Boardroom Roles by Adrian Cadbury

EXECUTIVE SUMMARY

- The role of the board is to direct not to manage.
- Balance of board membership and choice of individuals are key.
- Chairmen are responsible for the effectiveness of their boards.
- Non-executive directors have a particular contribution to make to the work of a board.
- Board committees are important structurally and for the tasks they undertake.
- Executive directors should be appointed solely for the value they can add to the board.
- Board members have different roles; what matters is how they combine to form the board team.

ROLE OF THE BOARD

The crispest definition of a board's role is Sir John Harvey Jones'l*to create tomorrow's company out of to112*". Boards are in place to direct and not to manage. Boards have the task of defining the purpose of their enterprises and of agreeing the strategy for achieving that purpose. They are responsible for appointing chief executives to turn strategic plans into action, for supporting and counselling them in so doing and if necessary for replacing them. Above all boards are there to provide leadership and it is in that context that the roles of board members need to be considered.

BOARD COMPOSITION

A single board at the head of a company is the commonest form of board structure. Unitary boards of this nature are made up of executive and non-executive or outside directors. Two-tier boards separate these two kinds of director and their structure is covered briefly in the box. Given that both executive and outside directors sit on unitary boards, the first issue is the balance between them. Ten years ago the ratio on UK boards was around two-thirds executive directors and one-third outside directors. This has now moved closer to parity and in future I would expect outside directors to be in the majority. This is already the position in the United States where the chief executive is often the only executive on the board and is usually its chairman as well.

In addition to the question of balance, there is the question of size. There is a clear move to smaller boards, both in Britain and in the US. Martin Lipton and Jay W. Lorsch in their "Modest Proposal for Improving Corporate Governance" recommend a maximum board size of ten and favour eight or nine. The argument for smaller boards is that they enable all the directors to get to know each other and to contribute effectively in board discussions, thus arriving at a true consensus. The crucial point is that boards are teams and provide collective leadership. So the balance of membership and choice of individuals are key to forming the team.

THE CHAIRMAN'S ROLE

Chairmen are responsible for the effectiveness of their boards. This responsibility rests with chairmen whatever their other duties. It leads on to the point that all companies are different and the issues they face are constantly changing. Individual boards have to follow accepted board principles, but in ways which meet their particular circumstances. It is chairmen who have the responsibility of ensuring that the make-up of their boards is appropriate for the challenges ahead. Similarly, it is chairmen who have the task of welding their directors into an effective team. Effective boards are not brought into being simply by sitting competent individuals around a board table. Creating effective boards requires effort by their members, but above all coaching and leadership by their chairmen. This is an argument for chairmen not also being chief executives.

Chairmen are responsible for the running of their boards. Their responsibilities include the agenda, the provision of adequate and timely information to all directors and the actual conduct of board meetings. They are also, provided they are not chief executives, responsible for putting in place a means by which their boards can evaluate their own performance.

Where chairmen are also chief executives, their duties in relation to their boards remain the same, but their deputy or a senior outside director would be responsible for the appraisal of the chief executive and for the review of the board's performance.

ROLE OF THE OUTSIDE DIRECTORS

All directors are equal in that they all carry the same legal responsibilities. Outside or non-executive directors are in that sense no different from their executive colleagues. They do however have particular contributions to make to their boards by virtue of standing further back from the business. One is in reviewing the performance of the chief executive and the executive team; clearly the outside directors are the only board members in a position to do this objectively.

> **"Outside directors bring with them their experience in fields which are different from those of the executive directors."**

Another is in relation to potential conflicts of interest, such as those between the interests of the executives and those of the shareholders. Examples are directors' pay, dividends versus re-investment and whether top appointments should be made from within or outside the company. Decisions on these matters are ultimately decisions of the whole board, but the outside directors are well-placed to give a lead over where the best interests of the company – to which all directors owe their duty – lie.

Outside directors bring with them their experience in fields which are different from those of the executive directors and this external experience is of particular value in the formulation of strategy. The potential advantage which the unitary board has over the two-tier board is that it provides the opportunity to combine, in the same body, the depth of knowledge of the business of the executives with the breadth of knowledge of the outside directors. Once again, it is up to chairmen to make the most of these different viewpoints by the way they structure board debates.

