

*Note to Derek Higgs*

*The role and effectiveness  
of non executive directors*

I have had chance to review your consultation paper and terms of reference. I have also looked through the list of questions summarised in para 17 and subsequently broken down into a series of sub questions. I have limited my immediate comments to headings A through to E. With practical experience of governance issues in the British context and elsewhere I hope I can share these thoughts with you.

**A      *The Role***

1.      The issue of *role* drives to the heart of the wider issue of why NEDs were *invented* in the first place and whether they can play the role we expect of them. Reaching a clear and objective answer to that question may in turn help us to identify ***how that role can be effectively discharged***. NEDs have always been seen as a counterweight of sorts to executive directors. This raises the awkward question currently being asked by some well seasoned executive and non executive directors: why bother to appoint NEDs who can't, for all manner of practical reasons, measure up to the tasks they are faced with?

2.      The sub text of this might be read as suggesting that NEDs have been a convenient distraction allowing the public to feel that somehow independent NEDs would exercise the right sort of influence where conflicts might otherwise arise. In reality the conclusion of the sub text appears to be that the NED cannot perform this role. The way forward, it is argued, to make governance work, ***is to force responsibility for good governance back on the shoulders of executive directors*** where it rightfully belongs.

3.      My own view on this is that the role of the independent NED is an important one and is worth building upon. ***But it cannot be played out effectively within existing structures***. This is why the cynics are saying 'don't expect NEDs to do what should be done by executive directors'. The fact is that NEDs, in large corporations, have neither the resources nor the power base to be able to independently monitor the actions of executive directors and where appropriate call them to account.

4.      Though ENRON is not in most respects the best example to cite it is perhaps significant that the British appointed NED to its board has agreed that he did identify and express misgivings about various sensitive issues as he then saw them ***but failed to get fully satisfactory explanations or verification that changes he felt should be made had been made***. True or false this must remain a potentially serious limitation. Given the nature of the NED's task and the time normally invested in its discharge – can NEDs seriously be expected to be able to monitor complex arrangements, make detailed recommendations for changes and ensure that these have been implemented?

5.      There is a further twist to this argument. It is sometimes argued by executive directors that they do not always have a full picture of what is happening. Evidence following the demise of Railtrack Plc gives more than a hint that ***executive directors, when Railtrack Plc was a going concern, felt they were not fully in control of***

*events*. If full time executive directors have this feeling about what they do – then god help the NEDs!

***B Attracting & appointing***

6. The world of business is changing rapidly. There is growing pressure on corporations to behave responsibly and to be seen to be doing so. CSR (corporate social responsibility) – love it or hate it – is a powerful force driving corporations to respond to changing public expectations. The CSR movement is generally of the view that CSR is something that should be overseen by NEDs. In my experience this is not yet the case in many companies that undertake what they describe as CSR – though things are changing. These changes are seen as a means of ensuring that ***CSR exercises will rise above the level of PR and open the door to independent verification of claims.***

7. The question this raises is: how far NEDs are qualified in these changing times to deal with these new and evolving demands? Awkwardly the question that has to be asked is how far a former, perhaps retired executive director, is going to have the skills, background knowledge, experience and commitment to face these new challenges? ***Without appropriate skills – even in meeting the more orthodox interpretation of good governance – how can this task be effectively undertaken?***

8. There is another cited objection to existing arrangements for attracting and appointing NEDs. This objection is that selection is naturally made from a ***pool of talent that is too narrow and perhaps inevitably biased.*** This arises understandably because boards of directors are bound to favour selection of people from a similar background sharing similar views on the role of the board in corporate governance. This, with the best will in the world, must lead to a situation where selection favours a certain type of *status quo* profile. ***Rightly or wrongly this drives the public perception that NEDs are unlikely ever to be selected because of their independence of view.***

9. The only way that this can be addressed is through commonly shared values on what might otherwise be referred to as the *job description*. This might look as follows:

*The challenge*

- 1 *To be able to develop, promote and sustain high professional standards of governance and accountability for the Board as a whole and individual directors.*
- 2 *To enable the Board to realise its full potential through training and development.*
- 3 *To enable the corporation to aspire to the highest standards in terms of public expectations regarding governance and accountability*

*Skills needed*

*To have knowledge of existing and evolving techniques such as outcome based assessment and undertake*

- *Member training and development in corporate governance and accountability and the underpinning values and the mission of the corporation*
- *Decision consensus building on issues of best practice governance and accountability*
- *Implementation of effective governance and to report publicly thereon*
- *Intra and inter-processes of consultation within and outwith the corporation*

### ***C Structures and procedures***

10. Existing structures will have to change if the independent NED is to effectively operate. The board as a whole is going to have to ***commit to a new style of operation*** within the sorts of commitments set out in para 9 above. The chairman and CEO will need jointly to commit ***to providing access and co-operation*** with other board members along with the company secretary's department. The NED will need to be fully supported, politically and materially, in the discharge of these tasks.

11. This might very well result in the NED/NEDs submitting ***a separate report on governance*** to the Annual Report presented to shareholders/institutional investors and the public. The Office of Governance will have to be realistically budgeted for and otherwise resourced. This development is likely to be an inevitable consequence of pressures for independent social reporting and recommendations in respect of the OFR (Operating Financial Review) as made in the CLRR's proposals (Company Law Reform Report).

### ***D Relationships with shareholders and elsewhere***

12. An inevitable result of a change in commitment on the scale foreseen will place the Office of Governance in direct contact with shareholders of all categories and institutional investors. The Office of Governance will also need to establish links with other recognised stakeholders and to oversee any CSR initiatives.

13. The issue of stakeholders and their relationship with the corporation is one that is bound to arise. Whilst the law appears to state clearly that the shareholders own the corporation it is also accepted that other stakeholders must be recognised as part and parcel of good governance. This is flagged under the Directors' Duties heading within the CLRR review [op. cit. paras 3.7 & 3.8 refer].

### ***E Support***

14. These matters are addressed in outline in section C. The clear implication is that a different support structure and budget commitment will be required if the role of the NED is to be made more effective. It is also evident that the skills and experience base of the appointed NED will need to take account of these far reaching changes in job description.

***F Smaller companies***

15. The position of smaller companies is a matter that needs separate treatment. Small companies and not large companies writ small any more than large companies are small companies writ large. The needs of the small company are quite different.

***G International Experience***

16. There is much that can be learnt from international experience. Outside Anglo American jurisdictions it is difficult to make direct comparisons. The European model of corporate responsibility, governance and co-determination should be cause for reflection in the context of British board composition and accountability.

I hope these few thoughts may help in advancing your task. I shall otherwise be glad to contribute to the on-going work of your group. Please contact me if that is the case.

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