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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

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CORPORATE GOVERNANCE

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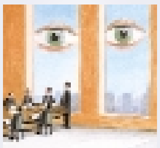

Management Quarterly

The aim of **Management Quarterly** is to provide Faculty members with a detailed review of a topical management theme, offering a range of articles which explore that theme and illustrate the practical application of management techniques.

This builds on the strategy of the first four years of the publication, when it followed some of the major threads of an MBA syllabus. Over that period, articles built up into a comprehensive overview of the knowledge needed to operate a successful business. The reader was enabled to understand current issues and debates in these areas, and distinguish core ideas from current fads.

Each part of **Management Quarterly** is self-standing, including useful references and details of further reading. Writers are selected from leading business schools, consultancies and professional institutions and organisations. Experts in each field explain and discuss the relevance, practicality and usefulness of key new concepts and ideas, thus enabling the senior executive to keep fully up to date.

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The views expressed in the articles in this issue are those of the authors and do not necessarily reflect those of the Faculty or the Institute.

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CONTENTS

CORPORATE GOVERNANCE

Foreword

By **Chris Jackson**, head of the Faculty of Finance and Management, ICAEW.

Corporate governance is a hot topic for most accountants but especially those in business. This has particularly been the case since the corporate crises in the United States which occupied so many headlines in 2002, when we conducted our member needs survey. It is therefore unsurprising that corporate governance was the second most highly rated topic in the survey.

Generally, the Faculty's approach is to present its members with a range of views and allow them to draw their own conclusions for their own businesses. Clearly, well-run companies need good corporate governance, but one of the big questions concerns getting the right balance between control and wealth creation. To use a football analogy, a team needs a good defence but that alone is insufficient to win matches. A team is unlikely to win without a good defence but it is only going to win if it also has a good attack.

A second important issue is the need for the right attitude – at its simplest, good corporate governance is running the company 'properly' on behalf of the shareholders and other stakeholders. Form-filling and systems are not a substitute for a good business plan, an assessment of risks and integrity and care in operations which should help directors and managers know that the fundamentals are being followed properly. Good governance could be described as an attitude and a state of mind.

We commissioned six articles to examine corporate governance from different perspectives. Alastair Ross Goobey, once described as the godfather of corporate governance and whose views always attract attention, writes from the investor's perspective. We asked Mark Goyder, director of think tank Tomorrow's Company to provide some challenging ideas on non-executives. Ruth Bender of Cranfield looks at the topical issue of remuneration committees.

Much of what has been written about governance seems addressed primarily to the larger corporate, but good practice is needed in all sizes of organisation – so we invited John Pierce of the Quoted Companies Alliance to discuss this issue. Simon Webley of the Institute of Business Ethics examines whether there is a link between being well regarded on the stock market and good corporate governance. Finally Jonathan Hunt, the Institute's head of corporate governance, assesses the principal changes in the Combined Code and looks to the future; and this is followed by the main text of the Code.

Faculty members will need to keep abreast of the principal issues in corporate governance, which will have an increasing effect on companies, both public and private, as time goes by. This special issue of *Management Quarterly* should help to inform members about this vital subject – to which we will undoubtedly return in the months and years ahead. MQ

Learning the lessons of bad governance

Spurred on by occasional corporate scandals, the City has put the theory of good corporate governance into practice – and the major investment institutions have led the way. Here **Alastair Ross Goobey,** chairman of the International Corporate Governance Network (ICGN), describes the background.

Directors and investors are on the same side. At least they ought to be. In the light of recent very public rows, this may seem to be a rather Pollyanna-ish view of the world, but it bears saying. The purpose of a joint-stock company is to optimise the long-term returns of the risk-taking investors, the shareholders. A mutual company (and I have been a director of three mutual companies), or a co-operative, can try to meet myriad objectives. There, the ownership is imprecise and the purpose of the business is not clear. As soon as a company takes risk capital from outsiders however, it must act in their long-term interests.

Corporate governance has developed because capitalism has turned into a system controlled by two agents – business and investment managers

The question of corporate governance has developed because capitalism has turned into a system controlled by two sets of agents – the professional business and investment managers. When the shareholders and managers were one and the same people – a prevalent feature of business up until the Second World War – the question of whether these long-term returns were being optimised was a secondary one. 'Clogs to clogs' might have been the consequence, but that outcome was in the hands of the family members. Indeed, in some countries, notably Germany, the public equity markets still represent a relatively small share of the national wealth.

During the 1950s, however, it became the norm that the larger public UK companies were being run by non-family managers, who had relatively low levels of personal wealth tied up in the company, and shareholdings were being concentrated in the hands of professional investment managers, running pension and insurance funds. The principal means by which professional business managers were monitored and controlled was through the operation of boards of directors, on whom the outside shareholders relied for the proper and profitable development of their investment.

There were egregious examples where the executives became over-dominant in the boardroom. The case of Sir Bernard Docker was the first one to impinge on my consciousness, even as a young boy. Sir Bernard was the chairman of BSA (Birmingham Small Arms), which, in the early 1950s owned Daimler cars. Sir Bernard had married (en deuxième noces) an ex-showgirl who loved the high life. They had a large yacht on which they entertained lavishly (and it was never clear whether this was a personal possession, or run at the company's expense). Worst of all, each year Sir Bernard would produce, at enormous expense, a 'special' Daimler designed to meet his wife's tastes. This culminated in the gold Daimler. Eventually even the notoriously supine investors took umbrage, and, led by the Prudential, Sir Bernard was thrown out.

Such cases were exceptional, and in many areas of commerce the boards were wholly non-executive. When I started in investment at the end of the 1960s, there were no executives on most of the bank or insurance company boards. The 'chief general manager' would attend, of course, but not as a voting member. The boards consisted of retired generals, admirals, peers of the realm, and other worthies. Jim Slater was not alone in deducting points from the price-earnings ratio of a company for each such board member.

A focus on governance

The current focus on corporate governance really began in the late 1970s and 1980s. In that period we suffered several instances of companies where the executive rode roughshod over the interests of the outside shareholders. Tiny Rowland, who ran Lonrho as if it was his own, eventually drove his non-executives into resigning en masse, prompting him to comment that such directors were about as useful as decorations on a Christmas tree. The collapses of Polly Peck and the Maxwell empire similarly alerted those who had not hitherto been over-concerned that there was a problem. The result was the Cadbury Committee, whose report was published in December 1992.

The institutional shareholders had not been entirely unaware that these risks existed, nor had they been idle. The Institutional Shareholders Committee, under the aegis of the Bank of England, had discussed governance, under the tutelage of Jonathan Charkham, then the governor's adviser on such things. Both the National Association of Pension Funds (NAPF) and the Association of British Insurers (ABI) had investment subcommittees. They would set up case committees where individual companies had fallen into difficulties (almost always ex-post the event). There was a well-reasoned series of essays about the role of boards published by the NAPF before the Cadbury report, entitled 'Creative tension'.

The Cadbury report proposed that greater clarity should be introduced into the boardroom to help ensure that a proper balance was maintained between the executives' interests and those of the absentee investors. The outside, non-executive directors were the first line of defence for the shareholder. The analysis and prescription contained in the Cadbury report have held up remarkably well over more than 10 years. It is a tribute to Sir Adrian and his colleagues both that so little of what they said has been undermined by more recent experience, and that few truly awful instances of poor governance, such as BSA in the 1950s, have come to light in the UK.

However, if the institutions thought that adherence by companies to the Cadbury report's recommendations would be enough, they were wrong. Although a board is clearly the first level of control, there have been instances where directors, both executive and non-executive, have succumbed to 'group-think'. Too often a strong chief executive has been able to convince his colleagues that they should put aside their misgivings and follow his agenda. Perhaps the most obvious area in which this has been a matter of public disagreement has been over directors' remuneration, a subject to which I will return below.

> Too often a strong chief executive has convinced colleagues to follow his agenda

I have sat on several boards, and observed many, many more in action. One of the greatest criticisms of the institutional investor's actions in this area is that we are generally unqualified to comment. It is suggested that we have neither the business nor the boardroom experience to add anything useful to the way in which companies are managed or governed.

On the contrary, running an investment management business is no different from running any other sort of business, although I freely admit that, as an industry, we have not proved ourselves superior beings in this field. More importantly, as large shareholders, we have learned, often at a high cost, what works and what doesn't work in the composition and functioning of boards. The responsibilities of institutional investors towards their clients in the execution of their role as stewards of the companies in which they buy shares have not been high enough on the agenda in the past.

Four areas of attention

This is one of the four areas onto which much of the attention of investors, regulators and governments have focused since the collapse of the market bubble, which obscured many failings in governance. Shareholder rights, transparency, independent directors and shareholder responsibilities are the four.

> The Cadbury report proposed that greater clarity should be introduced into the boardroom

It may seem odd that the rights of shareholders are not yet fully established, even in quite advanced stock markets. The fact that we are still waiting for a Takeover Directive from the European Union is mostly because some states jealously guard rights that move away from 'one share, one vote'. On the other hand, minority shareholders also need protection. This may seem contradictory, on the basis of one share, one vote, but for capital markets to work properly, no dominant shareholder should be able to trample over the rights of others. These problems have been more prevalent in emerging economies, where families have not hesitated to switch assets between their private and public company holdings with impunity. But even in the UK we have had a recent case where a family dominance left the outside shareholders impotent.

There is evidence that the presence of independent directors reduces a company's cost of capital

Transparency is not the same thing as disclosure. Too much disclosure can create opacity. It is not easy to grasp the message of note 34 on page 90 of the accounts together with a further note on page 294 of a 10k-registration statement in the US. The imminence of the introduction of a mandatory 'operating and financial review' (OFR) to UK annual reports is an opportunity for companies to tell us how they judge their own success. One hopes it is not simply based on the earnings per share figure for a year, let alone a quarter. Is a company gaining market share? Is staff turnover very high? What is customer satisfaction like? Are managers measured on return on capital employed, or value added, or cash flow return on investment? All these would produce much more interesting answers than many of the words currently contained in the chief executive officer's (CEO's) annual review.

Executive remuneration is a classic area of obfuscation. In many cases there is simply not enough information for the investors to make up their minds about the structure, since too much discretion is given to the remuneration committee. Last year the ICGN published a report, 'Executive remuneration – the caucus race', which made several suggestions as to how outsiders might be able to judge the appropriateness of pay structures. One idea is for companies to publish model outcomes, based on calculations often only they can make. We could then, at last, see what the intent of the committee is. Shareholders are delighted to reward great performance, but we need to know how the company judges that performance. It cannot be right, as in Alice in Wonderland's caucus race, that 'all shall have prizes'.

Shareholders have greater confidence in boards with appropriate controls

The importance of independence

The enhanced role of independent directors has been the clearest consensus around the world over the past two years. All recently published codes or guidelines or even legislation have accentuated their importance. France's Bouton report, Germany's Cromme report, Sarbanes-Oxley and the proposed new listing agreements for the New York Stock Exchange and NASDAQ, the Higgs report in the UK and the European Commission's new action plan in response to the Winter report – all these place enormous weight on the contribution of the outside director.

No-one would claim that the mere presence of independent directors will make a company more profitable, but there is increasing evidence that they do reduce the cost of capital for companies, because shareholders have greater confidence in boards with appropriate controls. The role of the outside director is not primarily that of a policeman, of course. They are there to bring expertise and experience that the executives may not have, and to help guide the strategic course of the company. However, if they are not to prevent executives from acting without constraint, who is? Outside shareholders cannot act until often it is too late. In over 30 years of investing, I would simply note that almost all the real disasters in my portfolios have been companies in which overweening executives have ridden rough-shod over the interests of the outside shareholders.

They have been able to do this often because the boards were simply not peopled by outsiders, were either too weak or, more often, were too few to stand up to this bullying. Tiny Rowland, whom I have mentioned earlier, eventually had to bring in an outside investor, who began to improve the governance of Lonrho. Indeed, I was subject to an invitation to become one of his nominees as a non-executive, which I rejected. Fortunately other brave souls did step forward, and the days of buccaneering by Rowland were numbered. Although he did have large numbers of loyal individual shareholders, the company was not as strong as he would claim.