The role of outside directors in helping to resolve conflicts of interest does not imply that they have higher standards than their executive colleagues. The difference is simply that they can judge these matters more

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objectively because their interests are less directly involved. There are however differences between outside directors themselves. Independent outside directors are defined by the Combined Code of the London Stock Exchange as follows, "*the majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement*." (The Combined Code of The London Stock Exchange was published in June 1998. Companies listed on the London Stock Exchange are required to disclose how far they comply with the Code as a condition of listing.) Outside directors who do not fulfil these criteria may be valued board members in their own right but they cannot be classed as independent.

Another provision of the Combined Code is that there should be a recognised senior member among the non-executive directors to whom concerns may be conveyed, even when the chairman is not the chief executive. This new role is valuable when the two posts are combined, as it makes clear to whom directors or investors should go if there are problems at the head of the company. Where the two posts are separate it could lead to confusion.

ROLE OF BOARD COMMITTEES

As the responsibilities of directors have become more demanding, boards have increasingly formed committees to deal with some of their more detailed work. The Combined Code requires all quoted companies to establish audit and remuneration committees and, unless they have a small board, nomination committees. These committees strengthen the position of the outside directors, of whom they are made up, and are important for the work they do. The essential point is that they are committees of the board. It is the board which appoints them, sets their terms of reference and turns their recommendations into decisions.

ROLE OF EXECUTIVE DIRECTORS

The duties of executive directors are the same as those of the outside directors. They are as responsible for the monitoring task of the board as the outside directors, who in turn are as responsible for the strategy and leadership of the company as the executives. This means that executive directors have to take their executive hats off on entering the boardroom and put on their directorial ones. They should only be appointed for the contribution they can make to the board and they are there to further the company's interests not those of their function or department. It is not an easy transition to make and executive directors can be helped to adopt their new non-managerial role through appropriate training or through a non-executive directorship elsewhere.

ROLE OF THE COMPANY SECRETARY

Chairmen and board members should be able to look to the company secretary for impartial and professional guidance on their responsibilities and all directors should have access to the advice and services of a company secretary, who is responsible for ensuring that board procedures are followed.

MINI-CASE: TWO-TIER BOARDS

These boards are constituted of a supervisory board whose members are all non-executive and a management board made up of executive directors. The management board is responsible for strategy as well as for running the business. The supervisory board appoints and can dismiss the management board and no-one can be on both boards. The legal responsibilities of the two boards and of their directors are different, whereas with a unitary board all directors have the same legal duties however the board is structured.

Since supervisory boards often have employee members, this raises the question of their role on boards. My view is that employees can most effectively participate at levels below the board, where the decisions are taken that affect them most directly to which they can contribute knowledgeably.

MAKING IT HAPPEN

- Make the board concentrate on corporate purpose, appropriate strategy, and appointing a chief executive who can turn strategy into action.
- Appoint a chairman who is not chief executive, and will put in place effective measures of the board's performance.
- Keep the board to an absolute maximum of 10 members, with a majority of outside, non-executive directors.
- Ensure that non-executive directors are independent of management and free from connections that may affect their judgment.
- Use the whole board to pick outsiders who can fill gaps in the experience and backgrounds of existing directors.
- Train executives in filling their non-managerial boardroom role and let them learn from non-executive posts elsewhere.

CONCLUSION

Although board members have different roles, what counts is the way those roles are combined in the board team. This is why board selection is so fundamental. Directors should only be appointed for the value they can add to their boards. All directors should have terms of office to enable renewal to take place, although I am against rigid rules tying retirement to age or length of board service.

The search for outside directors should be purposeful with the aim of filling gaps in the experience and backgrounds of the existing directors and their selection should involve the board as a whole. Chairmen, however, have a particular responsibility for the choice of board members since it is they who have to turn them into an effective team.

ABOUT THE AUTHOR

Sir Adrian Cadbury is an author and former CEO of Cadbury-Schweppes Plc. He is a European expert on corporate governance and chairman of OECD panel on corporate goverance.

THE BEST SOURCES OF HELP

Books:

"Making It Happen", John Harvey-Jones, London: HarperCollins Publishers
A brilliant, first hand account of how to chair a board and transform an international enterprise through board leadership

"The Corporate Board: confronting the paradoxes", Ada Demb & F-Friedrich Neubauer, Oxford: Oxford University Press
An excellent academic study of the way in which boards in 8 countries are meeting the challenges of a fast-changing, competitive environment.

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