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CRA

Corporate Renewal Associates Limited

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6 September 1991

24th Sept 3 pm.
Self-Renewal.
John W. Gardner.
1963.
Corporate Renewal.
CCG. booklet.
Sir Cyril Hawker. President.
Tom Lossius.

Sir Adrian Cadbury
Rising Sun House
Baker's Lane
Knowle
Solihull
West Midlands B93 8PT

Dear Adrian

It is several months ago that we last met since when a certain amount of water has flowed over the dam (or under the bridge) and another Henley Regatta is history. I was interested to read Angela Mackay's piece in the **Times** about your Committee on Corporate Governance which I hope ("hopefully"?) is progressing well.

The reason for this letter is to try to find a date for lunch or dinner with you in the nearish future (I have been reading P G Wodehouse again). You are, of course, coming to our colloquium lunch on 4 December and we are looking forward to that. But I'd like to see you much sooner if possible to try out some ideas on you.

I am leaving for the US on Saturday but will be back on the 23rd. Could you call this office in the meantime to see what you could manage? In my absence Lillian Taylor here has my diary and can commit me to just about anything in reason.

All the best, as ever

Hugh

HUGH PARKER

Cttee f.a. welcome chance broader discn.
" set up by FRC. SE. Alg Prof. concerned about stds. a/cg. rep'g/audit
all of which back to bd, critical comment.
Numerous papers. ISC ABI IFMA Alcg bodies. PA. etc.
Deal with partic. aspects. ~~way bds.~~ / constituted ~~un~~, ~~unlinked~~, not followed up.
But virtually every one sees ~~better~~ wider, more courageous, more indep'dt neds as saviour system.
Basically supt. this view, but 1st thought air. More we load special resps onto neds, more differentiate between insiders/o/s. on bd. a risk is to ~~VS~~ bd. as a collegiate whole, unity. I believe valuable/impt.
ISC. — different rep'tg. lines to diff. constituency. — Chmn.
Not taking posn. between unitary/2 tier, both wk. well in practice.
real doubts about hybrid, response to pressures for reform.
2nd thought centres on para 8.
How do we maintain unity & vitality ~~of bds~~?
Inherited post merger bd. at C.S. inevitable trade off
In a way stood. target better balance in line with tasks ahead.
Conscious always lot behind, pieces in place, what was reqd had changed
~~Every time~~ wrong pieces time to time dropped out spoiling pattern.
~~Peter~~ Carrington became minister, another excellent o/s dir died, we lost fin. dirs — one to Bob T&L — R. — Beecham — Grand Met. (Gals Viyella)
2ndly a time in/out, way bd. wh. was changed sometimes imperceptibly / markedly.
— One ~~task~~ aim balance appropriate tasks. ahead.
— Two provide competn for succession, my job as Chmn or c/execs.
V. int'd Leslie in thoughts on competn. ~~How~~ What kind of ~~pattn~~ shape of bd wk to, what determines, how arrive at it.
Link with 1st point, simply that this vital section is looking at bd as a whole, as a collective, believe that how well the bd. works unit, how well bd members wk tgther. is the key, hence concern pressures for separate duties for

CRA COLLOQUIUM

CORPORATE GOVERNANCE: 'THE ART OF GOOD BOARDMAKING'

Wednesday, 4th December 1991

In his opening comments, Sir Adrian Cadbury identified two issues within the emerging emphasis on NXDs as the watchdog of integrity; How to maintain the unity of the Board if NXDs are seen as a different class of director with areas of special responsibility to stakeholders outside the Board? How to maintain the vitality and appropriateness of the Board in response to continually changing circumstances and avoid the too common experience of ending up with the Board that ideally you wanted at the outset?

The subsequent discussion focussed around the following key themes;

- The expectancies and accountabilities placed on NXDs have increased sharply. However, executive directors frequently continue to see them as either non-entities or irritating blockages. For the Board as a whole to be effective there is a need for EDs to be educated about the distinctive role and added value that NXDs have.

- The role of the Chairman is critical to the conduct of the Board and its openness. He has particular responsibility for ensuring an independent contribution from the executive directors, and for easing their transition to Board membership.

- There is a delicate balance between major issues being pre-digested within the executive and submitted in 'final form' to the Board, and allowing premature discussion of ideas that have not been rigorously analysed. The danger of "over-cooking" is that the decision is already taken and the contribution of the Board has been pre-empted. If "under-cooked" expensive Board time is wrongly used and NXDs are invited inappropriately onto executive territory. One solution is to involve NXDs in the pre-discussion of key assumptions and goals as a starting point for executive development of specific strategies and their progressive review by the Board.

- Different economic and company conditions require different sets of skills and structures in the Boardroom. There is obvious merit in periodically and objectively reviewing the performance and appropriateness of the Chairman and NXDs, and the functioning of the Board as a whole. This is easier once review mechanisms and fixed terms of office are agreed for non executive Board members, to complement the regular performance reviews of their executive counterparts.

- The renewal of the Board by planned retirements and new appointments maintains freshness and independence, and can be very powerful in its 'knock on' effect.

- The combination of Chairman and CE is frequently criticised. However in conditions requiring urgency and drive the need for a single focus of power may override the benefits of a control mechanism. The combined Chairman/CE is also uniquely placed to empower executive directors in a way that the non-executive Chairman may not be able to do given the presence of the CE on the Board.

- Boards can be costly mechanisms for what they contribute. Nonetheless the remuneration of NXDs should reflect the real costs of high calibre independent contributions and the accountabilities they have as directors.

It was agreed that there is no generic formula for good boardmaking; it will vary according to the needs and circumstances of the organisation. Nevertheless, there are characteristics of emerging practice which can be contrasted with common practice to show potential areas for improved governance. The CRA version of the alternatives is shown overleaf.

CORPORATE GOVERNANCE: 'THE ART OF GOOD BOARDMAKING'

	COMMON PRACTICE	EMERGING PRACTICE
BOARD	Hire and fire Chairman and CE Audit Remuneration Assess executive proposals	Quality and depth of executive team Standards of integrity Criteria Assumptions and process
INFORMATION	Full access to executive information Know the business Drowning in data	Independent perspective Know enough Provision of key information
STRUCTURE	Some NXDs	Strong NXDs
PROCESS	Responsive and supportive Strategy confirming	Rigorous and challenging Setting direction and standards
ROLES	Chairman and CE as one NXDs bring external perspective EDs represent divisions CE sets strategy Chairman sets the agenda	Chairman and CE as one and a half NXDs set standards and pace EDs adopt a Group perspective CE presents options and assumptions Chairman manages the debate

CA

THE NON-EXECUTIVE DIRECTOR
IN THE U.K.

CRA

Corporate Renewal Associates

CONTENTS

FORWARD

This paper is based on a series of discussions with the Chairmen and non-executive directors of a large number of companies. It also incorporates experience gained at first hand in various assignments where C.R.A. has been able to assess the contribution made by non-executive members of the Board. It describes the constraints which inhibit them, and ways and circumstances in which they can act effectively as guarantor and, above all, contribute meaningfully to the strategic development of the business.

The paper does not argue the case for structural changes in the Boards of UK companies but is concerned with non-executive directors on mixed Boards. Specific recommendations are made to improve their effectiveness and these would be equally appropriate in the event of two tier board structures being adopted.

