



The 2018 Non-Executive Directors' Association Annual Debate Report

The 2018 Non-Executive Directors' Association Debate held at Smith & Williamson's London office in Moorgate, on Tuesday 16 October 2018, questioned whether question whether NEDs are doing enough in the current climate to positively challenge and engage with the Executive team.

Executive Summary

The 2018 Debate motion was: **"This House believes that NEDs are failing to hold the Executive to account."** A vote was taken at the start and end of the debate and the motion was held, despite a 10% swing towards the opposition.

The **Proposers** argued:

- We just need to look at the news for regular examples of corporate failure.
- The symptoms of these corporate failures can be found in the Boardroom.
- This leads to widespread issues – trust in business is fragile (Public Trust in Business is only 43%) – this is a real problem.
- Although we can try to be sympathetic to NEDs, there is no excuse for these issues.
- There are also internal issues that are causing NEDs to fail in their duties including, board composition, an imbalance of consideration to stakeholders, a lack of oversight on culture and ethics and a focus on short term vs. long term strategy.

The **Opposers** argued:

- The majority of NEDs are NOT failing in their roles, some are failing, but by no means all of them.
- We may think that NEDs are failing because of media focus on the bad stories – but these are just a minority – the number of corporate failures counts for less than 1% of all companies on the UK Stock Exchange.
- It is a British trait to focus on failure, other countries would focus on the exemplar (Diageo, Aviva)
- British businesses are very successful; the London Stock Exchange is the envy of the world.
- The British system of corporate governance is replicated globally, with the UK Corporate Governance Code being held up as a gold standard.

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The Debate Report

The Debate motion was:

"This house believes that NEDs are failing to hold the Executive to account"

Creating the Boardroom dynamic

In adopting the debate format to explore this very topical issue it was recognised that there may be a close parallel between a debate and a boardroom. In each situation, there must be respect for the opposing view, but also an atmosphere of constructive challenge after careful listening.

The Chairman

Barry Gamble, an experienced Chairman of debates and of companies

The Debaters

Proposing the motion:

- **Peter Williams**, Chairman *boohoo.com plc*, *SID Rightmove plc*, *NED U and I Group plc*; **seconded by**
- **Jacqui Ferguson**, *NED Tesco Bank*, *NED Wood Group*, *NED Croda International plc*, *UK NED Awards 2018 "One to Watch" Winner*

Opposing the motion:

- **Terri Duhon**, *NED Rathbone Brothers plc*, *NED Morgan Stanley*, *Associate Fellow Saïd Business School, University of Oxford*; **seconded by**
- **Gary Browning**, *Chairman EtonBridge Partners Ltd*, *Chairman Corndel Ltd*, *NED CloudCall plc*,

It is important to note that there should be no assumption that the debater's personal views either did or did not coincide with the side of the motion for which they argued.



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Background to the Motion

The 2018 NED Debate sought to consider the state of play in the board room, by looking at how the executive and the NEDs are working together.

The Work and Pensions and BEIS Committee, stated "*The Company's Non-Executive Directors failed to scrutinise or challenge reckless executives*" as one of their key findings in their report on Carillion, which was published in May 2018. This, along with other high-profile corporate governance failures, has led many to believe that the Non-Executive is failing in its remit to hold the Executive to account.

However, there are arguments that governance activities in the UK remain strong as the number of problems that are exposed are in overall terms low. The recent release of the updated UK Corporate Governance Code, the updated QCA Corporate Governance Code and the new Wates Principles for large private companies, also shows that corporate governance is very much being re-enforced, particularly with the emphasis on board effectiveness and the role and duties of directors, both executive and non-executive.

Some of the key themes that the Debate set out to explore included:

- Does the media cover corporate governance success and failures fairly, or just focus on the negatives?
- Are boardrooms diverse enough and are NEDs briefed properly to allow them to undertake their roles successfully?
- Is the corporate governance system in the UK fit for purpose or just a box-tick exercise?

The Indicative Vote

Before the Debate started Barry Gamble, the Chairman, called for a straw poll of the Motion and a summary of the result is set out below:

The Indicative Vote	
For the Motion:	73%
Against the Motion:	24%
Abstained:	3%

Proposers of the Motion (*Peter Williams & Jacqui Ferguson*)

The Proposers summarised their argument into the following points:

1. Firstly, we just need to follow the news, to hear of regular occurrences of corporate failure:
 - JJB Sports – A criminal CEO who destroyed the company.
 - Co-operative Bank – Capital shortfall, not helped by a Chairman, who was alleged to have been involved in illicit activities.
 - Rolls Royce – Bribery cases at the highest echelons of the organisation.
 - Carillion – A complete collapse, perhaps caused by a too complicated group structure with too many acquisitions.
 - Persimmon – No cap on the reward structure.
2. The symptom of these can be found in the Boardroom:
 - Dominant CEOs with weak management teams.
 - Chair's that are overly compliant and not real leaders of their board.
 - A failure of the Company to provide the NED with sufficient information.
 - A lack of challenge from NEDs, all leading to a lack of diversity.