In the UK context there has been some debate about the recommendations in the Higgs review. The Financial Reporting Council has given its final view, and, as expected, some of the wording in the original 'Code of best practice' has been amended. There still seems to be an onus on boards themselves to judge whether a member is independent. The 'badges' of independence are now widely agreed around the world. Those with familial, large shareholding or previous employment connections with a company cannot be seen to be independent, no matter how much, in their own minds, they are. Long service on a board raises the possibility that the individual may become complacent, or too much part of the furniture, and refreshment of boards at infrequent but regular intervals is to be desired. None of these definitions of independence should prevent non-independents from serving; the balance of the board must at least reflect a clear plurality of independent outsiders among the non-executives.

The role of accountants

It would be bizarre indeed if, in a document being published by the accountancy profession, no mention was made of accounting and its role in governance. Fortunately, after many years of disappointment, I have reverted to simple tests about the true profitability of companies, rather than relying simply on published profits and balance sheets.

This is not a criticism of the accounting profession, simply that accounts cannot tell you everything you need to know on two pages. I have long adhered to cash conversion as the best indicator. I am on the board of a company that has long been a cash cow, but more recently, despite declaring good profits, has not been generating excess cash. This tells me more than anything else, and raises the important questions. Nevertheless, the Smith report's emphasis on properly peopled audit committees, with members who have sufficient expertise to understand what is being put before them, is a very important additional safeguard for outside shareholders.

Now there is a concern that we may not be able to find sufficient qualified and willing candidates to fill these independent director roles. The Tyson report, which followed up the Higgs review, makes some intelligent suggestions as to where good people may be found who have hitherto not been considered. We must be aware that some people will simply not be willing to take the reputational, and, potentially, financial risk of being a non-executive director. This would clearly be in no-one's interests. I hope we can find sensible ways to indemnify diligent outside directors.

> There is a concern we may not be able to find sufficient qualified and willing candidates to fill these independent director roles

The world of governance has changed dramatically over two years. When I went in the late 1990s to the US and observed that the lionising of the president/CEO was making them behave like kings of the jungle, I would be received politely but quizzically with "The economy is strong, the stock market is strong. What particular fault needs addressing?" That is no longer true. Even the most Darwinian investor now understands that it may be possible to reduce the risk in his portfolio without, importantly, reducing the propensity for companies to take risks overall, through ensuring proper governance. I only hope we do not forget that lesson in the throes of another bull market. MQ

The non-existent non-executive

How should a company's directors behave? **Mark Goyder**, director of Tomorrow's Company, argues that all those who sit on, or influence boards have a part to play in leadership – and if companies object to 'box-checking' regulation, then they need to demonstrate that it is not needed.

An agenda for tomorrow's effective board

The dust is still to settle on an emotional debate about the future role of non-executive directors. The danger is that, having made their feelings known, many directors will go back to normal, muttering about the invasion of box-tickers. They will adjust their compliance, but in the process, they will have missed the really important questions thrown up in the debate over Higgs and over the Combined Code. There are much more significant changes that are being driven by external pressures of competition and public attitudes, the experience of recent corporate failures, and the implications of new regulatory change.

Directors are the trustees of the long-term health of an enterprise. They have to balance leadership and accountability, performance and conformance

For more than a decade Tomorrow's Company has been stimulating and influencing some of these changes, and helping businesses to make sense of them. At a time when we are about to embark on a major new programme on the governance and leadership of the companies of tomorrow, the most important questions that we believe should be addressed in this debate are:

1. what are boards for?
2. to whom does the board owe its duty?
3. where do shareholders come in and how is their role best safeguarded?
4. what do boards need to change in the way they discharge their duty? and
5. what does that imply for the role of the chairman and non-executive directors of that board?

The answers offered here are provisional. This is a living debate, being rapidly moulded by major external changes as well as business imperatives. For companies, and indeed for the accounting profession, the key to the successful handling of this debate is to stop seeing the issue in terms of "what is the least we can get away with?" and to start seeing governance as an essential weapon in securing a more robust foundation for corporate success in fast changing times and markets.

For reasons which become clear in this article, the term non-executive director (NED) is potentially misleading. Tomorrow's Company prefers to use 'outside director' or 'independent director'.

1. What are boards for?

Directors are elected by shareholders to direct the company – a job that is different from their other roles.

They are the trustees of the long-term health of the enterprise. They have to balance leadership and accountability, performance and conformance.

In law, there is no such thing as an 'executive director' or a 'non-executive director'. The law treats all directors as equal, with a common duty (expected to be clarified in the proposed reform of company law) owed to the company, and one vote each around the boardroom table. Therefore, in law, all directors are effectively part-time, and should be treated as such. Some are internal, and apart from their duties in directing the company have a separate executive role. Some are external – and cannot fulfil their role unless they dedicate sufficient time to placing their fingers on the pulse of the organisation, and to managing risk for shareholders by looking beyond financial measurements to the values, behaviours and relationships on which success depends.

Directors are responsible for overseeing the honest and effective conduct of the business. By directing the company they add value, not in the same way that a marketing or operations director adds value, but by ensuring that the company is properly focused on the activities that drive results now and in the future. Boards are accountable to shareholders for the total value delivered to shareholders and stakeholders.

A business is not the private property of its shareholders. Nor is it simply a bundle of transactions. It is an economic and a social entity. Economic results are only possible because there is responsibility, trust and loyalty in its relationships. Directors need to understand how all these elements come together to create the success and the survival of the business. They must be able to assure themselves not simply that the financial results are robust but that the constituent functions of the company are healthy, and therefore capable of delivering enduring value. This will imply a much broader approach to the definition, measurement and reporting of success.[1]

2. To whom does the board owe its duty?

Although the directors are elected by the shareholders, and are accountable to them through the formal process of the annual general meeting (AGM) and the annual report, they owe their duty not to shareholders but to the company. This is a vital distinction.

The job of a director is to focus on the long-term well-being of the company. That may not be the same thing as focusing on the immediate state of its share price. It does not necessarily mean giving today's shareholders what they are clamouring for; judgement is needed to balance the interests of today's shareholders with those of tomorrow.

As Niall Fitzgerald of Unilever put it recently, "If the only thing that concerned me was doubling profits, I could do it but we would be out of business a few years later... If we are not respectful of the environment and of the societies where we operate, people will cease to trust us and our brands, will cease to buy them and we are out of business."[2]

Much nonsense has been talked over the last decade about shareholder value. It is often implied, if not said, that directors who worry about the company's values, relationships and behaviours are somehow losing their focus on the bottom line and really important issues to shareholders. The opposite is the case. If the independent directors in Enron had worried more about these issues, it is inconceivable that they could have missed the gaping 'disconnect' between that company's stated values and its actual behaviours, behaviours which ultimately wiped out all shareholder value.[3]

> It is often implied that directors who worry about the company's values, relationships, etc, are losing focus on the bottom line. The opposite is the case

3. Where do shareholders come in and how is their role best safeguarded?

The Institute of Directors describes the responsibility of directors as being "to act on behalf of the shareholders of the company and everything they do should be done with that in mind".

This advice is only sound if directors recognise that acting on behalf of shareholders is not the same as seeking to inflate the share price or following every trend set by the capital markets. Companies can and should take the initiative in deciding what kind of balance sheet they want to see (for example debt to equity ratio) and what kind of shareholders they want to attract.

Companies are established to fulfil a purpose, and, in the fulfilment of that purpose, to deliver a return to their shareholders. Some companies express their purpose as the creation of shareholder value. Others express their purpose in a broader way, with profitability and distribution of value to shareholders viewed as a necessary pre-condition of fulfilling that purpose.

All directors are there to serve the enterprise, to hold it to its chosen purpose, and secure its future well-being. They cannot serve present or future shareholders if they fail to understand the financial health of the business. Equally they will have failed if they do not understand the linkage between the things managers are doing today and the future value and performance of the business.

> Directors must understand the link between managers' actions today and the future value of the business

As shareholders in Marconi will testify, it is also a serious dereliction of any director's duty to believe that directors are simply there to give shareholders whatever they want. To paraphrase Edmund Burke's famous defence of representative democracy, what directors owe the shareholders who elected them "is not their obedience but their judgement".

Directors need to confront the CEO on behalf of shareholders, or equally confront shareholders in order to defend the company

It is therefore a mistake to start treating particular directors as special representatives of the shareholders. All directors are elected by and accountable to shareholders. But in fulfilling their duty to the company they may need to confront the chief executive officer (CEO) on behalf of shareholders, or equally confront the shareholders in order to defend the company over the short, medium and long term against the pressures brought by today's shareholders.

Shareholders will prosper if the company prospers: except in specific situations, such as insolvency or a takeover, the duty of directors is to ensure that the company prospers as a going concern.

The relationship with shareholders should revolve around the chairman and CEO. In the event of dissatisfaction with this relationship, then there should be shareholder access to the independent directors as a body. The Higgs report had suggestions to make about how independent directors might contribute to the effective running of this relationship: the problem was that in the debate that followed, there was not enough distinction made between what happens normally and what happens when things break down. In the normal course of events, there should be no reason to single out a senior independent director to complicate the company's conversations with investors. On the other hand, once trust, confidence and communications are breaking down, there is every reason to bring in this figure to re-establish dialogue and ensure that difficult messages are heard and acted upon.

There is too much unthinking reliance on exisiting financial reporting

The experience of companies backed by venture capital lenders is instructive, if only because they see it as part of their role to support and equip independent directors to do a good job. As a result, the accountability and objectives of independent directors are clearer. For example, 3i also invests heavily in the sharing of experience and learning among different directors.

4. What do boards need to change in the way they discharge their duty?

There are two tribes who meet in the boardroom, each with their own chief. The 'executives' will usually have discussed things in the executive committee. The chief executive will do the talking at the board meeting. It would be rare for the 'executives' to say anything discordant. The 'non-executives' will not usually have met separately, and socially they may move in different circles. In knowledge terms this isolation puts them at a disadvantage, because they may find it difficult to know enough about the technical background to the issues raised or the hidden agendas to challenge the views taken by the 'executives'. Unless the chairman – their 'chief' – is unusually forceful and effective they are in danger of being marginalised.

It is nearly 10 years since the publication of the Cadbury report. From Wickes to Marconi, we have continued to see company failures which can be traced to failures in governance. There has been good work done which sets a clear agenda for the board as a whole. This includes the Chartered Director qualification awarded by the Privy Council and administered by the Institute of Directors (IOD), the ICAEW's initiative which led to the Turnbull committee on risk, and the DTI's Company Law Review.

Yet, in spite of this work, the prevalent reaction to corporate failure is to look in isolation at the role and performance of 'non-executive' directors – that if they are better selected, better paid, less incestuous, or better informed this will lead to effective change in the way companies are led and the way they perform.

The truth may be much simpler and harsher. Independent directors could undoubtedly do more, but why ignore directors as a whole? There is some evidence that links good governance generally with stock market performance. However, there is no research, or practice, which shows "the crucial role played by non-executive directors in improving company performance and accountability" as the introduction to the Higgs review puts it.

There is inadequate focus on the purpose of the company and the drivers of its success. There is too much unthinking reliance on the existing financial reporting – too little effort is made to review key elements in future success, such as culture, succession, reputation or customer loyalty. As a result, shareholders are exposed to additional risk. In particular, the behavioural audit trail needs to be followed with the same rigour as the financial. But this cannot be mandated by any new code. The new Company Law Review framework, including the proposal for the operating and financial review (OFR), and the Turnbull guidance to directors are there to be used but they will only provide protection if directors define opportunity and risk with sufficient breadth.

The practical changes needed to make all company directors more effective revolve around:

- a separate contract for all directors, whether inside or outside;
- a full induction for directors, covering the purpose and values of the business, its markets, key relationships and other drivers of success, an introduction to the major risks;
- the need for all directors to become more professional – a commitment by boards to increase steadily the number of chartered directors. This process starts with understanding their duties as directors. In the long term, developments such as the IOD's Chartered Director programme could be used to ensure that directors understand the duties unique to the role, and are equipped to fulfil them. In the Tomorrow's Company evidence to Higgs we proposed a new target: that within five years at least two members of every listed company board should have qualified as a Chartered Director, and within 10 years every listed company director should be undergoing or have completed this qualification. While the Higgs report decided against setting any mandatory targets, the best boards will now start to set their own;
- an effective process of boardroom appraisal – there should be an annual process of individual and mutual appraisal between chairman and each board member, and the annual report should explain how it has been conducted;
- a strategic approach to the new OFR – directors will be required to satisfy themselves that material information has been provided in the OFR – in order to do this, a fundamental review will be needed of the underlying drivers of success in the business, and this should in turn stimulate a major shift in the agenda of many boards; and
- a commitment by independent directors to spend sufficient time in the business. Too little time and access is allowed for independent directors to expose themselves to 'ordinary' workers in the business and to feel the pulse of the organisation. All directors including independent directors should be able to decide for themselves which sites they want to visit anywhere in the world and procedures should allow for these visits to be accommodated with a minimum of advance warning.