NON-EXECUTIVE DIRECTORS AND PUBLIC COMPANY BOARDS

Corporate leadership is exercised in the great majority of public companies in the UK through mixed Boards composed mainly of executive directors. The Chairman may be part-time and non-executive, or full time and by definition therefore the Chief Executive.

The executive directors will be on the Board by virtue of their seniority and responsibility, either for a division of the business or a central function: the non-executives typically in smaller companies will be former executives, representatives of acquired companies, professional advisers or outsiders appointed to make a particular contribution; and in the larger companies they tend to be prominent figures with broad ranging experience from other comparable companies.

As board members, whether executive or non-executive, they are responsible for:

- determining the strategic direction of the business.

- supervising its execution in terms of results.

- controlling management in terms of standards and practices.

- acting as fiduciary trustee for all interests associated with the company

The recurring question asked of mixed Boards composed in this way is whether they can discharge this portfolio of responsibilities without substantial loss of effectiveness in one area or another.

The main debate has focussed on the potential conflict between the 'management' and the 'trustee' aspects of the Board's role. Responses have centred around either a different structure for the corporate governance, or the introduction of a special committee within the Board to improve its control and increase its accountability for standards and practices. Each of these courses carries a special risk in the particular context of the U.K. The first, involving a two tier structure, carries the potential threat of a representative supervisory council of claimant and adversary groups. The second implies an Audit Committee, which could introduce a different kind of divisiveness to do with accountability.

Neither addresses directly the question of the mixed Board's strategic capability to identify and respond to strategic turning points in their increasingly changing environments and both, in their emphasis on representation and control, tend to detract from the primary obligation of the Board to ensure real growth in earnings and therefore security of employment.

An alternative is to accept unitary Boards as they presently are, with their particular history and characteristics, and progressively achieve from within the sharper focus on strategic issues and fiduciary obligations, which distinguishes corporate direction from executive management.

Amongst the components of corporate leadership, the non-executive director is the most relevantly placed to help this transition and to prepare the company for a possible change of structure, whether voluntary or imposed. He is arguably also the least prepared.

THE ROLE OF THE NON-EXECUTIVE DIRECTOR

The role potentially has three major parts:

- the traditional as 'friend' of the company, 'man of affairs' and participant
- the audit as external guarantor and internal support for 'best' accounting standards and business practices.
- the strategic as focus for the key issues emerging within and outside the company

The traditional role is relatively straightforward and constitutes the normal expectations of both the individual and the company. In effect the non-executive because a part of the executive leadership team and shares in planning and performance reviews generally. By virtue of being an outsider he can contribute breadth of experience and external information and contracts. In a special way we can also be a sounding board for the Chairman, particularly on people, and act as 'friend' of the company to the outside world.

The audit role is more complex and contentious because it begins to differentiate the accountability of the non-executive from that of his executive colleagues. Although both have the same fiduciary responsibility, in practical terms the non-executive's obligations are larger. The executives are dependent to a degree on the Chief Executive as part of the organisational hierarchy and there is a positive value in the singularity of view and momentum developed by an executive team. There is therefore a particular contribution to be made by an outside director in reinforcing the responsibilities of the finance director and the internal and external auditors for financial standards, and assuming special accountability for the integrity of the accounts and business practices generally.

The strategic role, of helping to shape the direction and balance of the company, is the most difficult to define and least understood by both the individual and the Board. It is different from the traditional role of contributing from a broad base to business strategies which have been generated by the executive directors in their primary function as managers. It goes beyond the participative role and necessitates standing back from executive enthusiasms.

It consists , in essense, of achieving an independent perspective of the critical issues as a basis for appraising the plans developed by the executives themselves. It requires an overview of the total company and access by the non executive to information which is cast with that objective.

It also requires process skills of a very particular kind in order to be effective within a Board where a great deal of executive knowledge and competence will already exist; which will have evolved its own style and process of decision making; and which, except in exceptional circumstances, will not be looking for new directions which are not part of the existing momentum.

Within this portfolio of potential roles, the nature and urgency of the non-executive's contribution will be determined by the particular circumstances of the company. Rule one for the non-executive is to read the corporate priorities and culture clearly and early so that his contribution is central to the key issues, carries the appropriate urgency, and begins as it intends to go on.

THE CONSTRAINTS ON EFFECTIVENESS

In each of these roles the non-executive director operates within constraints which exist in large part independently of his personal qualities and experience.

- **Lack of initial credibility:** he starts as an outsider to an established group, selected in many cases with loosely defined expectations and on the recommendation of the Chairman, and seen by executive colleagues to have a special relationship with him.

- **Lack of time:** as an executive with another company his time availability will be low; if he is not; the constraint is set by the schedule of board meetings, the difficulty or sensitivity of assessing individual executives who are not on the Board and the Chairman's discretionary use of his time.

- **Lack of information:** the problem is less one of quantity than relevance. The information flow to a Board in most cases reflects its disposition and obligation to monitor past performance, evaluate specific projects and review plans flowing out of the executive. It is shaped essentially to meet the requirements of executive management. Very few information systems distinguish the leading indicators of change which are significant for corporate direction or provide the vantage point from which a non-executive can focus his own perspective of the key issues against which to test and evaluate executive proposals.

- **Lack of opportunity:** the average Board spends a low proportion of its time on developing corporate strategy and the adequacy of its conversion into business plans, budgets and accountabilities. The flow of information and strategic assumptions reflects the mental continuity of the executive and possesses its own momentum and shape from the past. The opportunity for the non-executive to break into that pattern of procedure and information is therefore low.

- **Lack of power:** where a non-executive works through these problems and identifies a need for strategic change of direction earlier than the executives i.e. when he shifts from the traditional role, the quality of the relationship established with the rest of the Board, particularly the Chairman, becomes especially significant. The only tools available are his powers of personal persuasion supported in the last resort by resignation. Where he is not supported by other non-executives his effectiveness will be minimal. Where the Chairman is also Chief Executive it will be indiscernible without his support, except in the case of declining fortune.

The personal skills and stature of the individual non-executive director clearly after the strength of the constraints: the structure and processes of the Board itself will enhance or detract from those skills. However, they are relatively insignificant in the context of an executive team committed to a particular course of action, without the attendant pressures which are generated from within and without by a clearly recognised need for change.

RISKS AND PRODUCTIVITY

The essentially negative view about non-executives on a unitary Board holds that the constraints are such that, as one component only of corporate leadership and heavily dependent on the quality of their executive colleagues, they can at best enhance the company's stature to the outside world and contribute experience and special knowledge to the executive directors, in what is essentially their leadership of the company.

The more positive view is that non-executive directors have demonstrated in a number of cases that, provided the circumstances of the company are favourable and certain changes are made which facilitate rather than inhibit their contribution, they can improve the productivity of the Board substantially and its role becomes more sharply focused, as a consequence on issues of strategy and corporate governance.

The question is how? Experience from situations where, by common consent the non-executive directors have made a major strategic contribution suggests there are three conditions for success:

- the quality of the individual appointed
- the way in which the Board works
- clear pressure on the Board to change because of inadequate performance.

The last condition is clearly undesirable but both of the first tow areas tend to be approached in a very different way when a company is confronting a major problem of confidence and the role and relevance of the non-executive becomes sharply upgraded. The question is how to borrow the best of the changes which occur during a crisis and incorporate them into routine board practice, without the turbulence which attends and precedes a crisis.

