

U.K. CORPORATE GOVERNANCE

There are two basic concerns about British boards of directors, first their effectiveness & second their accountability. To some extent the two go together.

Under the heading of effectiveness, why in general are British co's not better run? Under that of a/cability, co's exercise considerable econ & social power to whom are they answerable & to whom should they be answerable?

Do not believe these concerns will fade when the economy is once again in full flood, they are too fundamental & too firmly on the public/political agenda.

Criticisms of board effectiveness include:-

- Britain's share of world trade has until recently fallen consistently & the country's growth rate has lagged that of similar nations, apparent failure to be internationally competitive.
- It is widely held that boards concentrate on meeting short-term market expectations expressed in earnings per share, at the expense of investment, building businesses & increasing s/ldr. value over the longer-term.
- Boards are said to be too tolerant for too long of poor/mediocre mgt. performance.
- Finally some major co's have collapsed, when their previously published results gave no apparent warning of the true state of their finances. Can we trust directors' reports and what value can be put on the unqualified audits which usually accompanied them?

Should add that etee. chairing on fm. aspects. Corp. govt aims to report at end May. Our recommendns. will be focused on the control & reporting functions of boards & role of auditors (J.C. member of etee, Michael Fowle ^{splendid} ~~best~~ paper manditory)

Turn now to accountability. The formal system is clear. The s/hldrs. elect the dirs, the dirs report on their stewardship to the s/hldrs. in genl. mtg. & s/hldrs appoint auditors to provide an external check on the dirs' financial statements. Thus the s/hldrs. elect the dirs. to run the business on their behalf & hold them answerable for its progress.

1st point, how & to whom, in addition to s/hldrs, shld. boards be accountable?

as we all know

Second point, there is a chasm ^{as we all know} between the formal structure & reality. By & large dirs. appoint themselves, AGM's are not a serious exercise in acbility & s/hldrs have no direct link with the auditors, who are put forward & paid by the mgt. whose reports/systems they are there to check.

Major institutional investors can hold boards to account and have intervened directly in extreme cases over the composition of boards. The major problem though is the vastly larger number of boards which are underperforming, but not sufficiently conspicuously to demand s/hldr. action. That kind of

Of all the deficiencies of the ^{governance} system, the inability of the shareholders to exercise control is the most striking. The frustration felt by shareholders at their impotence, erupted this time last year over directors' pay & compensation received by directors who had demonstrably failed & finally been fired.

How could some of these deficiencies best be tackled? I would suggest that there would be a considerable measure of agreement on actions to increase board effectiveness,

- Recognition of the central importance of the chairman's role if a board is to function effectively & - an argument in principle (quite apart from the concentration of power argument) for a chairman who is not also the chief executive.
 - The need for boards to have a balance of inside exec. directors & outside, independent directors, & for outside directors to be sufficient in number & calibre for their views to carry significant weight in the board's decisions.
 - Having an information system & committee structure to support the outside directors, in particular an audit committee, but also remuneration committees.
 - Boards should have some systematic means of appraising their own performance.
- An interesting question is if there is general agreement that this is the direction in which boards should move, why doesn't it happen, or at least happen faster.

This brings us to a basic deficiency of the present system - how board members are chosen. 80% board appointments made through loosely termed old boy network. Not, ^{proved} necessarily, ^{been} disastrous way of appointing directors, but it leads to replacing like with like, to complacency & to a lack of challenge on boards.

In my view it is out of date, unprofessional & unacceptable.

The process of appointment is important. It should start with the task, not with 'think of a name'. When the board's needs are identified, candidates ~~that~~ ^{who} could meet ~~these~~ ^{needs} can be purposefully sought. In addition to having a proper process it is essential to widen the pool from which potential directors are drawn.

Pro NED which JC. founded can assist boards on both counts.

On accountability, simply say that there are ways in which s/hldr could exercise more control over boards, one of them would be to make AGM's more effective in that regard ^{which would be perfectly possible}, another as in the U.S. would be to develop s/hldr. _{resolutions}

The issue is one of s/hldr. responsibilities as well as rights. S/hldr. are for practical purposes, even if not ⁱⁿ strictly legal terms, the owners of the companies in which they hold shares. Can they be encouraged to act more like owners, in spite of the fact that the institutions are intermediaries acting on behalf of _{others?}

End with three policy questions which need to resolve in tackling the deficiencies I have discussed.

1) How can change in corporate governance best be brought about?

Where do the levers lie to bring about change? How far could & should

the institutional s/hdrs in particular use their collective clout to increase board effectiveness? Where does that leave accountability to other constituencies?

Where does regulation come in & what should be the mix between self & statutory regulation?

2) Do most of the proposals for improving board effectiveness ^{which I have outlined} expect too

much of outside directors? They are outsiders, they are part-time; what

experience /

training will they need to carry out the monitoring tasks we may be loading

on them? But incidentally raises the general? If ^{all} ₁ dirs shld. be trained

3) Last? follows on from that is constitutionally the most important.

The more we give specific tasks to o/s dirs, the more we differentiate

them from exec. dirs. Can the essential unity of the unitary board

be maintained, if in practice we have two classes of director

with different sets of responsibilities?