What does that imply for the role of the chairman, company secretary, and the executive or non-executive directors of that board? Is there any special role for independent directors?

5. The role of the chairman...

The chairman's duties need strengthening to reflect the legal position. This is as chairman of the board – not the company.

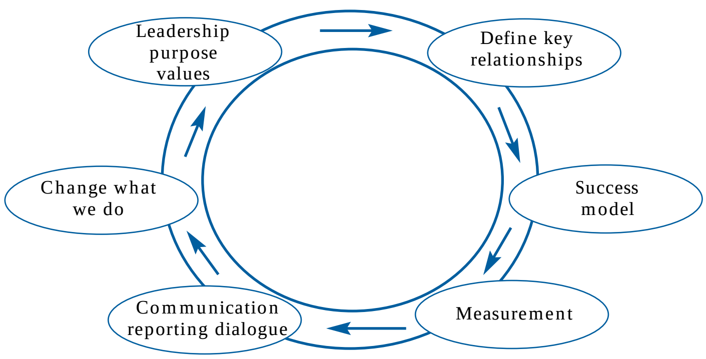
It is the job of the chairman to ensure that directors are recruited in a balanced and professional way, and not selected by the CEO or a ruling clique. Once the directors are appointed, it is the chairman's job to ensure that the board has the necessary competence to understand the business and its accounts, and that it acts responsibly, accountably and as an effective team.

> It is the job of the chairman of the board to review the effectiveness of the CEO

Teams are only effective if they have shared clarity about the job they are there to do, and respect the division of labour that is necessary among them to do that job. Having ensured that the board is clear about its role, the chairman should ensure that the design of the agenda and the allocation of time reflects the real drivers of success in the business. The board agenda needs to follow the logic of what Tomorrow's Company calls 'the virtuous circle of governance' (see Figure 1, below).

It is the chairman's job to review the effectiveness of the CEO. When things go wrong it is for the chairman, in consultation with colleagues, to decide whether changes are needed in the leadership of the organisation.

Figure 1 The virtuous circle of governance



… and the role of independent directors

They are part of a unitary board, owing their accountability to shareholders but their duty to the company.

As suggested in the draft statement of directors duties in the DTI Company Law Review, the basic goal of directors should be the success of the company in the collective best interests of shareholders, but directors should also recognise, as the circumstances require, the company's need to foster relationships with its employees, customers and suppliers, its need to maintain its business reputation, and its need to consider the impact on the community and the environment.

Good governance is crucial to the future success of business

All directors are there to seek to ensure that the company has the right strategy, the right resources, and the right behaviours.

Within this unitary framework the unique contribution of independent directors is that of independence but this can only be effectively carried out in a context of:

- good induction and training. Regular exposure to real people across the business and its relationships;
- shared purpose and values throughout the board; and
- sufficient time – the commitment will vary with the scale of the enterprise but for every formal day of attendance (board meetings, board subcommittees, AGM), it should be assumed that an independent director spends a minimum of two days in preparation, whether this means studying papers, discussing issues with board colleagues or executives, plus further time talking to shareholders and people inside and about the business. For international and geographically dispersed businesses time for travel needs to be added to this to calculate the number of days.

Conclusion

Good governance is crucial to the future success of business. It is critical that we regain the trust that is essential to the operation of capitalism. Getting governance right is a vital part of this. If business objects to box-ticking solutions, it is for business to show the leadership and imagination that removes the need for such compliance.

All those who sit on, or influence boards have a part to play in this process of leadership.

It is often said, that you can tell a lot about the CEO's style of leadership by looking at his/her diary and how he or she spends their time. You can tell a lot about the governance of an organisation by the board agenda, and how the board spends its time. In any board on which readers of this journal sit, they should ask themselves what they can do to improve the focus of the board around the following issues:

- *the purpose of the organisation* – why it exists;
- *the company's values* – what it stands for and what it will not stand for;
- *the company's key relationships* – who it depends on for success;
- *the company's success model* – the combined ingredients of its success;
- *its strategy* – the route by which that success will be achieved;
- *its measurement* – the financial and non-financial indicators it needs that point to future as well as past performance; and
- *its accountability and communication* – the processes of dialogue and reporting by which it informs its stakeholders and learns from their feedback.

It is these issues, not the technicalities of compliance, which are central to effectiveness of governance as a contributor to the future success of our companies. It is upon these questions that boards should concentrate more of their attention. MQ

Tomorrow's Company is a business-led think-tank. It is developing a new programme on the leadership and governance of businesses.
For further details contact Marcia Griffiths, marcia@tomorrowscompany.com

Footnotes

1 'Tomorrow's Company, the role of business in a changing world'
Tomorrow's Company, 1995; and
'Sooner sharper simpler, a lean vision of an inclusive annual report'
Tomorrow's Company, 1998

2 Interview with *The Guardian*, 5 July 2003

3 'Lessons from Enron'
Goyder, M
Tomorrow's Company 2002

The role of the remuneration committee

A public company's remuneration committee deals with some of the most sensitive – and potentially controversial – corporate issues of all. **Ruth Bender**, lecturer in finance at Cranfield School of Management, considers the challenges faced by these committees in the new regulatory environment and offers her advice.

Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose.

Combined Code, para B.1

Within this principle quoted from the Combined Code we can see clearly the potential conflict faced by members of a remuneration committee. Pay is a human resources (HR) issue, and has to be set to attract good people to the company, motivate them towards the right objectives, and persuade them to stay with the business.

At the same time, executive pay is a governance issue – executives potentially have the power to influence their own remuneration against the interests of shareholders, and good governance demands independent control. The reconciliation of these two points of view is the issue that confronts most remuneration committees.

Terms of reference

In setting up a remuneration committee certain matters have to be included in its terms of reference. The Combined Code (2003) sets out what the terms of reference might be for listed companies (see the box, right, for a summary). Some of the key decisions that have to be made in setting up the committee are discussed below.

The composition of the committee
Best practice suggests that the remuneration committee should be independent, which means that wherever possible it should comprise exclusively independent non-executive directors (NEDs). Although this might not be possible – nor indeed desirable – for a private company, it is the norm for listed companies in compliance with the Combined Code.

The Higgs dataset shows that on average listed companies in the UK have three members in their remuneration committees (FTSE100 companies have slightly more), of which statistically the vast majority are non-executives.

Executive pay is a governance issue

Principal duties of the remuneration committee

- Determine and agree with the board the broad remuneration policy for executives.
- Take delegated responsibility for setting executive remuneration.
- Determine targets for performance-related pay schemes.
- Determine pension arrangements for executives.
- Ensure termination payments are fair to the individual and the company.
- Determine total individual remuneration package for each executive.
- Have due regard to the Code, and other guidance.
- Be aware of and advise on major changes in employee benefit structures throughout the group.
- Agree the policy for authorising the CEO's and chairman's expense claims.
- Ensure full disclosure in line with regulations.
- Take full responsibility for the appointment of consultants advising the committee.
- Report the frequency of and attendance at committee meetings in the annual report.
- Make the committee's terms of reference publicly available.

Summarised from good practice suggestions attached to the Combined Code.

There are two main decisions to be made

The remit of the committee

There are two main decisions to be made as regards the remit of the remuneration committee, one relating to its position vis-à-vis the board, and the other being how far that remit extends through the management levels of the organisation.

As regards the position of the committee vis-à-vis the board, a key issue to determine is whether the committee *decides* or *recommends* executive pay. Two sets of decisions need to be made – the over-arching remuneration policies to be followed, and the individual directors' packages (see the box on page 15). Remuneration committees could be charged with determining both of these, and advising the board as to their decisions. Alternatively, the remuneration committee could be charged with making a recommendation to the board on remuneration policies, but with the final decision to be made by the board. In this second alternative the committee would still be responsible for determining individual remuneration packages.

The advantage of having the committee make the final decision on policy is that it very clearly separates executive pay from the executives themselves, who would have no input into the decision. For example, if the policy were a board decision, it would be theoretically possible for the board executives to manoeuvre a policy of 'upper quartile' pay, whether or not that was justified for the particular company. By retaining committee control of that decision, such a potential conflict of interest is avoided.

The HR professional is a bridge between the company and the committee and the outside world

Having said that, the advantage of having the board make the policy decision is that HR strategy is a fundamental part of the company's competitive strategy, and as such it is appropriate that it is a board matter.

In practice, the distinction between advising and deciding can be less important than it may seem, due to the involvement of senior executives in the committee's deliberations, as discussed later. Also, as with many corporate governance issues, the actual practice might be determined by the relationships between individuals on the board, regardless of the formally laid down procedures.

The other key decision to be made on the remuneration committee's terms of reference is how deeply its remit takes it into the organisation. For example, the committee may be responsible only for executive board members. In some companies the committee determines the pay for executive board members and also members of the top team. In other companies the remuneration committee can, in addition, have an advisory role for several layers of management below the top team. The guidelines do suggest that the committee, in setting executive pay, should be aware of the remuneration through the organisation.

Servicing the committee

The remuneration committee will generally be serviced by an HR professional. As NEDs, the committee members inevitably have a lesser understanding of the detail of the company than do the executives. And as NEDs, with differing backgrounds, it is unlikely that they will have a detailed knowledge of the ever-changing market practices in executive pay (although they should keep up to date with regular training sessions). The HR professional is an essential bridge between the company and the committee, and the committee and the outside world.

The most fundamental point to note in this area is that the committee, and in particular its chairman, must feel confident in trusting the supporting HR professional. The committee is heavily dependent on information supplied by this individual – for example, comparative salary figures in other companies, appropriate remuneration structures. If there is a lack of trust, the situation is intolerable for the NEDs on the committee, and would also leave the HR professional in an impossible position, providing advice that is constantly queried.

The HR professional generally has two reporting lines – to the committee and to his/her direct boss, perhaps the HR director or the CEO. This gives an inherent conflict, which can be uncomfortable to manage if the committee and the senior executives disagree as to how to proceed. Clear terms of reference need to be established.

Relationship with the CEO

The Combined Code (para B.2) states that "the remuneration committee should consult the chairman and/or chief executive about their proposals relating to the remuneration of other executive directors…".

Good corporate governance might suggest that the company's CEO should remain separate from the deliberations of the remuneration committee to avoid undue influence. However, again we face the problem that executive pay is an HR issue, and one that needs to be linked closely to the company's strategy. It is unreasonable to hold a CEO accountable for his/her team's performance and not give him/her some influence over the structure of their remuneration packages. Good people can be hard to retain, and the CEO must be given the ability to manage the executive team in the most appropriate way. However, this has to be handled within the confines of acceptable governance practices.

Each company has to decide whether the CEO automatically attends remuneration committee meetings (except when his/her own pay is being discussed) or only attends occasional meetings; their input into the meeting agenda; their relationship with consultants, etc. Both sides (although under the UK's unitary board structure it seems invidious to discuss 'sides') have to be comfortable with the arrangements.

Relationship with external consultants

It is common, although not universal, for remuneration committees to take advice from specialist remuneration consultants regarding, for example, the structure of schemes or the rates of pay.