For his own part the non-executive has an overwhelming need to be effective in more positive role.

- Negatively, because the risks are much larger than is generally understood: the disrepute, which attaches to him by association in the event of a strategic failure of the company or a shortfall of standards, is considerably larger than that attaching to the executive director. The charge at the end of the day is that he should have surmounted precisely those same constraints which encourage him up to that time to play a partial and participatory role only. Reputations are easily marred by failure and rarely made by success. And the associated risk is that failure carries over from the individual to his main employer as well.

- Positively, because the traditional role is unlikely to satisfy the non-executive of quality who is concerned to contribute strategically to the development of the business.

THE AUDIT ROLE AND CONVENTIONAL AUDIT

Non-executive directors have the same responsibilities in law as executive directors and are not protected by their reliance on the judgement of the Chairman or Chief Executive or other executive board members. They are entitled to rely on the advice of a qualified and independent outsider, but must themselves then exercise their own judgement.

In practical terms, and in the eyes of the outside world, the non-executive's obligations are greater, precisely because the executive directors are in large measure dependent on the goodwill of the Chief Executive.

The thrust has come from the finance profession 'inside' and 'outside' companies, in the wake of well publicised cases, for ways of supporting the internal and external auditor and the Finance director as to acceptable practice within the company.

The most publicised solution is the establishment of Audit committees of the board as the vehicle through which the non-executive might act more effectively as guarantor to society as a whole for the conduct of the business. It is a concept borrowed from the USA, where it was developed to meet different circumstances and different legal requirements.

The merits of the Audit Committee lie in the opportunity it allows for non-executives to get access to information and to test areas of potential concern directly with the external auditor, without the filter of the executive, and particularly the Chief Executive, in between. There is also an intangible benefit in the sheer presence of the committee with the potential authority to examine corporate activities from the perspective of standards and practices within a unitary structure where executives endorse at one stage and review at another.

There are clearly also disadvantages:

There are clearly also disadvantages:

- the fragmentation of the Board into apparently more and less accountable group
- the shift of emphasis in the non-executive's role towards control and away from strategic contribution
- the consumption of scarce non-executive time
- the potential diminution of the primary role and accountability of the auditors
- the altered relationships of the Finance Director and the Chief Executive

and the risk that more is lost than is gained by the introduction of a special committee.

The alternative, which commends itself to many non-executives and Boards alike, is for the Board as a whole to have direct and free ranging access once or twice a year to the external auditors substituting in effect the whole Board for the Audit Committee. The non-executives can play a leading part in those meetings and seek the assurance they require, without impairing the unity of the board, and the auditors would need to consider carefully how to be most effective in those particular meetings.

To further protect the company and himself the non-executive should consider the following areas very carefully

- the stature of the external auditor in the context of the size and complexity of the business

- the quality of the Finance director on the main Board

- the quality of the internal auditing system

Consideration could also be given to making the non-executive directors specifically accountable for recommending the re-election of the auditors and the continuation of the particular audit partner.

THE STRATEGIC ROLE AND STRATEGIC AUDIT

The third, and in our view most substantial component of the non-executive's role, is to make a strategic contribution to the growth and security of the business, which complements but is different to that made by the executive directors.

In essence it consists of standing back from corporate enthusiasms and probing for the critical issues in the business and its environment and evaluating their scale and their urgency as a framework against which to evaluate the actions and plans of the executive.

To do this non-executive requires a very pronounced 'helicopter' skill in order to get specific decisions into an overall perspective in terms of balance, realism and timing.

Most choose to 'fly low' from the outset and contribute to the specifics of a business plan or product programme and, to the extent they can, their credit balance with their executive colleagues will be high.

In most cases they are encouraged to stay at that low level by the kind of information they receive and the agenda items tabled for board meetings and it is extremely difficult to change elevation once a particular kind of contribution has come to be expected.

The difference in switching from a traditional and participatory role to a more strategic and independent perspective lies essentially in testing in sequence at three levels:

- the underlying causes of the current financial and market position of the company in terms of opportunities and threats in its areas of business and corporate strengths and weaknesses relative to competitors

- the quality of the strategy which is being devoted to its achievement.

The problem for the non-executive with limited time available is how to get at the key issues quickly in order to focus on priorities with the right degree of urgency and assess the appropriateness of the strategy which is presented.

In a sense the problem is analogous but more complex than the audit problem in that the non-executive needs to access information in a different way to the executive to establish his own perspective.

There is unfortunately no simple equivalent to the Audit Committee available and the non-executive is obliged in the first instance to do his own analysis until the internal information flow can be reformulated and new external and comparative information made available. In certain cases the establishment of a Strategy Committee has improved the quality of the dialogue about strategic issues.

A strategic audit process has been developed by C.R.A. which identifies a sequence of leading and confirming indicators for use, as a first step, by non-executive directors in testing the interrelationships between the determinant characteristics of a company and its strategy and resource plans.

SELECTION AND APPOINTMENT

There are broadly two kinds of circumstances which arise:

- the first where there is sufficient evidence of turbulence or decline for shareholders or the institutions to effectively nominate a new non-executive director or Chairman

- the second where a board of its own volition invites such an addition

There is also a twilight category where there is a measure of internal recognition of the need to change direction without as yet overt pressure from the outside.

The chances of making a poor executive appointment from outside the company are quite high unless care is given to matching not only the experience and ability of the individual to the company requirement but all the more senior levels, his 'chemistry' and style as well. The opportunity for making a poor selection of a non-executive director is much higher and more potentially damaging.

In the case of 'externally nominated' appointments, and they are numerous, it is often impossible to do the kind of pre-analysis which can reduce the risk because the appointment is unwelcome, although quite extensive matching can be done without direct access to the company. In all other circumstances there is a proven case for retaining professional intermediaries to ensure the fullest possible compatibility of the individual non-executive and the corporate requirement and a mutual understanding of the role and expectations.

To ensure the commitment of all board members the appointment process should involve:

- participation by all directors in the definition of the requirement

- short-listing and interviews by a sub-committee of the Board including the Chairman and preferably at least one existing non-executive and one executive director nominated by the Board

- a process for reporting back to the full Board prior to the final choice

- an opportunity to meet informally before attending the first board meeting

There are risks that' exchange' appointments between companies become 'formal' appointments only and are ineffective both for the receiving and the supplying companies.

Open-ended appointments without a finite term carry the risk of the non-executive becoming 'conjoined' with the executive and ceasing to bring a fresh and critical perspective and militate against both the independence of the individual and the flexibility of the company.

Choosing the right non-executive director in the right way from the outset is a necessary but not a sufficient condition for a successful appointment. At least of equal importance are the processes of the Board itself, which can facilitate or diminish the contribution by the non-executive directors regardless of their individual quality.

CHANGES IN BOARDROOM PROCESSES

The non-executive director's need to search out a new vantage point from which to access more clearly the key issues confronting the business is different in degree, not in kind, from that of the rest of the Board, and the most important single factor therefore in improving the productivity and effectiveness of the non-executive is for the Board itself to distinguish more sharply strategic issues from items of executive management.