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3. This leads to widespread issues – trust in business is fragile (Public Trust in Business is only 43% according to the Edelman Barometer) – this is a real problem.
4. We can try to be sympathetic to NEDS:
 - They spend insufficient time in the business.
 - Board Meetings have long agendas that mainly cover regulation and governance.
 - The Chair / CEO relationship can be too “cozy”.
 - Boards can often be viewed as dysfunctional in terms of how they operate.
5. However, there is no excuse for these issues:
 - The function of a NED is to be independent, impartial and impart knowledge.
 - Their responsibilities are: the strategic direction of the business; monitoring performance; remuneration of executives; communication to shareholders and other stakeholders; overseeing risk management and the assurance activities, both external and internal.
 - Therefore, holding the executive to account is a NED’s job – if they do not think they can do it, they should not take the role, if they do not have the right skills for that Board, NEDs should go out and get them.

There are numerous examples of failure in the world of retail, including JJB Sports, Blacks, Debenhams and BHS.

There are also internal areas that show that NEDs are failing:

- Board Composition – How can the Non-Execs. hold the Executive to account if they do not know what they do not know? There are numerous examples of NEDs and Boards not having the correct information:
 - TSB Bank – No NED with IT skills on the Board, despite their large scale technology changes and failures.
 - NEDs are responsible for identifying and getting the correct skills to serve their Boards properly.
- Imbalance of consideration of Stakeholders:
 - 20 of the FTSE 100 are on a Government backed public register.
 - Pay of FTSE 100 CEO’s has risen to 6 times the regular workforce, plus in a year when prices rose faster than earnings the largest quoted companies reported executive pay as increasing by 11% - is this fair?
- A lack of oversight on culture and ethics, which in themselves can be difficult areas to monitor.
 - NEDs are charged with overseeing culture, values and behaviors, but the traditional top down management on this is no longer feasible:
 - Susan Fowler’s blog on discrimination and harassment went viral, which ultimately led to the resignation of Uber’s CEO. Did NEDs know, and if yes why did they not act?
 - Elon Musk had to step down as Chairman of Tesla after his tweet stating that Tesla was going private. Why did the NEDs not take action here?
- Short Term Focus v. Long Term Strategy
 - We are in a major period of disruption, School of Business Washington reports that 40% of the S&P 100 will be gone by 2024.
 - Oversight of strategy is more key than ever before, companies need to adapt quickly to new business models, technologies and competitive threats, otherwise companies may be gone altogether:
 - Examples include: Blockbuster vs. Netflix, and the failure of Comet.
 - The traditional estate agent vs. online ‘disruptor’ companies such as Purple Bricks.

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Summary

NEDs are failing in their duty, because too many boards are:

- Lacking relevant knowledge, skills and a balanced board composition.
- Not acting on behalf of all their Stakeholders (e.g. Employees, Shareholders and Suppliers).
- Tolerating poor culture, ethics and behaviour.
- Failing to focus on strategic issues.
- Lacking strong challenge in the boardroom, compounded by insufficient information.

The Edelman Trust barometer reports that 57% of the public don't trust business because of excessive remuneration, tax avoidance and job threats and 20 of the FTSE 100 are on the government back public register of Shareholder disapproval.

These are the key tenets of the NEDs role, and therefore the evidence is clear that NEDs are failing to hold the Executive to account.



Opposers of the Motion (*Terri Duhon & Gary Browning*)

The Opposers argued that their side of the motion could be more challenging, however the argument that the majority of NEDs are failing in their fiduciary duty to treat all stakeholders appropriately and that the majority of NEDs are allowing a handful of unruly executives to run amok is simply not true.

The majority of NEDs are NOT failing in their roles, some are failing, but by no means all of them.

They argued that we perceive this, because as the saying goes "if it bleeds, it leads". The media only focus on the negatives, which may be viewed as no more than a handful of idiosyncratic anecdotal stories.

This is a very British trait to focus on the failure. In other countries we would lead with the exemplars, the likes of Diageo and Aviva; and the several thousand companies who have such good Corporate Governance that the UK System is seen as being the world's gold standard.

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Where is the evidence?