It should be noted that the relationship of the remuneration committee with the external consultants differs considerably from that of the audit committee with the external auditors. It is a non-statutory and non-exclusive relationship. By the latter is meant that a company can have one remuneration consultant, or none, or several. The consultant may provide advice to the company as well as to the committee; what is important

The CEO must be given the ability to manage the executive team appropriately

Examples of remuneration policies and packages

Company	Over-arching policy	How this translates into individual packages
Lloyds TSB (2002)	"The annual incentive scheme is designed to reflect specific goals linked to the performance of the business." Awards are based on group performance and the attainment of predetermined targets relating to total income, profit before tax and economic profit.	In 2002 the maximum incentive opportunity for the CEO and one other director was 100% of salary; the maximum for other executive directors was 75% of salary. For 2003 the maximum opportunity for all directors will be 100% of salary. The remuneration report does not state whether the stated performance targets apply equally to all directors.
	"The aim is to ensure that salaries are competitively set in relation to similar jobs within a wide range of FTSE 100 companies."	Salaries range between £215,250 and £700,000 per annum.
Legal & General (2002)	The variable cash bonus is "measured against pre-determined objectives…".	The remuneration report sets out the specific performance objectives for each executive director.
	"Executives' interests in both relative and absolute share price performance are important. This is facilitated by the use of share schemes and the encouragement to grow a significant personal shareholding in the business."	The group chief executive is expected to have a holding of shares valued at twice salary, while the other executive directors will be expected to build towards a holding valued at one times their salary.

is that the committee, and in particular its chairman, is satisfied that the advice being given is independent, and not influenced by other relationships that the consultants may have within the company. Because of the possibility of such influence, some companies have chosen to retain two sets of consultants: one to advise the HR department and one to advise the committee. This practice is not yet very widespread, and need not be implemented if the committee chairman is confident that the committee is receiving appropriate and independent advice.

The role of the NED involves challenging executives in matters of corporate governance

Committee meetings

The committee chairman has to establish the number of meetings in a year, and their agenda.

There are many links between the matters to be discussed by the committee and the annual cycle of budgeting and accounts preparation. Accordingly, it might be appropriate for the chairman to set out an annual cycle of meetings to cover such matters as bonus targets (related to budget approval), option payments (based on the financial results), approval of the published remuneration report (part of the annual report), etc. Many committees find it difficult to manage this effectively in less than four meetings a year, and often have more. However, care must be given to making the best use of the members' valuable time whilst still covering all of the items in sufficient depth.

In addition to the annual cycle of meetings, the agenda for the remuneration committee will include matters suggested by the chairman, the NEDs, the CEO or the HR professional. It is important that there is a clear process for such items to be placed on the agenda, whether it be at a scheduled meeting, or the subject of ad hoc meetings during the year.

References

- The Combined Code can be found at www.frc.org.uk/publications/content/CombinedCodeFinal.pdf
- The Higgs review, which led to the introduction of the Combined Code, together with many other UK corporate governance documents, can be found at www.ecgi.org/codes/country_pages/codes_uk.htm
- The Higgs dataset gives the supporting research underlying the Higgs review. It can be found at www.dti.gov.uk/cld/non_exec_review

Conclusion

The role of the NED involves both supporting the executive team in its management of the company, and monitoring and challenging it in matters of corporate governance. This can be a difficult balance to manage, and one of the main areas in which the potential conflict of duties emerges is in the working of the remuneration committee, which has both a strategic and a governance role. It is vital that the role of the remuneration committee is clearly understood by all members of the board, and that its terms of reference are appropriate for the role it is to play. MQ

Why good behaviour matters to business

Listed companies are the main target of corporate governance initiatives. Here **John Pierce**, chief executive of the Quoted Companies Alliance, encourages those boards who are 'battle weary' after a series of high-profile reports and reviews to embrace the new governance standard through self-interest as much as altruism.

There is mounting evidence that investors recognise the added value of good governance procedures in business, so much so that they are willing to pay a premium for the shares of companies with well defined and articulated governance principles in place in the boardroom. It is a separate, but related debate that good governance should filter down into each level of business, developing and growing a culture of trust, honesty, respect and loyalty that in the minutiae of decisions and attitudes on the factory floor or offices from top to bottom accumulate to an imprecise yet undeniable 'added value'. The culture is somehow more productive and, therefore, profitable for the owners of the business.

Like all practices, good or bad, the example is set at the top of the organisation. In today's climate the lust for good governance and transparency is growing apace, unfortunately not because of clear understanding (yet) of its positive impact on a business and its results, but because of the malpractice within some companies which has triggered a hue and cry for change.

Nevertheless, whatever the motivation, a groundswell is growing for increased accountability and transparency in the running of quoted companies – those businesses where the managers of the business are not the sole or majority owners of the business. It is more a job for a business PhD thesis, than for this article, to trace the gradual 'disconnect' between the ownership, and the running, of a company with issued shares.

The history of the joint stock companies in the UK which grew out of the need for contributions to working capital for overseas exploration and trade, and major infrastructure projects such as canal building and the early railways, saw a structure develop where no longer could the wealth of one person – the sole owner – support such a huge business venture. The entrepreneur had to look beyond his own resources (including his bank) to business associates who in return for their contribution or investment received a dividend and, if the project was successful, in due course, a handsome multiplying of the original investment when the project was sold on to a new set of owners.

In such early cases the number of investors was relatively small. There was, therefore, an opportunity – so long as the 'project leader' was honest – to be aware of what was going on, how one's money was being used, and the chance to protect it if it seemed at risk. However, as those of you who know Trollope's 'Way of the World' will recall, if the 'boss' is a rogue intent on swindling the investors, the chances are he is likely to succeed – at least for a while. That was as much the case then, in Victorian times, as it is now in Enron times.

> There is growing demand for increased accountability and transparency in the running of quoted companies

Where companies go wrong

So after 200 odd years, have we learned nothing? Has no-one come up with a system to prevent such goings-on, people investing their often hard earned money in companies only to see it disappear at the hands of dishonest or incompetent managers?

Of course a great deal has been done – various Companies Acts and other legislation to combat fraud, etc – to cut down the opportunities for people to 'get away with things'. But how do you so regulate or influence the behaviour of managers without looking over their shoulders all the time, or without developing rules and regulations that will be so time-consuming, costly and restrictive that nothing will ever get done? Some may say that we have already reached that stage!

For any business to progress, risks have to be taken – it is a fact of life (and I only wish the Financial Services Authority and the European Commission took this on board). But for those risks to be reasonable/acceptable/proportionate to the expected gains, then a set of checks and balances has to be put in place – a bridge of integrity or control between the owners of the capital (shareholders) and those hired as its stewards (the managers and directors).

It needed a handful of corporate scandals to jerk the UK business community into action... The development of the Cadbury code was an enormously important step

Somewhere along the history of the modern day company from its roots there has been a disconnect at worst, and a malfunction at best, in balancing the interests of the shareholders with the freedom of the directors to maximise their investment.

Directors are 'stewards'

Whether they like it or not, the directors of a company are the stewards of the company's assets, acting on behalf of, accountable to, and employed by the owners, to protect those assets for the future growth of the business and future 'generations' of shareholders. It's all about sustainability over the long term, though it is not just about maintaining the status quo. Boards of directors have a responsibility to see the assets of the business increase over the long term. This must not be confused with an increase in share price, although in a perfect world the two would go hand in hand.

But there is the other aspect of stewardship, which is not putting at risk the assets under your charge. Recent business history has classic examples of risky strategies going wrong and shareholder value being destroyed in a major and catastrophic fashion – Marconi and Cable & Wireless within our own shores to name but two. Where was the governance mechanism or boardroom competence to challenge, and perhaps to have prevented, such calamities? As we know, hindsight is a wonderful thing, but a few basic questions about market size, competitor activity in the field, customers' appetite for product innovation, etc seem to have gone unasked or brushed aside by an arrogant management.

Another type of risk was illustrated in dramatic fashion too, on the other side of the Atlantic, when the great firm of Andersens was brought crashing down, because seemingly the consequence of risky practices either was not recognised, was played down at the top, or was coached through the partnership ranks. It will remain a salutary warning to businesses of all types for many a year to come – maintain and improve the standards and features that have grown the business, but tamper with them and risk losing the respect of your market at your peril.

It is this high level oversight that governance should encompass and it is only possible to extract its true effectiveness in the unitary board concept we have in the UK. The non-executive element of the board must have an opportunity to understand the business – get 'under its skin' – if it is to serve the shareholders' long term interests, not only in the 'control' aspect of their responsibilities but also in the 'contribution' aspect.

Achieving a balance

Herein lies one of the fascinating issues of corporate governance. How do you achieve the balance of control versus freedom, risk versus stagnation, incentives versus greed, etc? The key has to be the voluntary signing up to a code of conduct, a set of principles of behaviour and responsibilities, such as were first developed under Cadbury 10 years ago, and which the world is now copying.

It needed a handful of corporate scandals to jerk the UK business community into action, with the realisation that if it did not come up with a workable and 'policeable' set of business principles then the government would do so instead. And if that had happened there would be no going back. The development of the Cadbury code of corporate governance was an enormously important step. Since 1992 it has been expanded and refined, but its essence, its voluntary nature and 'comply or explain' regime, has endured.

It came close – too close for comfort – to losing its principles-based structure, when Derek Higgs' recent review of the 'Role and effectiveness of non-executive directors' moved in its translation into the new Combined Code, to a more prescriptive rules-type paper. Thankfully, the Financial Reporting Council has taken on board the concerns about this dangerous change. We have seen the inadequacy of rules-type regulation versus broad principles in the parallel case of the UK's accounting standards based on principles and those of the US based on rules, which unfortunately to some, become a challenge to get round. The principles catch all and should not allow that latitude.

Only a principles-based regime can endure in my view. Corporate relationships are a fascinating labyrinth of human, business, community and commercial relationships all operating on a dynamic social stage where attitudes and expectations are constantly changing. In addition a principles-based regime can have flexibility of application, and be relevant to companies of all sizes and styles of management.

The Combined Code is considered so flexible that the only exception for smaller companies in the code provisions concerns the number of independent non-executive directors. Companies outside the FTSE350 should have at least two whereas in larger companies they should comprise at least half the board, excluding the chairman. Indeed, given the endless permutations of business type and size, a rules-based system would not work.

Issues with the Combined Code

Not that the present Combined Code – or perhaps rather the way it is applied – is beyond criticism. Let's look at two current issues.

The code seems to have failed to deal with the perennially contentious subject of directors' remuneration. And here we must remind ourselves, again, that directors are merely the stewards for the owners of the company. Clearly, companies have fallen short of the inherently 'nosey' and 'jealous' observers of corporate life. Ask anyone which pages of a set of accounts they turn to first, and invariably the answer will include 'directors' pay'.

There is much companies should do to meet shareholder expectations on remuneration of directors and to fend off criticism.

Not least of all is to relate pay to results. The recent publication of the DTI consultation paper 'Rewards for failure' was a logical and not unduly surprising reaction to the 'fat cat' payments to the 'dearly' departed at some well-known companies. It is human nature that greed will push at the boundaries of social acceptability and when this happens in public – and directors' pay is very public – society objects, and the politicians and government step in.

The government is on record as saying that "it is for shareholders, not government to decide whether executive pay is set at appropriate levels." This is, of course, quite right. If the law does eventually step in, corporate governance will have failed. We can but hope that the corporate world heeds the wake-up call that was the GlaxoSmithKline shareholders' rejection of their chief executive's pay package.

In the complex dynamics of the relationships revolving around corporate governance, the governance within companies will only 'keep up' with shareholder (owner) expectations if the latter express them clearly. In the development of the equity board culture, share ownership has moved many miles from the original company model where investors could get around the table and converse with the management (stewards). No satisfactory mechanism has evolved to replicate that opportunity for such communication.

A principles-based regime can have flexibility of application, and be relevant to companies of all sizes, and styles of management

Indeed, even the yearly opportunity for this – the annual general meeting (AGM) – is treated with disdain by many boards. Just recently the chairman of a FTSE100 company upset small shareholders by implying that their presence was a wasteful diversion. It is just this type of arrogant attitude from a few company directors that will spur shareholders at large (or heaven forbid, again, the government) to step in and demand change.

The AGM is the bastion of corporate gover-

In addition to the UK government's interventions, we now have the European Commission putting in its 'euroworth'

nance, at the very heart of the shareholder/manager relationship, where the directors are legally obliged to appear before their employers to give an account of themselves. Thankfully, there are many companies that do use the occasion in a very positive way, to explain business developments and generally 'market' themselves and their strategy. What we have to be careful about is that again the poor behaviour of the 'luddite' boards does not trigger regulatory intervention.

Another significant criticism of corporate governance as applied in the UK emanates from the 'comply or explain' principle, emphasised throughout Derek Higgs review, and brought to the fore in the response by the Quoted Companies Alliance. The argument runs that it is all very well for a company to explain why it has not complied with a particular governance recommendation, but the readers of the accounts, the shareholders, must then read its explanation and judge it on its merits.