The two most important indicators of the way in which the Board operates in practice are the agendas and the information flow. There are numerous examples of Boards sanctioning specific investment projects with sound return at the same time as the balance sheet is becoming overheated, interest rates are moving sharply up and exchange rates of exposed currency borrowings worsening. The agenda item identified the investment project, not the balance sheet gearing and the information system did not highlight any leading indicators for interest rates or currency trends.

A third requirement is to involve the Board more positively and earlier in the strategic options which are considered at the outset of the planning process. Far too often plans are developed and presented against retained decisions around a momentum rather than basic decisions of balance, shape and timing.

In order to get up to speed quickly and help shape internal information to meet their own requirements, non-executives have found it helpful, particularly at the outset, for the Chairman to nominate formally one particular executive in the company (fiance or planning) to respond to the information requests of the non-executives as if they emanated from himself in terms of the required quality and speed of response.

To overcome the sense of 'pre-determination' of many board meetings, which often resemble a re-run of earlier management meetings with the addition of one or two non-executives, a few Boards have begun to experiment with the occasional Board meeting given over entirely to the non-executives to run and thrust as they will. The experiments, despite early occasional stumbling, in most cases have produced a different kind of strategic discussion and, in particular cases, completely re-routed the direction of strategic thinking.

The conscious attempt to introduce some or all of these changes, together with periodic free ranging direct access to the internal and external auditors for the whole Board, has been found to overcome in effectiveness of the non-executive director.

SOURCES OF NON-EXECUTIVE DIRECTORS AND EXTERNAL DEVELOPMENT PROGRAMMES

The question is, assuming companies themselves are prepared to address the selection process methodically and reconsider whether their boardroom processes encourage or inhibit strategic consideration, where do individual non-executives come from who are able to contribute in the way?

A large number of existing non-executive directors fall into five categories:

- former executives of the company
- shareholders or their representatives
- institutional representatives or professional advisers
- leading figures from other companies who may be approaching retirement
- friends or nominees of the Chairman

None should be avoided per se, but all have potential limitations:

- the former executive has been there before, knows and probably insists on the detail, will either protect his past creation or compete with the new incumbent and will continue to think like an executive as part of the hierarchy
- representatives, of whatever constituency, should by definition be partial or protective in their outlook and have their major contributions to make outside the boardroom
- institutional representatives are not necessarily skilled in individual management and advisers are normally doing some other work within the company
- leading names around the age of retirement are, with shining exceptions, prone to be long in experience but short in cutting edge
- Supporters by definition do not bring the objectivity commensurate with their accountability.

There are good arguments, therefore, for a genuinely objective process of identification and selection in the large pool of executive talent which exists and all the evidence points to there being an adequate supply of competent executives willing and able to contribute as non-executive directors, provided their specific qualities and experience are tailored to particular company situations.

The problem is that they are largely anonymous to the outside world and rarely are approached with the right opportunity or timing because supply and demand tend not to find a natural market and the machinery for making the market is highly fragmented.

Many companies are now actively seeking external directorships for their key executives recognising the value to themselves and the individual of experience gained in 'total' ~~a~~ management situations for which there is often no clear internal preparation.

We have developed a programme of External Development for key executives, in the very large companies as well as the small, which is aimed to help structure market availability by identifying and evaluating with the supplying company in advance of a specific opportunity the abilities, personalties and objectives of key executives who might benefit from a particular kind of non-executive experience and whose availability is already established.

CONCLUSIONS

The Present situation

- The effectiveness of the mixed Board, which is typical in the UK, in the areas of corporate governance and strategic direction is challenged by many parties and the non-executive director is the most relevantly positioned of all the components of corporate leadership to improve the effectiveness of boards in these areas without a change of structure.

- In the great majority of cases he is inadequately prepared for that role, having been cast traditionally as a participating director on an ad hoc basis within an essentially executive framework of decision making.

- Yet increasingly, accountability is being placed on the non-executive director for the integrity of the accounts and the security and growth of the business and increasingly odium attached to those associated with failure in these areas.

- The constraints of credibility, time, opportunity, tool and above all information, which conspire to constrain his role within the framework recognised by the executive, have been overcome in a number of cases where companies have confronted a major problem of confidence.

Audit Committees

- Audit Committees are one way for the non-executive to act more effectively as 'guarantors' for the conduct of the business but many boards and non-executives believe their advantages can be gained by giving the whole Board periodic assess to the internal and external auditors to probe and test directly any area of potential concern without the attendant disadvantages of fragmentation and the emphasis on control.

The Strategic Role

- There is no simple solution in the third and most important area of responsibility of contributing strategically to the growth and security of the business in a way which complements and extends executive thinking.

- The selection process of the non-executive, the expectations which surround him and the information he receives, tend to inhibit rather than facilitate his early appreciation of the key issues of the business

- Equally important are the changes in boardroom processes to ensure an appropriate flow of information on agenda items of strategic concern and adequate opportunity for the non-executive to consider proposals and plans from his own perspective.

- Giving over one board meeting a year entirely to non-executives, integrating them into the early stages of the planning cycle and nominating specific information points within the company for their use have been well received innovations.

- Consideration should be given to the establishment of a Strategy Committee of the Board to improve the quality of the dialogue about strategic issues.

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CRA

Corporate Renewal Associates Limited

COLLOQUIA

ON

CORPORATE GOVERNANCE

September 1991 - May 1992

PRIVATE & CONFIDENTIAL

Copy No: 115

FOREWORD

CRA have advanced the cause of effective boards by holding these colloquia. All of us concerned with the workings of boards welcome the chance to meet and discuss constructively the issues which we face in common. Such opportunities are far too rare.

There is a clear thread which runs through this collection of admirably succinct summaries; it is that the part played by the chairman is crucial. Chairmen are largely responsible for how their boards are made up and solely responsible for how they are run. This leads on to such questions as, what kind of chairmen should boards be looking for, what skills and experience do they require and how can they be helped to improve their chairmanship? The best chance of our finding our individual answers to these questions is through the kind of dialogue which follows.

Sir Adrian Cadbury

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BRIAN SMITH	Chairman, BAA Plc: 14 November 1991 (p.11) *"The issue is how to save the chief executive from himself?"*
ROBIN BIGGAM	Chairman, BICC Plc: 9 October 1991 (p.12) *"The concept of worker directors is not unmanageable."*
JOHN GARDINER	Chairman & CE, The Laird Group Plc: 26 September 1991 (p.13) *"The prerequisite for a good board is the Chairman's desire to have one."*

