, the chairman needs to ensure that they can commit sufficient time to attend board meetings and make an effective contribution.*

*The appetite for academic experience is generally limited to those companies which have a specific technical requirement, eg scientific expertise. There is some limited potential to increase the pool of non-executive directors by considering candidates from academic organisations, however the focus is likely to be on those candidates who are essentially business managers of complex organisations with significant budgets.*

3. What is the relationship between headhunters and boards/nomination committees? Do you feel that you get clear guidance on the kind of individual a board is looking to recruit?

*The headhunter's relationship tends to be with the Chairman (except when appointing a Chairman), rather than with the whole of the board or even the nominations committee. The Chairman, with input from the CEO, gives guidance on the type of individual that is required and is the primary point of contact. The Nominations Committee typically gets involved once a shortlist has been drawn up and will contribute views on potential candidates during the interview process.*

## **Additional Information**

### **Analysis of compensation for US Boards**

- Board Retainer (Average Cash \$33,079, Stock \$12868)  
The equivalent of a base salary. May be paid in cash, stock or a combination of both.
- Board Meeting fee (Average \$1,151)  
Payment per board meeting attended.
- Committee meeting fee (Average \$867)  
Payment per committee meeting attended. Usually cash, but sometimes paid in stock. Use is declining.
- Committee retainer (Average \$693)  
Annual payment for membership of a board committee.
- Committee Chair fee (Average \$207)  
Payment per committee meeting chaired.
- Committee Chair retainer (Average \$5,958)  
Annual payment for chairing a board committee. Usually cash, but sometimes paid in stock. Use is increasing in order to reflect the growing emphasis on the role of committee chairs.
- Stock awards (Average \$81,157)  
May be paid as stock grant, stock options, restricted stock, deferred stock.
- Pension benefits  
Use has dramatically declined; very few boards now offer pension benefits.
- Total Package (Average \$152,626)  
On average 62% of this is paid in stock, 38% in cash. Cash payment has remained fairly level over the past 5 years, with a sudden increase in 2001 of 7%. Stock values have increased by 225%. The majority of companies allow directors to swap some or all of the cash payment for stock. 72% of companies allow directors to defer their compensation into an investment account until they retire. The majority of companies require directors to own 3-5 times their annual retainer in stock.

Based on data provided by Pearl, Meyer & Partners in their report “Director Compensation 2001. Board in the Spotlight. Study of the Top 200 Companies.”

**TMP Worldwide, founded in 1967, is a NASDAQ 100 and an S&P 500 company, and the world’s largest recruitment advertising agency**

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