The concern of many companies is that corporate governance has become an 'industry', with professional advisers, and professional 'checkers' working on behalf of fund managers and institutional investors. These people may have no first-hand knowledge of the business, when they read an explanation it will mean very little to them, and they will tend to put a cross in the appropriate box on their governance checklist. This is of great concern to the QCA as an organisation representing small and mid-cap quoted companies who are afforded shorter review time by the 'box tickers'.

The EU should ensure adequate co-ordination of national corporate governance codes

As a counter to this behaviour the QCA encourages members to ensure their investor relations strategy is reviewed frequently to provide sufficient time and resource to communicate regularly with all shareholders. Explanations about governance issues should be part of a 'conversational' style of communication, not just saved up as a formal statement in the annual report.

Viewed from the outside, the whole GlaxoSmithKline 'affair' should have been avoidable. Was this a breakdown in shareholder communications and investor relations, with the chairman and board misjudging investor attitudes? Was there a fatal 'disconnect' between owner and steward?

The danger is that this kind of disconnect can grow like a weed to the point where investors question whether they can trust the judgment of the board – ie, they will ask whether the board is acting in its own interest rather than that of the shareholders.

The European dimension

In addition to the UK government's interventions, we now have the European Commission putting in its 'euroworth'. The recent press announcement (21/5/03) from Brussels on the 'Company law and corporate governance action plan' commences the corporate governance section with the reassurance that "The commission does not believe that a European corporate governance code would offer significant added value but would simply add an additional layer between international principles and national codes." Then comes the sting:

"However, a self-regulatory market approach, based solely on non-binding recommendations, is not sufficient to guarantee sound corporate governance. In view of the growing integration of European capital markets, the European Union should adopt a common approach covering a few essential rules and should ensure adequate co-ordination of national corporate governance codes.

The commission sees the following initiatives as the most urgent ones:

- introduction of an annual corporate governance statement. Listed companies should be required to include in their annual documents a coherent and descriptive statement covering the key elements of their corporate governance structures and practices;
- development of a legislative framework aiming at helping shareholders to exercise various rights (for example, asking questions, tabling resolutions, voting in absentia, participating in general meetings via electronic means). These facilities should be offered to shareholders across the EU, and specific problems relating to cross-border voting should be solved urgently;
- adoption of a recommendation aiming at promoting the role of (independent) non-executive or supervisory directors. Minimum standards on the creation, composition and role of the nomination, remuneration and audit committees

should be defined at EU level and enforced by member states, at least on a 'comply or explain' basis;

- adoption of a recommendation on directors' remuneration. Member states should be rapidly invited to put in place an appropriate regulatory regime giving shareholders more transparency and influence, which includes detailed disclosure of individual remuneration; and
- creation of a European Corporate Governance Forum to help encourage co-ordination and convergence of national codes and of the way they are enforced and monitored.

Other corporate governance initiatives proposed in the action plan cover: achieving better information on the role played by institutional investors in corporate governance; giving further effect to the principle of proportionality between capital and control; offering listed companies the choice between the one-tier and two-tier board structures; and enhancing directors' responsibilities for financial and key non-financial statements. The action plan notes that there is a strong medium to long term case for aiming to establish a real shareholder democracy and that the commission intends to undertake a study on the consequences of such an approach."

The benefits will show

And so the debate goes on. Many boards are 'battle weary' from the seemingly never ending corporate governance debate, and the pressure always to be up there with 'best practice'. It is, however, a valuable consolation that not only are they doing the right thing, there is growing evidence that a sound governance policy and practice is good for your share price.

Many boards are 'battle weary'... but it pays to have a sound governance policy

A report produced back in 2000 by McKinsey recorded that investors were willing to pay 18% more for the shares of a well-governed UK company over a company with similar financial performance but poorer governance procedures.

Some directors are cynical that there is such a direct correlation, but with markets as they are, to achieve a boost from a sound corporate governance policy seems a wise idea. MQ

Ethics and corporate performance

There is a demonstrable link between good corporate governance and being well-regarded in the stock market, according to **Simon Webley**, research director at the Institute of Business Ethics. He looks at those companies that have adopted 'codes' of ethical practice and finds that they tend to perform better than the others.

Standards of business behaviour – business ethics – tend to mirror standards of moral behaviour in society at large. In a survey of directors in the early 1970s, in answer to the question "what would advance the ethical standards in your company?"[1], the highest priority was given to the answer: "higher ethical standards in society generally".

One reason for the poor regard that people have for business integrity is that discussion of business ethics is somewhat muted

It follows that public expectations of a higher level of probity in the business sector are unlikely to be fulfilled unless standards of conduct in society are maintained or improved. To enable this to happen, leaders in all spheres of public and private life have an obligation to set an example (or act as role models). Politicians are often singled out because of their high media profile but they are not alone. A vigilant free press and electronic media are quick to point out failure.

Opinion polls over the last 15 years asking who is trusted to tell the truth show that business leaders remain stubbornly in the bottom quartile (doctors are the most trusted).

Mistrust of business

What is the basis for mistrust of business leaders? *The Economist* recently posed a pertinent question: "when money and morality clash, what should a company do?"

Until the 1980s, most companies consoled themselves with the thought that such a clash is more theoretical than real. "Money and morality go hand in hand" was the prevailing culture before a series of well-publicised business scandals in the 1990s such as the Guinness/Distillers takeover battle, insurance overselling, the Barings bank crash and Robert Maxwell's plundering of his employees' pension fund. In the US, Enron's, WorldCom's and Arthur Andersen's behaviour has reinforced public mistrust of business.

How can business leaders restore public trust?

One reason for the poor regard that people have for business integrity is that discussion of business ethics is somewhat muted. Lip service is paid to the idea of doing business in a way which takes means into account as well as ends. But too often, words are not translated into action especially in difficult economic conditions. Business leaders tend to be reticent to speak up for morality in business life. This could in part be because they are unsure of the business case. If a link could be established between doing business ethically and the bottom line, then there would be much greater incentive to embed high standards throughout an organisation and to talk more widely about them.

Business response

The responsibility for maintaining standards of behaviour in the community generally and therefore of corporate business behaviour has, up until mid way through the last century, been largely left to those institutions in society which have been the source of setting and imparting moral standards. These include the family, schools and religious institutions – notably, in the UK, the church. But each of these has become less reliable as a source of ethical guidance, as moral confusion has grown and former standards of behaviour are increasingly challenged. To fill the vacuum created by what has been described as 'the moral daze', there has been an eruption of legal directives aimed at civil organisations enshrining moral standards.

Yet over the same period there has been a loosening of legal restraints in the realm of private behaviour. Regulators and regulative authorities (police, the judiciary) are gradually replacing the long established moral leaders (parent, teachers, clergyman) in society. Some question whether this is sensible.

In the last 10 years, increasing aspects of business activity have been regulated by mandatory obligations that hitherto, were left to discretion. These include laws effecting equal opportunities, minimum wage, health and safety at work, and treatment of 'whistleblowers', and more recently, employee entitlements. The recent review of company law, for instance, recommended changes in relation to corporate conduct, and legislation is being prepared to update the 1985 Companies Act.

Ethical business practice

The drive to espouse high ethical standards has had some success as business leaders now have to consider not only their profitability, but also their attitude to wider corporate responsibilities based on their values and business ethics. At the same time, corporate governance procedures have been under review, and the progress reflected in the Combined Code on corporate governance is impressive.

Larger corporations (the IBE estimates 80 out of the top 100) set out explicitly, usually in a code of ethics or conduct, what they consider to be their purpose and values. At the same time, they are meeting an obligation to provide guidance to their staff as to how to resolve ethical dilemmas that they will meet in the course of day-to-day business.

Business values

UK corporations are generally reticent about using terms about ethical values in their codes of ethics. But an IBE survey of preambles to 20 current codes of large UK corporations shows the frequency of mention of value-implicit words (see box below). This list provides an indication of the thinking behind the introduction of corporate codes.

Doing business on the basis of agreed core values is an essential place to start in a corporate ethics programme. But employees at all levels of a company expect and are entitled to guidance on how to resolve ethical dilemmas that they may encounter in the course of their day-to-day business life.

Time and effort put into designing and implementing a code of conduct (or ethics or practice) meets this obligation. But can it be shown to make a difference? Can it be said to be worthwhile?

> Business leaders now have to consider not only their profitability, but also their attitude to wider corporate responsibilities

Does business ethics pay?

Recent research has provided a positive answer to this question. The IBE[2] has shown that in comparing the performance of large UK companies with and without codes of ethics or their equivalent, those with codes financially out-performed the others in the period 1997 to 2001. But is having a code of ethics to guide staff on dealing with business dilemmas, a sufficient indication that a company actually behaves in an ethical fashion? After all, Enron had a code of business practice (albeit written by lawyers).

In the research,[3] three tests were used to see whether what a company claims about its business behaviour is in fact what happens, ie that having a code of business ethics makes a difference to corporate behaviour. First, 41 in the sample were matched with an assessment produced by the SERM rating agency as to their capability to reduce what is called their 'socio/ethical' risks. This is a measure of policies in place to address eight

Ethical value words *

- Fairness
- Honesty
- Integrity
- Openness
- Respect
- Responsibility
- Trust

* *Most common words found in the preambles of a random sample of 17 codes published or revised between 2001-2003.*

variables in this field, such as poor corporate governance. The comparisons show that those with codes were consistently rated higher in their policies for lessening these risks than those without codes.

Second, a peer assessment survey was used to indicate what other businesses thought about the behaviour of companies in the sample. The annual list of 'Britain's most admired companies' published by *Management Today* was analysed to find out which companies have been in the list for five consecutive years (1997 to 2001). Of the 24 companies that fulfiled this criterion, 19 were found to have had a code over the period. The sample of companies used in the research was restricted to those that had a code in place for five years or longer in order to provide consistency.

Research shows UK companies with codes of ethics financially out-performed those without

The results of these tests indicated that it could be said that having a code of business ethics constituted a valid proxy for assuming that a company took its commitment to business ethics seriously.

Financial tests

Having established this, five tests which measure changes in corporate value (market value added [MVA]; economic value added [EVA]; price/earnings ratio; return on capital employed and profitability) were considered. The first two measures, which are considered the most reliable ones, showed that companies with codes in the sample of 41, for which consistent data was available, clearly out-performed those that had stated in previous IBE surveys that they did not have one (see Figure 1, below and Figure 2, opposite).

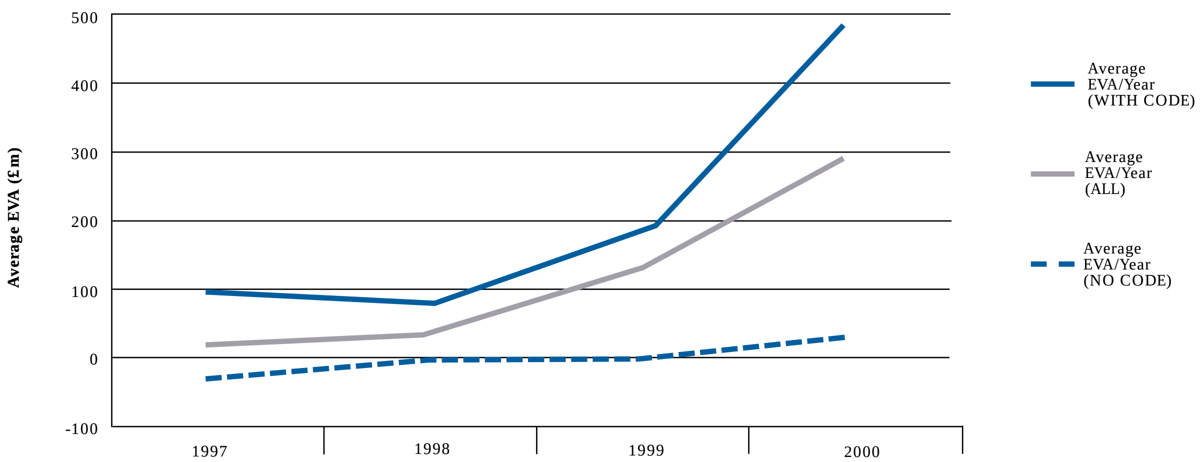
The results of the price/earnings ratio analyses showed remarkable stability in the figures of those with codes compared with others in the years 1997 to 2001 (see Figure 3 on page 26). The return on capital employed measure indicated that since 1999 when the economic down-turn started, those companies with codes out-performed those who did not have one for the earlier years, the situation was reversed. On profitability, there was a significant positive difference for those companies with codes among the 28 companies in this sample.