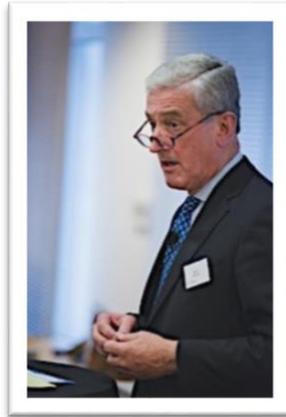
- Business Success:
 - Credit Spreads, Default Swaps and Stock Prices have never been higher – a clear indication of successful companies.
 - The London Stock Exchange is still the envy of the world.
- Remuneration:
 - If executives are running amok, there is no better place to start looking than in the world of remuneration.
 - The IA and IAS provide oversight of Remuneration, they act in the interest of shareholders and their aim is to ensure that executives are not overpaid. Only 5 – 10% of remuneration proposals have been recommended for rejection, so in over 90% of cases Shareholders have accepted remuneration packages.
 - NED remuneration is also relatively low, with a huge amount of responsibility – there is no difference in liability between the ED role and the NED role. NEDs often do not undertake their roles for the money or financial package, but rather “to do the right thing”.
- Diversity:
 - The argument that NEDs are not challenging in the boardroom, because everyone in the boardroom is the same is false.
 - There has been a significant step forward in diversity over the last 10 years.
 - There are still improvements to be made, but boardroom diversity has changed dramatically.
- The UK Corporate Governance Code has been held out as a gold standard throughout the world:
 - It has been developed over decades in law, with updates from:
 - Cadbury (1991) – the role between executives and non-executives
 - Greenbury (1995) – director remuneration
 - Hampel (1998) – a combination and harmonization of the Cadbury and Greenbury recommendations, using a common sense approach.
 - Higgs (2003) – the role and effectiveness of non-executive directors and the audit committee
 - Sharman (2011) – going concern and liquidity risks
 - Numerous countries and jurisdictions use the UK Corporate Governance Principles to guide their own.
 - The UK constantly reviews and updates its Corporate Governance principles, every time there is an issue we identify the gap and address it.
 - The 2007 EU League Table of Corporate Governance, put the UK in first place with Ireland.
- The numbers of Corporate Failure are, in real number terms, minimal:
 - Of 2,163 listed companies, 99% of these do corporate governance well.
 - There have been failures, such as Polly Peck or more recently Patisserie Valerie, but these are rare.
 - Even 20 examples of corporate failure would be less than 1% of all the companies on the UK Stock Exchange.

In summary the UK Corporate Governance System contains:

- More checks and balances and more history.
- Good old-fashioned character, which shows that NEDs do their roles not for the prestige and remuneration, but in order to hold the executive to account.

Although some evidence does support the motion, the number of failures across the UK is extremely low, showing that NEDs are holding the executive to account.

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Barry Gamble,
The Debate Chairman

Some key points from the Floor of The House

- The only way in which it is possible to understand the extent to which execs. are held back by NEDs, is to have exit polls of outgoing execs.
- It is impossible for NEDs to control the board – they simply do not have all the information.
- First time NEDs are more likely to challenge, but execs. want NEDs with experience – it can be a bit of a “Catch-22” experience.
- Is mentoring more important? (NED = set out their stall, no one expects a challenge vs. Mentoring = more supervisory in nature)
- There is a danger that NEDs just broadcast from past experience and do not look more to the future of their business.
- Do not forget that under the eyes of law (and recently reiterated by The Lord Chief Justice) EDs and NEDs have the same accountability for a business’s decisions, it just happens that a NED is part time.
- Is better training for NEDs needed? NEDA and others can and do play a big role in training.
- NEDs should ensure Boards are well run, rather than actually running the board.
- In order to achieve greater diversity, more training is needed.
- When board evaluations take place, they note a surprising lack of challenge from NEDs.
- Board packs are written and controlled by Execs., they filter the information that NEDs see.
- The accountants are also not at fault always as the Execs filter the information available during the audit.
- NEDs may operate as more of a ‘supervisory board’ – perhaps it is time to recognise them as that?
- We are subject to nature. Failure and crashes are natural. Are NEDs too constrained by regulation and paperwork?
- Only 1% of NEDs and EDs have a tech background, they are under represented on Boards in the FTSE. (Although the Nasdaq has better figures). Companies now are so technology focused – NEDs with AI / DA and VR backgrounds are needed.
- The CIO and the CTO tend to report into the CFO – this means that technology becomes about the costs rather than understanding the technology.
- The Companies Act Section 172 changes are providing more focus on NED accountability and the Wates Principles are moving us in the right direction.

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Conclusions

Proposers

- ✓ There are too many failures.
- ✓ The Corporate Governance Code may exist, but how many individuals actually follow it? The majority of NEDs have not even read it!
- ✓ There is no institute currently for NEDs, or forum for consultation (a future role for NEDA?).
- ✓ 57% of the Public do not trust business.

Opposers

- ✓ Board evaluations did not occur 20 years ago, these are now standard practice.
- ✓ There are significant education opportunities for NEDs – and participation rates are high.
- ✓ NED pay is not significant or linked to performance.
- ✓ Imagine a world without a Board and NEDS – they promote accountability.
- ✓ Being a NED is a role based on principles, these are not broken; they are evolving and improving. They are not failing.
- ✓ Integrity in the UK is top class, we should be proud of our corporate governance system.

The Final Vote

After the Debate Barry Gamble, the Chairman, called for a new poll of the Motion and a summary of the result, including the initial Indicative Vote, is set out below. **Although the motion was carried there was a 10% swing towards the opposers.**

The Indicative Vote		Final Vote	
For the Motion:	73%	For the Motion:	66%
Against the Motion:	24%	Against the Motion:	34%
Abstained:	3%	Abstained:	0%

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From Left to Right:

Graham Durgan (*NEDA Chairman*), **Peter Williams & Jacqui Ferguson** (*The Proposers*), **Barry Gamble** (*Debate Chairman*), **Terri Duhon & Gary Browning** (*The Opposers*)



Guy Rigby

(Smith & Williamson Partner & NEDA Non-Executive Director)

**Save The Date: The 2019 Non-Executive Directors' Association Debate
on Wednesday 16 October 2019**



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