

THE BVALCO 'FOOD FOR THOUGHT FORUM'

DISCUSSION AND DEBATE FOR CHAIRMEN, BOARD DIRECTORS AND CO. SECRETARIAT

27th October 2011 – Topic 7: The Unitary Board

In the Cadbury report published in 1992 in the wake of the corporate scandals associated with the collapse of the Robert Maxwell empire, the basic system of corporate governance in Britain was adjudged sound. The stated aim of its proposals therefore was to strengthen the unitary board system and increase its effectiveness, not replace it. There have been further subsequent reviews of corporate governance, none of which has changed this fundamental approach.

Cadbury also recommended that the board should include non-executive directors of sufficient calibre and number for their views to carry significant weight in the board's decisions. Typically this has resulted in a majority of non-executives on a board and shareholders have drawn comfort from the injection of independent scrutiny.

Recently however Sir David Walker and the FRC have questioned whether compliance with the governance standards set by Cadbury and others is enough in itself. Behaviour and personal dynamics within the boardroom have been identified as critical issues to address; managing the relationship between the executives and non-executives is an essential part of this. There is increasing evidence that regulators and shareholders are looking to the non-executives to act as "corporate policemen" or at least an effective counter-balance to the executives.

Guests were invited to consider the following questions:

- Whether these demands were disturbing the balance on the board in a significant and unhelpful way.
- If this is an issue, what can be done to correct this imbalance?
- Are more radical changes necessary? For example, would it help to have the non-executives in a minority on a board or should we adopt the more radical solution of a two-tier continental type board?

The Discussion

The following is a summary of the issues discussed and the thoughts expressed. This document is intended to provoke thinking rather than offer solutions as “no one size fits all”.

The point was made that “policing” is only part of the function of a director. The term “corporate policemen” as applied to non-executives is unhelpful as it tends to over-dramatize the monitoring element of their function and deflect the focus away from other essential functions such as involvement in strategy formation and mentoring. It was however acknowledged that the increasing demands for evident challenge in the boardroom, particularly in the regulated sector, and an expectation to see this recorded in the minutes of the meeting is creating strains which need to be managed. The issues around the demands for more challenge however seem to be more around how they are recorded to the satisfaction of third party observers, particularly the regulators, rather than concerns that challenge is not happening.

The following broad proposition was offered as an analysis of what was described as the law of unintended consequences. It was argued that executives in the current environment are more focused on short term results and paid on the basis of short term results. The average tenure of CEOs in office has shortened significantly in recent years, strengthening their tendency to focus on the short-term. They are more inclined to work for short term gains, neglecting the longer term issues of the company. In such a situation the NEDs need to be there to bring a longer term perspective. But at the same time NEDs themselves are increasingly subject to pressures with regard to safeguarding their own reputations. NEDs are becoming more of a “professional” class with a portfolio of appointments (optimally no more than five); and as a consequence their personal reputations are critical. They cannot afford to be associated with failure and accordingly their approach in the boardroom may be more affected by self-interest rather than loyalty to the company itself. The unintended consequence of this is to drive more of a wedge between executives and non-executives and it is no longer reasonable to assume that a board will act in a unitary fashion.

One contributor pointed out that the boardroom provides a forum in which the natural rivalries between executives and non-executives can be played out. Challenge in such circumstances is capable of being interpreted in a number of different ways and currently no one has defined the protocol around this. Much obviously depends on the personalities of the people involved; the dynamics between the Chief Executive and members of the board and the ability of the members of the board to see themselves as representatives of an entity not of their own personal interests.

No-one thought that the weighting on numbers on the board in favour of the non-executives makes much difference; executives are usually robust enough not to be cowed by a “them and us” mentality. More important is the way in which the business of the board is chaired.

Asked what they thought a good chairman ‘looked like’, the response was “someone who understands the importance of assuming a wide corporate responsibility and a way of working with the executives which is supportive. She or he must be a big personality and prepared to lead properly.” It was pointed out that the expectations of the role of the chair vary depending on one’s

culture and the jurisdiction. In the US the chairman is expected to have a much greater involvement in the business and substantially greater depth of knowledge of the detail than his or her UK counterpart, who tends to have a more detached role intent on facilitating board performance as a group. Nonetheless expectations of the chair to secure the effective performance of the board are greater than ever.

So while it was generally accepted that there is now increasing scrutiny of effective corporate governance within the boardroom giving rise additional pressures which need to be managed, there was no sense that there is any need to adopt any radical solution such as altering the balance of representation of executives and non-executives on the board. Nor was it thought that the two tier continental structure would offer any additional benefits, but rather would give rise to a whole different set of issues associated with having members of a board appointed to represent vested interests.

As to what could be done to better oil the wheels of the unitary board, the importance of the role of the chairman as a facilitator and team manager has already been discussed. The chairman and non-executives had to be “more skilful in building relationships than before, taking care not to focus too much on an adversarial emphasis”. Numbers are important, in the sense that a board should not be any larger than that required to do the job. It was not felt that a minority of executives is necessarily an issue.

There was a discussion about how challenge could be managed so as to minimise the risk of unhelpful dynamics. Reference was made to the concerns about recording challenge in the board minutes and whether this, of itself, could give rise to problems. One way of managing a challenge in a transparent and non-adversarial way, which has been discussed, is to appoint a director as devil’s advocate, who is specifically briefed to research and offer the counter argument to any significant proposal. It was acknowledged that most good decisions come out of an open and constructive debate. A good chairman is there to generate and encourage just such debate. Interestingly, in the light of Sir David Walker’s recommendations, it was noted that recent experience suggests that risk committees are becoming a forum in which these sorts of issues are naturally arising and where they are now being discussed and managed. Perhaps this is unsurprising given the forward looking nature of their remit.

Conclusion

The mood of the meeting was that the suggestion of an inherent division in a board between executives and non-executives is at risk of being over-stated, although it was recognised that it is becoming much more of a reality in the regulated sector. More was expected of the non-executives to be ready, willing and able to look critically but constructively at the proposals and performance of the executive. Non-executive directors must spend more time getting to know the business if they are to ask the right questions. The chairman has a substantial responsibility in managing this and creating the right environment. Committees have a role to play in providing the right forum in which challenging debate can take place. Devils advocates could also be deployed to present counter-arguments on more strategic issues.

About Bvalco

Bvalco provides an independent, formal and rigorous board review. The UK Corporate Governance Code recommends that boards conduct a formal and rigorous external evaluation once every three years and a process of self review on an annual basis.

To support these requirements Bvalco offers the following services:

- The facilitation of a formal and rigorous external review of the Board using our unique approach.
- A confidential individual service for chairmen, board directors and company secretaries in support of their own annual internal review of the board's effectiveness.

The Bvalco 'Food for Thought Forum' is an invitation only lunch hosted by Bvalco on a monthly basis. The lunch runs from 12.30-2pm. A topic relevant to effective board functioning is tabled for each event.

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