So what conclusions can be drawn?

Firstly, those larger companies that take ethics seriously do better, in financial terms, than those that do not have any explicit indications that they have a policy in place. However, it cannot be automatically

Figure 1

Average economic value added (EVA) by year for major UK quoted companies 1997-2000



Source: 'Does business ethics pay?' IBE, 2003

assumed that a company without a code behaves unethically. What is apparent from this research is that the leadership of consistently well-managed companies accepts that having a corporate responsibility policy is an important part of its corporate governance agenda.

Secondly, companies with codes have a much more stable price/earnings ratio than those that do not have a code (see Figure 3). This means they tend to manage their financial assets more efficiently. Most financial analysts have not so far considered this aspect of company behaviour but might be well advised to do so in future.

Thirdly, companies with codes are consistently recorded as being more admired by their peer group than those that have no code. This indicates that even with top management changes, there remains an embedded policy of doing business ethically; it becomes part of a company's culture and reputation.

Fourthly, using a smaller sample than in the other tests, those with an ethics policy tended to be more profitable in the years 1998 and 1999 than those without. Profitability as a percentage of turnover was on average around 18% higher for those with codes in this period.

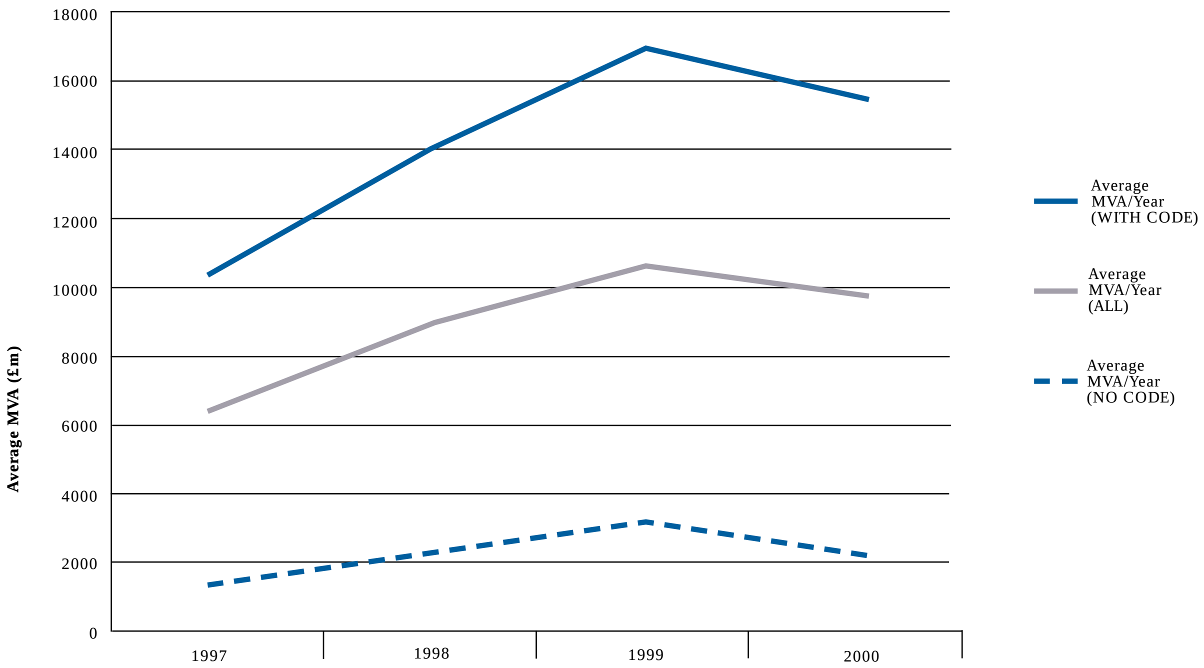
What are not yet clear are the mechanisms within a company that cause the enhanced economic performance. Some speculate that a large firm with a culture of trust and high ethical standards may be able to delegate decisions further down the management chain and thus save on 'bureaucracy'.

A company of this sort can perhaps more easily identify unethical behaviour and save on expensive remedial action, not least in litigation and public relations. Economies on marketing expenditure could be expected when customers select companies or brands which they trust. There is evidence too that staff, prefer working for such organisations, and that good quality staff are more

Companies with codes are consistently admired by their peer group

Figure 2

Average market value (MVA) by year for major UK quoted companies 1997-2000



Source: 'Does business ethics pay?' IBE, 2003

attracted to them and are retained. Risk insurance may be lower, as may the cost of capital. There is need for further work on the question of why business ethics pay.

Footnotes

1 'British businessmen's behaviour'
Treasure, J
Business Reponsibilities, Foundation for Business Responsibilities, NTC pubs 1997

2 Institute of Business Ethics:
www.ibe.org.uk

3 'Does business ethics pay?'
Webley, S and More, E
IBE 2003

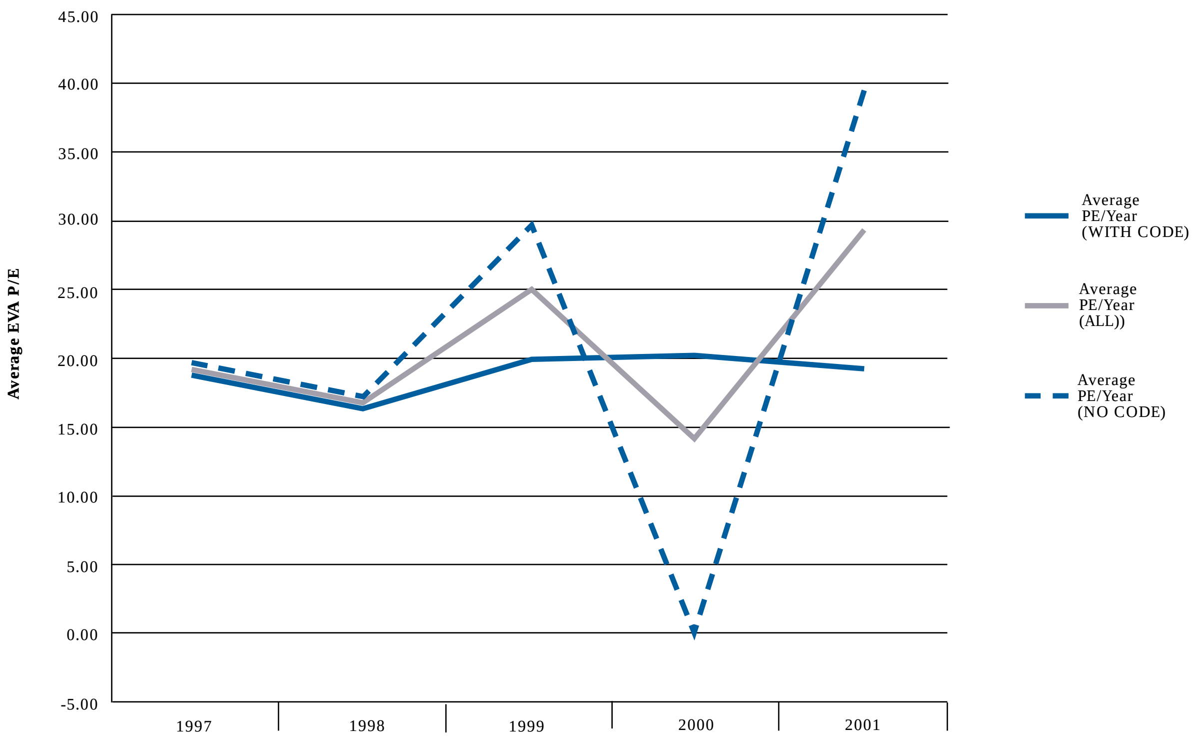
Conclusions

The evidence provided from the IBE study supports the contention that a sustainable business is one which is well managed and which takes business ethics seriously. Leaders of this sort of business do not need any assurance that their approach to the way they do business will also enhance their profitability: they know it to be true. Indeed, having an ethics policy is one hallmark of a well-managed organisation.

But there are a considerable number of companies with substantial international business interests that do not yet understand the importance of having a systematic approach to ensuring consistent ethical behaviour throughout the organisation. Without this, there will be an unacceptably high risk of what has been described as 'integrity failure'. Few companies survive such a reputation knock. So does business ethics pay? In the long run, the evidence points to a positive answer. MQ

Figure 3

Price/earnings ratio by year for major UK quoted companies 1997-2001



Source: 'Does business ethics pay?' IBE, 2003

How the Combined Code has evolved

The launch of the revised Combined Code in July this year was a milestone in the corporate governance debate in the UK. **Jonathan Hunt,** the Institute's head of corporate governance, highlights the key developments in the final version of the Code and looks at future governance issues.

Looking back, the launch of the revised Combined Code on 23 July, a week before the first anniversary of the now increasingly costly Sarbanes-Oxley Act, was a media success. The Code was warmly welcomed by many commentators, companies and investors.

The sometimes acrimonious debate over the roles of the chairman, the senior independent director and fears over boardroom disunity that followed the publication of the Higgs report was, apparently, forgotten. The work put in behind the scenes by all those involved, including the Institute, to help resolve these problems had had an effect. Consensus appeared to reign as the summer holidays approached.

Discussion, consensus and evolutionary development are very important to ensure the UK's self-regulatory approach to its voluntary Code does not turn into a US legislative approach. The government has rightly avoided Sarbanes-Oxley style solutions, but, at the invitation of Derek Higgs, it and the Financial Reporting Council (FRC) are likely to review progress on the Higgs recommendations sometime in 2005.

This should be a real incentive to all those involved to make the Code work and to develop effective mechanisms to ensure continuing dialogue and deal with difficulties that may arise.

Much will no doubt continue to be written about the revised Code and in particular about the new definitions of independence, the roles of various directors and the formal evaluation of the performance of boards, committees and individual directors. This article highlights just a few other changes to the new 'package' that includes the Code and the Smith and Turnbull reports.

Discussion and consensus are important to strengthen the self-regulatory approach

Disclosures

The increasing content of the Code and how it has changed this year is outlined in the table below.

In order to meet their continuing obligations under Rule 12.43A of the current Listing Rules, companies have to describe *how they apply* the Code's main and supporting principles and either confirm that they *comply* with the Code's provisions *or explain* non-compliance with specific provisions. The table shows that whilst the number of Code provisions has increased marginally, there are 21 new supporting principles requiring a narrative expla-

The changing shape of the Combined Code

Section 1 of the revised Code	Main principles	Supporting principles	Provisions
1998 Code	14	–	45
January 2003 proposals	15	–	82
July 2003 Code	14	21	48

nation that provides useful information to shareholders.

Disclosures are likely to be more extensive

Partly as a result of Section 2 of the Code (that applicable to institutional investors) shareholder interest and activity related to corporate governance disclosures will increase. They will, most likely, want informative explanations of non-compliance with any of the 48 Code provisions as well as a good understanding of how the 35 principles have been applied. As a result, disclosures are likely to be much more extensive, increasing the size of annual reports.

It is probably easier to achieve good practice status when new disclosure requirements come into force as an effort has to be made to get to grips with what is required then, in the context of your company, disclosures are drafted. A few thoughts – avoid padding of your corporate governance statements by merely repeating the words of the Code's principles and provisions; try to add something distinctive about how your company is applying the principles.

Now is an opportunity also to look at all the other corporate governance disclosures and consider the advantages of going beyond the bare minimum of the requirements to keep up with increasing expectations for disclosures. For example, boards could put some extra effort into their Turnbull disclosures, especially if the current wording is old and does not sufficiently reflect what the company is now doing on risk management and internal control.

Audit committees and the Smith report

Whilst the Code gives the audit committee a strengthened role with wide-ranging responsibilities including some related to whistleblowing, a key concern for the audit committee in the next year will be dealing with International Accounting Standards. A few points to note on the Code are:

Even if the Code does not apply to your business, you could consider it best practice

- bullet point 2 of Provision C.3.2 (and its associated paragraphs in the Smith report) raises the possibility of a risk committee composed of independent directors. This may not be how companies currently structure their risk committee(s) (where they have one);
- thought will also have to be given to how to protect the individual(s) who is (are) deemed to have 'recent and relevant' financial experience from becoming a target for dissatisfied litigants; and
- in future, audit committees will have to give an annual report describing their work in discharging the committee's responsibilities. What is to be said and in how much detail?