ALPHABETICAL LIST OF GUESTS

GUESTS AT AUTUMN 1991/SPRING 1992 COLLOQUIA

Name	Title	Company
David Backhouse	Chairman	Henderson Admin Group Plc
Robin Baillie	Chairman	Burson-Marsteller
John Baker	Chief Executive	National Power Company
Nicholas Barber	Chief Executive	Ocean Group Plc
John Bellak	Chairman	Severn Trent Plc
Alex Bernstein	Chairman	Granada Group Plc
Roger Bexon	Chairman	Laporte Plc
Robin Biggam	Chairman	BICC Plc
Colin Black	Chairman	Scottish Widows Assurance
Paul Brown	Director	Lloyds Bank Plc
Michael Butt	Chairman	International Council INSEAD
Sir Adrian Cadbury	Chairman	PRO NED
Sir Peter Carey	Chairman	Dalgety Plc
Sir Clifford Chetwood	Chairman	George Wimpey Plc
Sir Brian Corby	Chairman	Prudential Corporation Plc
Sir John Cuckney	Chairman	3i Group Plc
Peter Davis	Chairman & CE	Reed International Plc
Sir Graham Day	Chairman	Cadbury Schweppes Plc
M B Dearden	Chief Executive	Foseco International Ltd
Joseph Dwyer	Chief Executive	George Wimpey Plc
Michael Falcon	Chairman	Norwich Union
Charles Fisher	Chairman	Sharpe & Fisher
Michael Fogden	Chief Executive	The Employment Services Agency
Sir Alistair Frame	Chairman	Wellcome Plc
Sir Campbell Fraser	Chairman	Pauline Hyde & Associates
Rodney Galpin	Chairman & CE	Standard Chartered Bank
John Gardiner	Chairman & CE	The Laird Group Plc
Jan Hall	Chairman & CE	Coley Porter Bell
Ronnie Hampel	Chief Operating Officer	ICI Plc
Sir Christopher Harding	Chairman	British Nuclear Fuels Plc
Lord Haslam	Chairman	Bechtel Ltd
Ronald Henderson	Finance Director	BICC Plc
Nicholas Hood	Chairman	Wessex Water
Sir Simon Hornby	Chairman	WH Smith Group Plc

CORPORATE GOVERNANCE: 'THE ART OF GOOD BOARDMAKING'

Name	Title	Company
Sir Robin Ibbs	Deputy Chairman	Lloyds Bank Plc
John Jones	Chairman	Welsh Water
Sir Brian Kellett	Chairman	Port of London Authority
David Kendall	Chairman	Bunzl Plc
Philip Kimberley	Chief Executive	Fosroc International Ltd
Sir Richard Lloyd	Chairman	Hill Samuel Bank Ltd
David Lyon	Chief Executive	Bowater Plc
Keith Mackrell	Director	Standard Chartered Bank Plc
Robert Malpas	Chairman	Cookson Group Plc
John Maltby	Chairman	Atomic Energy Authority
Rob Margetts	Chairman & CE	Tioxide Group Plc
John Maxwell	Chief Executive	Provincial Group Plc
Geoffrey Mulcahy	Chairman and CE	Kingfisher Plc
Graeme Odgers	Chief Executive	Alfred McAlpine Plc
Peter Orchard	Chairman	The De La Rue Company Plc
Bruce Pattulo	Governor & Group CE	Bank of Scotland Plc
Michael Pickard	Chairman	LDDC
Sir John Quinton	Chairman	Barclays Bank Plc
Paul Sabin	Chief Executive	Kent County Council
John St Lawrence	Chief Executive	Reckitt & Coleman
Sir David Scholey	Chairman	SG Warburg Group Plc
Ken Scobie	Deputy Chairman & CE	Brent Walker Group
Sir Patrick Sheehy	Chairman	BAT Industries Plc
Dr Brian Smith	Chairman	BAA Plc
Cob Stenham	Chairman	Arjo Wiggins Appleton Plc
Tim Stevenson	Managing Director	Burmah Castrol Fuels Ltd
Michael Stoddart	Chairman	Electra Investments Trust Plc
Lord Swaythling	Chairman	Rothmans International
Jonathan Taylor	Chief Executive	Booker Plc
Sir Peter Walters	Chairman	Midland Bank Plc
Sam Whitbread	Chairman	Whitbread & Co Plc
Peter White	Group Chief Executive	Alliance & Leicester BS
Malcolm Williamson	Group Managing Director	Standard Chartered Bank
Nicholas Wills	Chairman	BET Plc
Charles Winter	Group Chief Executive	Royal Bank of Scotland
Roger Young	Chief Executive	Scottish Hydro-Electric Plc

COLLOQUIUM SUMMARIES

CORPORATE GOVERNANCE: 'THE ART OF GOOD BOARDMAKING'

Wednesday, 6 May 1992

In his opening comments, **Peter Walters** argued that the mechanics of governance is relatively straight-forward; the key is the mix of ingredients and how it is made to work. The Chairman has 4 constituencies to balance - shareholders, customers, employees and the community at large. He is the boss of the company; the CEO is the boss of the executive. The executives do not become instantly effective executive directors simply because of their appointment. They need training both in the formal dimensions of board membership, but also and most importantly, coaching by the Chairman in their new role. Agendas too often focus on the peripheral issues and information can easily become a 'hard cover confidence trick'. Remuneration committees have begun to be too closely associated with the top man and international directors can sometimes lose their cutting edge as monitors of board and the Chairman's performance.

The subsequent discussion focused around

- *Detachment.* The peculiar feature of boards is that good men and true as non-executive directors see clearly the key issues and intervene energetically. The paradox is that on their home base as executive directors or even Chairmen they often fail to be as incisive and challenging. Does this derive from the technical separation of ownership from management, or is it to do with the short-sightedness that comes from close involvement and the inability to be truly independent as a member of an executive team?

- *The role of investors and bankers.* It was very desirable for the institutions to take a medium term view about prospects and performance. The reality was that the short term pressure for EPS growth was dominant. The question was whether we were trying to recreate the role of investors as owners, when in reality they were renting a part of the company for a short period of time. It was possibly valid both to recognise the reality and attempt to change it. What was probably not prudent was to expect the accountabilities of ownership if the behaviour was consistent with rental.

- *The cards available to the non-executive director.* Once he has joined the extreme positions are card 1, which has printed on it 'Oi' and card 3, which says 'I'm off'. Neither carried a great deal of weight and the fruitful card was the middle ground of the processes for continuous formal and informal engagement with the executive directors. The role of the Chairman was critical on so many fronts and there was real value in a set of constitutional rules and regulatory procedures which were understood and rigorously observed.

In conclusion, it was clear that the board was an art form for which there was no set formula but an art form which lent itself, nonetheless, to some clear ground rules. The non-executive directors are not there as policemen, but as members of a team to create wealth and well-being for all the constituencies. Nonetheless, there came a time when they had to shift from 'supporters of the executive' to critics and ultimately catalysts of change. The unitary board is a kind of two tier board waiting to happen when circumstances dictate; for that reason non-executive directors should not be paid so much that they happen too late. There are circumstances where it may be better that there should be no non-executive directors so as not to provide spurious comfort to investors when leadership was clearly entrepreneurial and autocratic. Training and review for executive directors, non-executive directors, Chief Executives and Chairmen, not so much in the formal aspects of their roles but in their styles and ultimate accountabilities, were both crucial. Being able to ask the 'daft laddie' question, not just once but two or three times, was perhaps the ultimate hallmark of the open society.

Wednesday, 15 April 1992

In his opening comments, **Graham Day** argued that the process aspects of governance are probably overdone. There was a strong case for the separation of the Chairman and Chief Executive and the scope and procedures for the Audit and Remuneration committees should be formalised to counteract the changing composition of the board. Most important were the people in terms of the selection of non-executive directors, their numerical balance, and the extent to which 'constructive tension' characterised the board. He argued strongly for a term appointment of perhaps 3 years followed by the option to renew for at most one further 3 year period. The chairmanship of the board is critical to its performance and it is the task of the non-executive directors to ensure adequate succession planning, both for the Chief Executive and for the Chairman.

