COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

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18th July 1991

David Shaw Esq MP
House of Commons
LONDON SW1A 0AA

Dear David Shaw,

Thank you very much for your letter of 11 July and for sending me a copy of the memorandum on Corporate Governance prepared by the Bow Group Economic Affairs Standing Committee. I found this of great interest, and I am sure it will similarly be of great interest to the members of my Committee.

I am not at this stage able to offer you comments on my Committee's behalf on the substance of your recommendations, as we have not yet begun to consider the issues in detail. However in the expectation that we shall be further advanced by the end of the summer recess, I would be very pleased to meet you then and to discuss your recommendations with you.

Yours sincerely

Adrian Cadbury

Adrian Cadbury

CAD-03117

DAVID SHAW MP

HOUSE OF COMMONS
LONDON SW1A 0AA

Sir Adrian Cadbury
PO Box 433
Moorgate Place
London
EC2P 2BJ

11 July 1991

Dear Sir Adrian,

Thank you for your letter of 30th May regarding the Committee on Corporate Governance. I enclose a final draft of a memorandum which has been prepared by the members of the Bow Group Economic Affairs Standing Committee of which I am chairman. I hope that this will be of interest, and I would much appreciate your comments.

Yours sincerely,

David Shaw

P.S. It was quite coincidental that we were examining this issue at the same time your committee was being formed.

CORPORATE GOVERNANCE

The Bow Group Economic Committee are concerned at the adverse publicity being received by the City on account of the mis-management of some Public Limited Companies. Whilst many companies are well managed, there are some whose standards of Corporate Governance are not acceptable.

Examples of the concerns of the Committee are major company collapses, the City Fraud cases, the 22.7% increase in Director's remuneration at a time of economic difficulty, the secrecy of service contracts, the excessively large settlements for dismissed directors, the impotent feeling of shareholders, and the lack of clear communication to them of key information.

The Committee proposes some changes in Corporate Governance, most of which are merely to ensure that all major companies have the high standards of Corporate Governance now in use by the best companies. There are some new ideas, which the Committee feels will have widespread support, and will help to raise the standards of Corproate Governance.

The Committee asks you to examine the attached proposals, and to consider bringing them into force either by use of Statutory Instruments under existing Companies Acts, or by introducing new clauses into the next Companies Act.

On a separate but associated topic, the Committee questioned whether the auditing costs imposed on every Limited Company - which amount to £750 to £1000 for auditor fees and submission of the Tax Return to the Tax Inspector alone for even for the smallest company - were now a burden on enterprise for which there was sufficient benefit? After the welcome removal of the requirement for all such accounts to be filed annually in Companies House, who, today, needs the financial accounts for every small business to be audited?

PROPOSALS FOR CHANGES IN LAW CONCERNING MATTERS OF

CORPORATE GOVERNANCE

MAIN RECOMMENDATIONS

Non-Executive Directors

1. Define the responsibilities of Non-Executive Directors, to include their duties on the Audit and Compensation Committees. These Committes should have a majority of Non-Executive Directors.

2. Where there are no Non-Executive Directors, shareholders should easily be able to nominate candidates to stand for election as Watchdog Directors. The election of Watchdog Directors may be competitive, with more candidates than vacancies.

Compensation Committee

3. Define the duties, responsibilities and membership of the Compensation Committee in line with the best practices. This should include:-

   a. the Remuneration Package for Directors and senior Executives, and

   b. the incentive packages (to be based upon long-term preformance), including share options (the option price to be indexed), and

   c. any Service Contracts, which should not exceed 2 years without Shareholder support.

4. The Compensation Committee should publish the main terms (b) and (c) relating to Directors for election (and any other Directors for whom there is a change in terms) in the invitation to shareholders to the AGM.

Audit Committee

5. Define the duties, responsibilities and membership of the Audit Committee in line with the best practices. This should include:-

   a. reviewing the company's financial results, the scope and results of audits, and

   b. recommending the appointment of the company's external auditors, and reviewing their procedures for ensuring complianace with the company's policies on conflict of interest.

6. The external auditors should report to the Audit Committee.

Concentration of Power

7. The office of Chairman and Chief Executive should not be combined in Public Limited Company above a certain size, eg a market capitalisation of £50m.

Director's Training

8. Executive and Non-Executive Directors should be encouraged to attend a formal training course before or soon after their first appointment.

9. The training, should be on Business School lines, and should include:-

   a. Case-studies on Board responsibilities for planning the long-term future and prosperity of the business, and

   b. guidance for Executive Incentive Schemes, and

c. Director's legal responsibilities, and

d. best practice in relation to employees, customers, suppliers, the environment and the local community.

Service as Director

10. Before appointment, Directors should be informed that their appointment is for, say, 3 or 5 years. Re-appointment should be an exception.

11. Re-election of Executive and Non-Executive Directors shall require a 60% of shares voted for each subsequent re-election, and shall not be carried by a show of hands at the AGM.

12. Dismissal of a Director should, whenever possible, be achieved in the least harmful way to the individual concerned.

Communication with shareholders.

13. Resolutions for the AGM should be clear and comprehensible and should explain, in simple terms, why shareholders are being asked to support them.

14. The Annual Report should contain a "Shareholders' Information Section" with mandatory 5-year records graphically displayed. In addition to the normal charts revenue, profits, dividends etc., this should include:-

    a. Share price performance record compared to the FT or industry index, and

    b. Directors' total remuneration, including any compensation for loss of Office, and

    c. real Performance of revenue and pre-tax profits corrected for inflation. Profits from one-time non-trading events should be excluded.

    d. Investment record to include both capital and R & D as a proportion of revenue.

Auditors.

15. The duties of the Auditors should be explained in the Annual Report they should report doubtful matters in the Annual Report.

16. The value of other services provided by the Auditors should be revealed in the Annual Report, so that shareholders can decide whether to re-appoint them as Auditors.

As an example of good practice in the US covering most of the above points, a copy of the Invitation to the IBM Annual Meeting is attached.

Code of Corporate Governance

All of the above items should be incorporated in a published best practice model "Code of Corporate Governanace", which the Stock Exchange should ensure is adopted by all listed companies. The specific detailed Code of Corporate Governance adopted by an individual company should be maintained by the Company Secretary and should be available for inspection by a shareholder on request.

Bow Group Economic Committee - June 1991