The future

Sometime within the next year we may see the first output from the European Commission following its Communication on Company Law and Corporate Governance (May 2003). Whilst there does not seem to be an appetite for an EU-wide corporate governance code, reference is made in the communication to the need to develop 'a few essential rules' as well as a co-ordination body for the national codes.

What will this mean in practice? Work will also start on an 'annual corporate governance' statement to appear in annual reports of companies listed in EU member states. How will this differ from the extensive disclosures required by the revised Combined Code? Further afield, there may also be ramifications of the Sarbanes-Oxley Act to consider, such as on internal control over financial reporting.

After all the activity in the regulatory and corporate governance areas over recent months in the UK it is likely that directors, particularly in smaller listed companies, are nearing overload. In an ideal world, we would now enter a period of consolidation allowing recent developments to settle in. For a few months this may be true, providing you with time to get to grips with the new Code and to refresh old disclosures.

However, even with a deferred implementation date (reporting years beginning on or after 1 November 2003) the timetable is still demanding, added to which the FRC is encouraging early adoption. You need to start thinking about all the issues now. Even if the Combined Code does not apply to your organisation, you could consider it to be best practice to be followed. MQ

See Appendix A, opposite, for the updated text of the July 2003 Combined Code.

The Institute Library's governance links page is at: www.icaew.co.uk/corpgovinfo

APPENDIX A

The Combined Code*

Code on corporate governance

PREAMBLE

1. This Code supersedes and replaces the Combined Code issued by the Hampel Committee on Corporate Governance in June 1998. It derives from a review of the role and effectiveness of non-executive directors by Derek Higgs[1] and a review of audit committees[2] by a group led by Sir Robert Smith.

2. The Financial Services Authority has said that it will replace the 1998 Code that is annexed to the Listing Rules with the revised Code and will seek to make consequential Rule changes. There will be consultation on the necessary Rule changes but not further consultation on the Code provisions themselves.

3. It is intended that the new Code will apply for reporting years beginning on or after 1 November 2003.

4. The Code contains main and supporting principles and provisions. The existing Listing Rules require listed companies to make a disclosure statement in two parts in relation to the Code. In the first part of the statement, the company has to report on how it applies the principles in the Code. In future this will need to cover both main and supporting principles. The form and content of this part of the statement are not prescribed, the intention being that companies should have a free hand to explain their governance policies in the light of the principles, including any special circumstances applying to them which have led to a particular approach. In the second part of the statement the company has either to confirm that it complies with the Code's provisions or – where it does not – to provide an explanation. This 'comply or explain' approach has been in operation for over 10 years and the flexibility it offers has been widely welcomed both by company boards and by investors. It is for shareholders and others to evaluate the company's statement.

5. While it is expected that listed companies will comply with the Code's provisions most of the time, it is recognised that departure from the provisions of the Code may be justified in particular circumstances. Every company must review each provision carefully and give a considered explanation if it departs from the Code provisions.

6. Smaller listed companies, in particular those new to listing, may judge that some of the provisions are disproportionate or less relevant in their case. Some of the provisions do not apply to companies below FTSE 350. Such companies may nonetheless consider that it would be appropriate to adopt the approach in the Code and they are encouraged to consider this. Investment companies typically have a different board structure, which may affect the relevance of particular provisions.

7. Whilst recognising that directors are appointed by shareholders who are the owners of companies, it is important that those concerned with the evaluation of governance should do so with common sense in order to promote partnership and trust, based on mutual understanding. They should pay due regard to companies' individual circumstances and bear in mind in particular the size and complexity of the company and the nature of the risks and challenges it faces. Whilst shareholders have every right to challenge companies' explanations if they are unconvincing, they should not be evaluated in a mechanistic way and departures from the Code should not be automatically treated as breaches. Institutional shareholders and their agents should be careful to respond to the statements from companies in a manner that supports the 'comply or explain' principle. As the principles in Section 2 make clear, institutional shareholders should carefully consider explanations given for departure from the Code and make reasoned judgements in each case. They should put their views to the company and be prepared to enter a dialogue if they do not accept the company's position. Institutional shareholders should be prepared to put such views in writing where appropriate.

8. Nothing in this Code should be taken to override the general requirements of law to treat shareholders equally in access to information.

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* *The main body of 'The Combined Code on Corporate Governance' is reproduced here with the kind permission of the Financial Reporting Council. The full document, which also includes the Turnbull guidance, the Smith guidance and the Higgs report suggestions, is available for free download as a PDF at www.frc.org.uk*

9. This publication includes guidance on how to comply with particular parts of the Code: first, 'Internal control: guidance for directors on the Combined Code"[3], produced by the Turnbull committee, which relates to Code provisions on internal control (C.2 and part of C.3 in the Code); and, second, 'Audit committees: combined code guidance', produced by the Smith group, which relates to the provisions on audit committees and auditors (C.3 of the Code). In both cases, the guidance suggests ways of applying the relevant Code principles and of complying with the relevant Code provisions.

10. In addition, this volume also includes suggestions for good practice from the Higgs report.

11. The revised Code does not include material in the previous Code on the disclosure of directors' remuneration. This is because 'The directors' remuneration report Regulations 2002'[4] are now in force and supersede the earlier Code provisions. These require the directors of a company to prepare a remuneration report. It is important that this report is clear, transparent and understandable to shareholders.

Footnotes

1 'Review of the role and effectiveness of non-executive directors', published January 2003.
2 'Audit committees Combined Code guidance', published January 2003.
3 'Internal control: guidance for directors on the Combined Code', published by the Institute of Chartered Accountants in England and Wales in September 1999.
4 The Directors' Remuneration Report Regulations 2002, SI no.1986.

Code of best practice

SECTION 1 COMPANIES

A. DIRECTORS

A.1 The board

Main principle

Every company should be headed by an effective board, which is collectively responsible for the success of the company.

Supporting principles

The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met.

All directors must take decisions objectively in the interests of the company.

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing, and where necessary removing, executive directors, and in succession planning.

Code provisions

A.1.1 The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management.

A.1.2 The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the nomination, audit and remuneration committees. It should also set out the number of meetings of the board and those committees and individual attendance by directors.

A.1.3 The chairman should hold meetings with the non-executive directors without the executives present. Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance (as described in A.6.1) and on such other occasions as are deemed appropriate.

A.1.4 Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chairman, for circulation to the board, if they have any such concerns.

A.1.5 The company should arrange appropriate insurance cover in respect of legal action against its directors.

A.2 Chairman and chief executive

Main principle

There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.

Supporting principle

The chairman is responsible for leadership of the board, ensuring its effectiveness on all aspects of its role and setting its agenda. The chairman is also responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders. The chairman should also facilitate the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive directors.

Code provisions

A.2.1 The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.

A.2.2[5] The chairman should on appointment meet the independence criteria set out in A.3.1 below. A chief executive should not go on to be chairman of the same company. If exceptionally a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.

A.3 Board balance and independence

Main principle

The board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.

Supporting principles

The board should not be so large as to be unwieldy. The board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business and that changes to the board's composition can be managed without undue disruption.

To ensure that power and information are not concentrated in one or two individuals, there should be a strong presence on the board of both executive and non-executive directors.

The value of ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of committees.

No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee.

Code provisions

A.3.1 The board should identify in the annual report each non-executive director it considers to be independent.[6] The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;
- has close family ties with any of the company's advisers, directors or senior employees;
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.

A.3.2 Except for smaller companies [7], at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors.

A.3.3 The board should appoint one of the independent non-executive directors to be the senior independent director. The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or finance director has failed to resolve or for which such contact is inappropriate.

A.4 Appointments to the board

Main principle

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

Supporting principles

Appointments to the board should be made on merit and against objective criteria. Care should be taken to ensure that appointees have enough time available to devote to the job. This is particularly important in the case of chairmanships.

The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board.

Code provisions

A.4.1 There should be a nomination committee which should lead the process for board appointments and make recommendations to the board. A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship. The nomination committee should make available[8] its terms of reference, explaining its role and the authority delegated to it by the board.

A.4.2 The nomination committee should evaluate the balance of skills, knowledge and experience on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

A.4.3 For the appointment of a chairman, the nomination committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises. A chairman's other significant commitments should be disclosed to the board before appointment and included in the annual report. Changes to such commitments should be reported to the board as they arise, and included in the next annual report. No individual should be appointed to a second chairmanship of a FTSE 100 company[9].

A.4.4 The terms and conditions of appointment of non-executive directors should be made available for inspection[10] . The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the board before appointment, with a broad indication of the time involved and the board should be informed of subsequent changes.

A.4.5 The board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company.

A.4.6 A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director.

A.5 Information and professional development

Main principle

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

Supporting principles

The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. Management has an obligation to provide such information but directors should seek clarification or amplification where necessary.

The chairman should ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the board and on board committees. The company should provide the necessary resources for developing and updating its directors' knowledge and capabilities.

Under the direction of the chairman, the company secretary's responsibilities include ensuring good information flows within the board and its committees and between senior management and non-executive directors, as well as facilitating induction and assisting with professional development as required.

The company secretary should be responsible for advising the board through the chairman on all governance matters.

Code provisions

A.5.1 The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board. As part of this, the company should offer to major shareholders the opportunity to meet a new non-executive director.

A.5.2 The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties.

A.5.3 All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are complied with. Both the appointment and removal of the company secretary should be a matter for the board as a whole.

A.6 Performance evaluation

Main principle

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

Supporting principle

Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties). The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors.

Code provision

A.6.1 The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted. The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.

A.7 Re-election

Main principle

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. The board should ensure planned and progressive refreshing of the board.

Code provisions

A.7.1 All directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election.

A.7.2 Non-executive directors should be appointed for specified terms subject to re-election and to Companies Acts provisions relating to the removal of a director. The board should set out to shareholders in the papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected. The chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role. Any term beyond six years (eg two three-year terms) for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board. Non-executive directors may serve longer than nine years (eg three three-year terms), subject to annual re-election. Serving more than nine years could be relevant to the determination of a non-executive director's independence (as set out in provision A.3.1).

B. REMUNERATION

B.1 The level and make-up of remuneration[11]

Main principles

Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

Supporting principle

The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in performance. They should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.

Code provisions

Remuneration policy

B.1.1 The performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors and should be designed to align their interests with those of shareholders and to give these directors keen incentives to perform at the highest levels. In designing schemes of performance-related remuneration, the remuneration committee should follow the provisions in Schedule A to this Code.

B.1.2 Executive share options should not be offered at a discount save as permitted by the relevant provisions of the Listing Rules.

B.1.3 Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for non-executive directors should not include share options. If, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive director leaves the board. Holding of share options could be relevant to the determination of a non-executive director's independence (as set out in provision A.3.1).

B.1.4 Where a company releases an executive director to serve as a non-executive director elsewhere, the remuneration report[12] should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is.

Service contracts and compensation

B.1.5 The remuneration committee should carefully consider what compensation commitments (including pension contributions and all other elements) their directors' terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.

B.1.6 Notice or contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.

B.2 Procedure

Main principle

There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Supporting principles

The remuneration committee should consult the chairman and/or chief executive about their proposals relating to the remuneration of other executive directors. The remuneration committee should also be responsible for appointing any consultants in respect of executive director remuneration. Where executive directors or senior management are involved in advising or supporting the remuneration committee, care should be taken to recognise and avoid conflicts of interest.

The chairman of the board should ensure that the company maintains contact as required with its principal shareholders about remuneration in the same way as for other matters.

Code provisions

B.2.1 The board should establish a remuneration committee of at least three, or in the case of smaller companies[13] two, members, who should all be independent non-executive directors. The remuneration committee should make available[14] its terms of reference, explaining its role and the authority delegated to it by the board. Where remuneration consultants are appointed, a statement should be made available[15] of whether they have any other connection with the company.

B.2.2 The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments. The committee should also recommend and monitor the level and structure of remuneration for senior management. The definition of 'senior management' for this purpose should be determined by the board but should normally include the first layer of management below board level.

B.2.3 The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive.

B.2.4 Shareholders should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules) and significant changes to existing schemes, save in the circumstances permitted by the Listing Rules.