The subsequent discussion focused around

- *The conduct of board meetings.* Nowhere in the literature was adequate attention given to exactly what happened in the course of a board meeting which made it either effective or ineffective. Ideas that were raised included the deliberate introduction of a 'reflective' period in the occasional board agenda, concentration on fewer items, and the recognition of the 'grit value' of the genuinely provocative participant.

- *Their composition and functioning.* There was a real problem in finding the right talent with sufficient time to contribute effectively. Potential supply sources other than the outstanding top talent of other companies which was already stretched, were professional non-executive directors, first level but invisible staff in the major corporations, the recently retired who bring outstanding experience and continued zeal, and avoiding the artificial exclusion of potential contributors by virtue of their age. Induction programmes ranged from practically nothing to 2 weeks.

- *The role of the board.* There was a danger of polarising the board with committee structures which were exclusively non-executive and the emphasis on the accountability of the outside directors. If they were going to assume larger responsibilities then they should be assessed with the same degree of formalism as the executives. This was a short step from a two-tier board structure in practice and risked undermining the role of the Chief Executive. The bottom line role of the outsiders is to hire and fire the Chief Executive, and to that should be added the eventuality of the Chairman as well. The test of good process is the willingness and capability to raise the flag of revolt should that ever become necessary. The proof of good process is that the flag never actually has to be raised.

In conclusion, the following points were highlighted. The real role of the non executive directors is about the development of management succession; added to that was the creation of expectation about standards of performance; the 'institutionalisation' of the irritant component on the board; the crucial nature of the linkage between the executive directors and the non executive directors; the conduct of meetings and the dichotomy between the value of the irritant and the need for good team performance; the recognition that the pendulum swings and needs change; the crucial role of the Chairman in creating style and openness; the need to reduce the number of subjects that the board spends time on; the involvement of the non executive directors by the Chairman in determining agendas; the mandatory needs to familiarise the outsiders with the reality of the business and to formally review their performance. Left unanswered was the question "who guards the strategic flame?" Strategy will not bubble up of its own accord: it needs an internal galvanising event equivalent to a bid or an acquisition. The information process is obviously critical since it both directs and constrains thinking.

Tuesday, 17 March 1992

In his opening comments, **Allstair Frame** outlined the ground rules for an effective board as including the separation of the Chairman and the Chief Executive roles, about an equal number of executive and independent directors, a broader mechanism than just the Chairman for identifying and appointing new independent directors, full information available to the independent directors through board papers, visits, and an annual strategy conference, and the clear early identification of succession.

The subsequent discussion focused around

- The importance of the Chairman's role in ensuring the induction of new directors in such a way that they were empowered to challenge vigorously and rigorously, supported by 'transparency' of information so that bridges were built effectively between the executive and the independent directors.

- Term appointments for independent directors found favour - with an initial period of 3 years followed by a further 3 years after review.

- There was a view that independent directors were paid too little for the risks they ran and the contribution they could potentially make; others were anxious that they should not become too dependent on this source of income. It was felt there was a good market at £20/25k and absolute agreement that pensions and perks were not a good idea.

- The strategy away-day (or 5) was felt to be a good mechanism for building teams and getting frank debate and understanding of the main issues. The key was to avoid producing surprises at board meetings, and a sequence or series of meetings might be the most appropriate way to take major decisions. A 'reflective' board meeting lasting 1.5 days was described which allowed more openness of discussion and a comparable capacity to build teams and get beyond the posturing. EPS was felt to be a way to set standards without competing with the executive for specific strategies.

In summing up, Leslie Dighton said that recent effectiveness reviews carried out by CRA have confirmed that many boards are low performing parts of the organisation against their potential; that very large companies use independent directors least effectively; that the relationships between executive directors and independent directors are a large part of the problem; and that the role of the Chairman is crucial in setting the style for the board as a whole.

Monday, 24 February 1992

In his opening comments, **David Kendall** defined the primary role of the board to be the selection and ownership of an agreed strategy and identified the Chairman's responsibility for managing a process that involves all directors in a real debate of commercial, financial, timing and risk/reward factors. This implies that the Board should be a single unit with no Maginot line dividing exec/non-exec directors; information should not replicate piles of executive data but succinctly monitor progress against strategic objectives, and enable strategic debate and decision making. Non-executive directors should have the gravitas, knowledge, experience and collective weight to speak out when the strategic debate is inadequate or when the executive team is not appropriate to carry the strategy through.
The subsequent discussion focused around

- Three broad types of Chairman. The half day per week Chairman of the Board Meeting; the full time Chairman who shares the role of Chief Executive; and the preferred model which implies a commitment of 2-3 days per week in order to understand the business and give sufficient time to the executive team as a whole. An effective relationship with the CE requires a clear pragmatic division of responsibilities based on relative personal strengths and open communication rather than being constrained by theoretically defined role models.

- The size of the board should be determined by a dynamic that enables a director to intervene a number of times on an issue without dominating the discussion. Too large a board can prevent real engagement in the debate and a style of making contributions by rote on all issues.

- The double imbalance in the supply and demand relationship for NXDs. It is busy executives who have the least time that contribute most as a non-executive, and higher risk and second tier companies which have the greatest potential to benefit from good NXDs are the least able to attract them.

- As part of determining strategy, the Board should look for ways of preventing the 'inevitable dip'. This requires recognising in advance the time for change and planning for appropriately skilled resources to be put in place throughout the business, including the boardroom.

In summing up, Keith Mackrell said that for the Board to fulfil its role of setting the fundamentals of the business there had to be a core of NXDs who were prepared to put up rather than shut up when required. The NXD should make his presence felt both inside and outside the Boardroom, and there can be added value from a degree of specialisation, establishing closer links with executives from part of the business. There is benefit from training executives through non executive directorships on other boards. However, there is no substitute for an experienced independent director who brings a mental map which questions assumptions, identifies potential problems before they occur and ensures alternative courses of action are considered. In terms of process he will know instinctively both how to support the executive and encourage openness of debate, and to challenge hard when the executive contribution is obviously inadequate.

Thursday, 13 February 1992

In his opening comments, **Robert Malpas** explored the roles of the Board and the Company Chairman. Few boards achieve their full potential: they must be more than custodial gate-keepers, but their contribution is often diminished by inappropriate structure and information. The Board must ensure that a vision and strategy for the company is constructed: its role is not to produce it nor rubber stamp it, but to be fully involved throughout an iterative process of setting the direction and the standards to be achieved. Profitability and growth are different and should not be confused: if there is insufficient eps growth the option of returning shareholder funds for more effective redistribution by shareholders themselves should not be overlooked.

Whatever his title, the Chairman has an executive role beyond that of properly conducting Board meetings: it is his task to ensure the executive is working effectively and can deliver the strategy, and except in extremis, he should not issue executive instructions, but rather exercise influence through the roles of adviser and coach.

The subsequent discussion focused around

- There is no generic solution for the respective roles of Chairman and Chief Executive, and no one model produces consistently better results. Success is dependent on making the best use of individual attributes.

- Renewal requires a delicate balance of delivering profit today and investing for long term strength within a strategy that has been effectively communicated to investors. The water companies talked of the strategy constraints implicit in the expectations of their original investors. Others argued that the Board were not just agents of the shareholders at any one time, and were givers rather than receivers of strategy.