C. ACCOUNTABILITY AND AUDIT

C.1 Financial reporting

Main principle

The board should present a balanced and understandable assessment of the company's position and prospects.

Supporting principle

The board's responsibility to present a balanced and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.

Code provisions

C.1.1 The directors should explain in the annual report their responsibility for preparing the accounts and there should be a statement by the auditors about their reporting responsibilities.

C.1.2 The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.

C.2 Internal control[16]

Main principle

The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

Code provision

C.2.1 The board should, at least annually, conduct a review of the effectiveness of the group's system of internal controls and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems.

C.3 Audit committee and auditors[17]

Main principle

The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.

Code provisions

C.3.1 The board should establish an audit committee of at least three, or in the case of smaller companies[18] two, members, who should all be independent non-executive directors. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.

C.3.2 The main role and responsibilities of the audit committee should be set out in written terms of reference and should include:

- to monitor the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;

- to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;
- to monitor and review the effectiveness of the company's internal audit function;
- to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
- to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
- to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.

C.3.3 The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available.[19] A separate section of the annual report should describe the work of the committee in discharging those responsibilities.

C.3.4 The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.

C.3.5 The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.

C.3.6 The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.

C.3.7 The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.

D RELATIONS WITH SHAREHOLDERS

D.1 Dialogue with institutional shareholders

Main principle

There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.[20]

Supporting principles

Whilst recognising that most shareholder contact is with the chief executive and finance director, the chairman (and the senior independent director and other directors as appropriate) should maintain sufficient contact with major shareholders to understand their issues and concerns.

The board should keep in touch with shareholder opinion in whatever ways are most practical and efficient.

Code provisions

D.1.1 The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders. Non-executive directors should be offered the opportunity to attend meetings with major shareholders and should expect to attend them if requested by major shareholders. The senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.

D.1.2 The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about their company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion.

D.2 Constructive use of the AGM

Main principle

The board should use the AGM to communicate with investors and to encourage their participation.

Code provisions

D.2.1 The company should count all proxy votes and, except where a poll is called, should indicate the level of proxies lodged on each resolution, and the balance for and against the resolution and the number of abstentions, after it has been dealt with on a show of hands. The company should ensure that votes cast are properly received and recorded.

D.2.2 The company should propose a separate resolution at the AGM on each substantially separate issue and should in particular propose a resolution at the AGM relating to the report and accounts.

D.2.3 The chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.

D.2.4 The company should arrange for the Notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting.

SECTION 2 INSTITUTIONAL SHAREHOLDERS

E. INSTITUTIONAL SHAREHOLDERS[21]

E.1 Dialogue with companies

Main principle

Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives.

Supporting principles

Institutional shareholders should apply the principles set out in the Institutional Shareholders' Committee's "The Responsibilities of Institutional Shareholders and Agents – Statement of Principles"[22], which should be reflected in fund manager contracts.

E.2 Evaluation of governance disclosures

Main principle

When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional shareholders should give due weight to all relevant factors drawn to their attention.

Supporting principle

Institutional shareholders should consider carefully explanations given for departure from this Code and make reasoned judgements in each case. They should give an explanation to the company, in writing where appropriate, and be prepared to enter a dialogue if they do not accept the company's position. They should avoid a box-ticking approach to assessing a company's corporate governance. They should bear in mind in particular the size and complexity of the company and the nature of the risks and challenges it faces.

E.3 Shareholder voting

Main principle

Institutional shareholders have a responsibility to make considered use of their votes.

Supporting principles

Institutional shareholders should take steps to ensure their voting intentions are being translated into practice.

Institutional shareholders should, on request, make available to their clients information on the proportion of resolutions on which votes were cast and non-discretionary proxies lodged.

Major shareholders should attend AGMs where appropriate and practicable. Companies and registrars should facilitate this.

SCHEDULE A

Provisions on the design of performance related remuneration

1. The remuneration committee should consider whether the directors should be eligible for annual bonuses. If so, performance conditions should be relevant, stretching and designed to enhance shareholder value. Upper limits should be set and disclosed. There may be a case for part payment in shares to be held for a significant period.

2. The remuneration committee should consider whether the directors should be eligible for benefits under long-term incentive schemes. Traditional share option schemes should be weighed against other kinds of long-term incentive scheme. In normal circumstances, shares granted or other forms of deferred remuneration should not vest, and options should not be exercisable, in less than three years. Directors should be encouraged to hold their shares for a further period after vesting or exercise, subject to the need to finance any costs of acquisition and associated tax liabilities.

3. Any new long-term incentive schemes which are proposed should be approved by shareholders and should preferably replace any existing schemes or at least form part of a well considered overall plan, incorporating existing schemes. The total rewards potentially available should not be excessive.

4. Payouts or grants under all incentive schemes, including new grants under existing share option schemes, should be subject to challenging performance criteria reflecting the company's objectives. Consideration should be given to criteria which reflect the company's performance relative to a group of comparator companies in some key variables such as total shareholder return.

5. Grants under executive share option and other long-term incentive schemes should normally be phased rather than awarded in one large block.

6. In general, only basic salary should be pensionable.

7. The remuneration committee should consider the pension consequences and associated costs to the company of basic salary increases and any other changes in pensionable remuneration, especially for directors close to retirement.

SCHEDULE B

Guidance on liability of non-executive directors – care, skill and diligence

1. Although non-executive directors and executive directors have as board members the same legal duties and objectives, the time devoted to the company's affairs is likely to be significantly less for a non-executive director than for an executive director and the detailed knowledge and experience of a company's affairs that could reasonably be expected of a non-executive director will generally be less than for an executive director. These matters may be relevant in assessing the knowledge, skill and experience which may reasonably be expected of a non-executive director and therefore the care, skill and diligence that a non-executive director may be expected to exercise.

2. In this context, the following elements of the Code may also be particularly relevant.

   (i) In order to enable directors to fulfil their duties, the Code states that:

   - the letter of appointment of the director should set out the expected time commitment (Code provision A.4.4); and
   - the board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. The chairman is responsible for ensuring that the directors are provided by management with accurate, timely and clear information (Code principles A.5).

   (ii) Non-executive directors should themselves:

   - undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company (Code principle A.5 and provision A.5.1);
   - seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice (Code principle A.5 and provision A.5.2);
   - where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the board and, to the extent that they are not resolved, ensure that they are recorded in the board minutes (Code provision A.1.4); and
   - give a statement to the board if they have such unresolved concerns on resignation (Code provision A.1.4).

3. It is up to each non-executive director to reach a view as to what is necessary in particular circumstances to comply with the duty of care, skill and diligence they owe as a director to the company. In considering whether or not a person is in breach of that duty, a court would take into account all relevant circumstances. These may include having regard to the above where relevant to the issue of liability of a non-executive director.

SCHEDULE C

Disclosure of corporate governance arrangements

The Listing Rules require a statement to be included in the annual report relating to compliance with the Code, as described in the preamble.

For ease of reference, the specific requirements in the Code for disclosure are set out below:

The annual report should record:

- a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management (A.1.1);
- the names of the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the nomination, audit and remuneration committees (A.1.2);
- the number of meetings of the board and those committees and individual attendance by directors (A.1.2);
- the names of the non-executive directors whom the board determines to be independent, with reasons where necessary (A.3.1);
- the other significant commitments of the chairman and any changes to them during the year (A.4.3);
- how performance evaluation of the board, its committees and its directors has been conducted (A.6.1); and
- the steps the board has taken to ensure that members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about their company (D.1.2).

The report should also include:

- a separate section describing the work of the nomination committee, including the process it has used in relation to board appointments and an explanation if neither external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director (A.4.6);
- a description of the work of the remuneration committee as required under the Directors' Remuneration Reporting Regulations 2002, and including, where an executive director serves as a non-executive director elsewhere, whether or not the director will retain such earnings and, if so, what the remuneration is (B.1.4);
- an explanation from the directors of their responsibility for preparing the accounts and a statement by the auditors about their reporting responsibilities (C.1.1);
- a statement from the directors that the business is a going concern, with supporting assumptions or qualifications as necessary (C.1.2);
- a report that the board has conducted a review of the effectiveness of the group's system of internal controls (C.2.1);
- a separate section describing the work of the audit committee in discharging its responsibilities (C.3.3);
- where there is no internal audit function, the reasons for the absence of such a function (C.3.5);
- where the board does not accept the audit committee's recommendation on the appointment, reappointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and the reasons why the board has taken a different position (C.3.6); and
- an explanation of how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded (C.3.7).

The following information should be made available (which may be met by making it available on request and placing the information available on the company's website):

- the terms of reference of the nomination, remuneration and audit committees, explaining their role and the authority delegated to them by the board (A.4.1, B.2.1 and C.3.3);
- the terms and conditions of appointment of non-executive directors (A.4.4) (see footnote 10 on page 9); and
- where remuneration consultants are appointed, a statement of whether they have any other connection with the company (B.2.1).

The board should set out to shareholders in the papers accompanying a resolution to elect or re-elect:

- sufficient biographical details to enable shareholders to take an informed decision on their election or re-election (A.7.1);
- why they believe an individual should be elected to a non-executive role (A.7.2); and
- on re-election of a non-executive director, confirmation from the chairman that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role, including commitment of time for board and committee meetings and any other duties (A.7.2).

The board should set out to shareholders in the papers recommending appointment or reappointment of an external auditor:

- if the board does not accept the audit committee's recommendation, a statement from the audit committee explaining the recommendation and from the board setting out reasons why they have taken a different position (C.3.6). MQ

For footnotes to pages 30 to 39, please see page 40.

Footnotes to the Combined Code *(see pages 30 to 39)*

5 Compliance or otherwise with this provision need only be reported for the year in which the appointment is made.

6 A.2.2 states that the chairman should, on appointment, meet the independence criteria set out in this provision, but thereafter the test of independence is not appropriate in relation to the chairman.

7 A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

8 The requirement to make the information available would be met by making it available on request and by including the information on the company's website.

9 Compliance or otherwise with this provision need only be reported for the year in which the appointment is made.

10 The terms and conditions of appointment of non-executive directors should be made available for inspection by any person at the company's registered office during normal business hours and at the AGM (for 15 minutes prior to the meeting and during the meeting).

11 Views have been sought by the Department of Trade and Industry by 30 September 2003 on whether, and if so how, further measures are required to enable shareholders to ensure that compensation reflects performance when directors' contracts are terminated: See "Rewards for Failure": Directors' Remuneration – Contracts, performance and severance, June 2003.

12 As required under the Directors' Remuneration Report Regulations.

13 See footnote 7.

14 See footnote 8.

15 See footnote 8.

16 The Turnbull guidance suggests means of applying this part of the Code.

17 The Smith guidance suggests means of applying this part of the Code.

18 See footnote 7.

19 See footnote 8.

20 Nothing in these principles or provisions should be taken to override the general requirements of law to treat shareholders equally in access to information.

21 Agents such as investment managers, or voting services, are frequently appointed by institutional shareholders to act on their behalf and these principles should accordingly be read as applying where appropriate to the agents of institutional shareholders.

22 Available at: www.investmentuk.org.uk/press/2002/20021021-01.pdf

Useful web sites

The Combined Code (2003) including the Smith guidance on audit committees
www.frc.org.uk/publications/content/CombinedCodeFinal.pdf

The Higgs review (2003) together with full details of research conducted and related information
www.dti.gov.uk/cld/non_exec_review

The Turnbull report (internal control) 1999
www.icaew.co.uk/internalcontrol

The Cadbury report (1992), Greenbury report (1995) and Hampel report (1998)
www.ecgi.org/codes/country_pages/codes_uk.htm

The Financial Services Authority's Listing Rules (2002) (see in particular paragraph 12.43A)
www.fsa.gov.uk/pubs/ukla/

Corporate governance codes in other countries
www.ecgi.org/codes/all_codes.htm

Information on the Company Law Review (2001) and the Company Law white paper (2002)
www.dti.gov.uk/cld/

The Myners Report on Institutional Investment in the UK (2001)
www.hm-treasury.gov.uk/media//843F0/31.pdf

The Tyson report on the recruitment anddevelopment of non-executive directors (2003)
www.london.edu/tysonreport/Tyson_Report_June_2003.pdf

The Institutional Shareholders' Committee's document 'The responsibilities of institutional shareholders and agents – statement of principles' (2002)
www.investmentuk.org/press/2002/20021021-01.pdf 81

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