- The strategy process should involve NXDs in the formulation and consideration of options to ensure breadth of input, shared understanding and commitment to an agreed outcome. Too many plans are derived from assumptions which have not been surfaced and tested for uncertainty and the cost of error.

- The warning shot was fired that governance can become the stuff of grey men and bureaucrats, who cramp and diminish the work of individual builders and creators of wealth A number of cases were cited where more evidence of the grey men of governance would have been hugely beneficial.

In summing up, Leslie Dighton said that the Chairman is responsible for stewardship of the whole company's well being and the effectiveness of the board as the agency for achieving and sustaining high performance. In the Boardroom he is uniquely placed to empower both executive and non-executive directors to be free men engaged in an open debate of the real issues. The Board as a whole is responsible for bringing about renewal through its own 'get-on-ability' and by liberating and reshaping existing talent which had become deformed by an earlier closed style. The theme, wherever possible, is to avoid shooting the pianist but make him play a different tune!

Thursday, 19 December 1991

In his opening remarks **David Lyon** focused on the separate roles of the Chairman and Chief Executive. He felt that for businesses beyond a certain size and type the demands of the job were too great to be carried out by one individual. There should be real complementarity between the different experience and skills of the two incumbents. Non-executive directors should be chosen for the contribution they can bring to a particular company. They must receive the right amount and quality of information in time and be prepared to devote sufficient time to get about the company to assess its 'heart, mind and soul'.

The subsequent discussion focused around the following key themes:

- There is no such thing as a non-executive chairman. He may be part-time but must always be available. He is not the Chief Executive but he is the architect of the Board, and carries the responsibility of appointing, monitoring and if necessary firing the Chief Executive. He establishes its composition; sets the agenda and influences the climate and quality of the discussion, and is critical to the conduct of the Board and its openness. He should be seen as the custodian of the spirit and performance of the company and presides at the Annual General Meeting of shareholders.

- The Chairman must be involved in and involve the Board in strategy. An effective contribution by the non-executives requires a balance between extremes of too much executive pre-digestion and single recommendation and of time-wasting lack of structure and focus. Such a balance might involve a structured but open discussion on options and assumptions before more detailed strategy work is carried out.

- The Board must be renewed by planned retirements and new appointments. Chairmen often achieve a board fully composed to their taste just before they retire. There seems great value in appointing NXDs for fixed terms. A tenure of a first three-year term renewable annually thereafter found considerable favour. A cut-off age of 65 had advantages but could exclude valuable experienced directors. Today's Board must be planning the next Chairman and Chief Executive several years in advance.

- The unitary board creates a confusion between the Chief Executive and his fellow 'junior' executive board members. Can the latter freely express the disagreement which their responsibilities as directors may require or must they commit themselves to the recommendations of the executive? Do executives fully understand the value and role of their 'candid friends', non-executive directors? Are there different problems for Holding company Boards which sometimes will be allocating resources between the 'turf' of executive directors, and integrated boards containing a 'matrix' of responsibilities? Does the concept of the two-tiered Board warrant revisitation?

It was felt that many Boards in the UK are operating well below their full potential and that there is considerable added value and competitive advantage to be achieved by improving their effectiveness against benchmarks of emerging best practice.

Wednesday, 4 December 1991

In his opening comments, **Sir Adrian Cadbury** identified two issues within the emerging emphasis on NXDs as the watchdog of integrity; How to maintain the unity of the Board if NXDs are seen as a different class of director with areas of special responsibility to stakeholders outside the Board? How to maintain the vitality and appropriateness of the Board in response to continually changing circumstances and avoid the too common experience of ending up with the Board that ideally you wanted at the outset?

The subsequent discussion focused around the following key themes;

- The role of the Chairman is critical to the conduct of the Board and its openness. He has particular responsibility for ensuring an independent contribution from the executive directors, and for easing their transition to Board membership. Although the combination of Chairman and CE is frequently criticised, in conditions requiring urgency and drive, the need for a single focus of power may override the benefits of a control mechanism. The combined Chairman/CE is also uniquely placed to empower executive directors in a way that the non-executive Chairman may not be able to do given the presence of the CE on the Board.

- Boards can be costly mechanisms for what they contribute. The expectancies and accountabilities placed on NXDs have increased sharply, but executive directors frequently continue to see them as either non-entities or irritating blockages. For the Board as a whole to be effective there is a need for EDs to be educated about the distinctive role and added value of NXDs and the remuneration of NXDs should reflect the real costs of high calibre independent contributions and the accountabilities they have as directors.

- Different economic and company conditions require different sets of skills and structures in the Boardroom. There is obvious merit in periodically and objectively reviewing the performance and appropriateness of the Chairman and NXDs, and the functioning of the Board as a whole. This is easier once review mechanisms and fixed terms of office are agreed for non executive Board members, to complement the regular performance reviews of their executive counterparts. The renewal of the Board by planned retirements and new appointments maintains freshness and independence, and can be very powerful in its 'knock on' effect.

- There is a delicate balance between major issues being pre-digested within the executive and submitted in 'final form' to the Board, and allowing premature discussion of ideas that have not been rigorously analysed. The danger of 'over-cooking' is that the decision is already taken and the contribution of the Board has been pre-empted. If 'under-cooked' expensive Board time is wrongly used and NXDs are invited inappropriately onto executive territory. One solution is to involve NXDs in the pre-discussion of key assumptions and goals as a starting point for executive development of specific strategies and their progressive review by the Board.

It was agreed that there is no generic formula for good boardmaking; it will vary according to the needs and circumstances of the organisation. Nevertheless, there are characteristics of emerging practice which can be contrasted with common practice to show potential areas for improved governance.

Thursday, 14 November 1991

In his opening comments, **Brian Smith** defined three key tasks of the Board: Ensure existing assets are vigorously exploited This requires the right people in the right place, ensuring they are appropriately trained, rewarded and supported by robust systems, and if performance is unsatisfactory, the people should be changed. Define the future direction of the company and get to it: this cannot be delegated. Set ethical standards for employees to understand and uphold.

The role and style of the chairman and chief executive are central to the achievement of these tasks. The driving, self-confident, dictatorial leader makes things happen, but if he has all the necessary authority and power, those same characteristics will lead to his and the company's failure. The issue is how to save the chief executive or the company from himself?

The subsequent discussion focused around:

- There is a difference between running the business and running the board. The CE is responsible for the former, the Chairman for the latter. Effective governance enables the executive team to make things happen but provides counter - balancing mechanisms for challenge, review, appointment and if necessary displacement.

- The primary responsibility of the Board is to appoint the right leader. There should be competition for succession and change mechanisms if that leader becomes inappropriate. The danger of a strong leader is that it makes succession harder, because frequently he will have destroyed potential candidates in the organisation. To avoid this requires checks and balances, insistence on management development, succession planning and the injection of high quality, challenging external recruits.

- A range of views were expressed about the role of the executive director on the Board: at one extreme, executives should represent the interests of their business division and argue their case - if there has been serious executive opposition, the alternative view should be expressed; at the other, the executive team should present a pre-agreed unified perspective with any disagreement being resolved in an executive committee. An alternative to both was that the executive director should adopt a group perspective on the Board and delegate the presentation of a case to the general manager level, giving them exposure to the NXDs.

- In the absence of an effective network, it is very difficult for NXDs to keep themselves informed. A good board requires good NXDs but their effectiveness is highly dependent on the quality of Boardroom debate and whether challenge is encouraged and fostered by the Chairman. A planned review period for NXDs creates the expectation for change, avoids violent collisions on the Board and ensures continued independent perspectives.

It was felt that there is no generic formula for good boardmaking since it will vary according to the needs and circumstances of the organisation, and reflect the culture and individuals that are in place. Never the less, there are characteristics of best practice which can be contrasted with common practice to show potential areas for improved governance.

Wednesday, 9 October 1991

In his opening comments, **Robin Biggam** defined the two key roles for the Board as providing leadership and discipline for the organisation. Three key governance issues were to do with:

The roles of Chairman and Chief Executive: Their combination or separation should not be dependent on hard and fast rules, but recognise the circumstances of an individual company. Their combination undoubtedly focuses power and in such a case the Chairman should not be a member of the audit and remuneration committees. He suggested that the Thorn EMI model showed ways of empowering the non executive directors.

The role of NXDs: The evidence of their value is mixed. They can bring independence and a perspective from the outside but they are not a substitute for a strong executive team. Their tenure should be restricted to between 3 and 5 years; they should not be too involved and become part of the management culture.

The structure of Boards: European pressure for a two tier board should be resisted. The fierceness of the opposition to Bullock may have abated; the concept of worker directors is not unmanageable, and in a choice, preferable to a two tier structure.

The subsequent discussion centred largely around the role of the non executive director;

- The law does not recognise a distinction between executive and non executive directors in terms of their accountability, but they clearly have different roles. The NXD's prime value comes not from being immersed in the technicalities of the business but from using independent judgement and experience gained outside the organisation.

- The quality of NXDs is more important than their quantity, but their effectiveness is hugely dependent on how the Chairman selects them and how he uses them on the board, and their involvement should not be confined to board meetings. Indeed the formal nature of a board meeting is not appropriate to reviewing plans and brainstorming key issues.

- The NXD can also be a valuable personal confidant for the Chairman, but there is a delicate balance between becoming too involved and maintaining independence. There is an optimum length of tenure for an NXD before which lack of knowledge of the business is a handicap, and beyond which there is emotional commitment to the past. The question was raised whether NXDs should have the means to commission independent consultants. There was felt to be a clear risk of polarising the board, but they should have the power to require a review to be carried out under the Chairman's auspices.

- In the event of a fundamental disagreement, the actions available to an individual NXD are limited; there is an option to resign, but it is frequently not in the best interests of the company to do so, or only to do so with public exposure. In crisis, NXDs collectively are able to force change, but deposing management is a nuclear weapon that can only be fired once.

There was an overall endorsement of NXDs, but they are not a proven salvation for corporate well being and their effectiveness is only as good as the quality of the individuals, the Chairman and the processes he uses to ensure their involvement. The potential contribution of an NXD is much greater when the organisation is in distress, but the more important question is how NXDs add value when there is no crisis. The key there is to join them with the executive in a process that generates joint ambitions and goals so that they have the means of evaluating executive recommendations in the context of a full consideration of the alternatives. This strategic linkage is the key to adding value. The evaluation of executive performance is the tool for change, and an insistence on information appropriate to their role is the guarantee of integrity throughout the business.

Thursday, 26 September 1991

In his opening comments, **John Gardiner** emphasised that the prerequisites for a good board are the Chairman's desire to have one and the presence of more than one NXD on the Board. The Chief Executive controls information, appointments and strategic thinking. The key role for the board, and particularly outside directors is the appointment, and if necessary firing of the Chief Executive. Shareholder representatives have no power because they do not have access to replacement management.

The subsequent discussion focused around:

- The role of the NXD is becoming increasingly exposed to a higher level of public expectation and scrutiny. This requires them to make a clear contribution, to be sufficiently available in the context of their other commitments and to be conscious at all times of their legal liabilities. The important question is how NXDs add value when there is no crisis, particularly regarding strategy formulation. Views ranged quite widely from a complete openness and sharing of options and assumptions prior to the agreement of strategy, to an essentially executive process which is thoroughly worked through and then presented to the board for acceptance.

- The NXD can be a valuable personal confidant for the Chairman, but there is a delicate balance between becoming too involved and maintaining independence; NXDs should not become too dependent on their emoluments and always retain the freedom to 'ask the daft laddie question'. There are dangers in too much proximity; the NXD's prime value comes not from a detailed knowledge of the business, but from using independent judgement and experience gained outside the organisation. There are a variety of ways to inform and 'educate' NXDs, ranging from circulating detailed minutes of key executive meetings to acting as godfather to a particular region, department or business, so that they are knowledgeable about people and business issues.

- The question arose in several guises as to the role of executive directors on the board. Although a number of different board structures were represented around the table, ranging from exclusively non executive main boards to those more pre-eminently executive, there was no clear definition of the executive director qua director.

- There is no point in looking to the institutions to improve corporate governance and therefore performance. Their role is to make money from owning and trading shares and not sorting out the problems of management, except, like the NXD, in extremis.

It was felt that there is no one formula for good boardmaking; it will vary according to the needs and circumstances of the organisation, and reflect the interplay of the personalities involved. The strategic process should include a dialogue that does not diminish the executive role but which enables NXDs to be equal participants in determining corporate ambition, priorities and risk. The effective board uses genuinely independent NXDs in order to stand periodically on higher ground, to be constantly mindful of risk and business cycles and to ensure that management capacity is in place for future problems as well as today's.

CONCLUSIONS

AND

OUTLINE OF A BOARD PROTOCOL

CONCLUSIONS and OUTLINE OF A BOARD PROTOCOL

There is a rich diversity in the 10 summaries. On some points there is a sharp difference of view - for example, the role of the Chairman exclusively as Chairman of the Board and its performance or as boss of the company, with consequential accountability for business performance standards, overall strategy and the integrity and reputation of the firm with all its constituencies. Surprisingly, perhaps, the differences are less striking than the common ground about the features and processes which in their aggregate are likely to characterise 'quality' Boards.

There is a large measure of agreement about:

- The Chairman's role in setting the style for Board meetings, and in introducing new directors, both executive and non-executive, so as to encourage their robust and effective participation from the start.
- The processes for developing strategy between the executives and the non executive directors, so that there is understanding and commitment by both.
- The dangers of the non-executive director as a separate class of director, but the reality of their additional accountability, over and above the executive directors for leadership and integrity (the idea of a unitary Board actually being a two-tier Board in waiting).
- The importance of the Board agenda and information flows to distinguish it from being another, albeit the most senior, management committee.
- The Board as a proxy for the market with more stringent standards and a recognition that there is a timeshare dimension to institutional investment which creates different behaviour to long-term ownership.
- The creation of active engagement by the non-executive directors and of the expectation of change by term appointments, formal reviews, the encouragement of grit in the system, and the transparency of information.
- The composition of the Board, its balance, its committee structure, and the selection of non-executive directors so as to avoid achieving the Board that the Chairman wants only at the end of his tenure of office.

Effectiveness reviews carried out by CRA have confirmed that many Boards have the potential for substantially improving their performance. There may be considerable value in developing from these building blocks a separate Board Protocol, which would serve to clarify the intentions and aspirations of the company with regard to its Board and help provide a measure of continuity through change.

Leslie Dighton
June 1992