Non-executive directors

Sack non-executive directors to force investors to do their job

The merry-go-round of board service, lubricated with fees, leaves few satisfied

Andrew Hill

Non-executives are under immense pressure as part-time outsiders, overseeing driven full-time experts © Bloomberg

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Time is up for non-executive directors. Through successive corporate crises and systemic catastrophes, despite — and in part because of — layers of codes and regulations, independent board members have failed to do the impossible job handed to them by complacent fund managers.

Here is the charge sheet. Executive recklessness: still untamed. Executive enterprise: often smothered. Executive pay: unchecked. Scandals and failures: recurrent. Sickly corporate cultures: unaltered. Complex operations: unmonitored. Trust in business: fragile.

This list is long. Directors will argue that they are not responsible for all of it. That is precisely the problem. Tighter governance has become the catch-all solution to all corporate, and some systemic, crises, with directors as useful scapegoats if things go wrong. Nobody will weep for people who sometimes earn multiples of average workers' salaries. But non-executives are under immense pressure as part-time outsiders, overseeing driven full-time experts, who are themselves trying to control companies that are often bafflingly complex.

A recent US study, "Are Boards Designed to Fail? (http://www.tandfonline.com/doi/abs/10.1080/19416520.2016.1120957#.VzhuWb5VS8o) detected many obstacles to proper oversight. They include excessive deference to the chief executive, who often decides when, or even whether, non-executives can visit operations and quiz managers. Then there is the sheer lack of time: here, former executives who boast of "going plural" — taking multiple directorships —should reflect that a singular focus would be more effective, if less lucrative. A new report from Tomorrow's Company ("UK Business: What's Wrong? What's Next? (http://tomorrowscompany.com/publication/uk-business-whats-wrong-whats-next/)") suggests the build-up of codes and rules, plus the public's knee-jerk attacks on directors after a corporate catastrophe, have made boards too risk averse. Separately, the think-tank lists 17 topics, from audit to strategy, on which directors are expected to act in the 30 days a year that is all they usually devote to the job.

Governance flaws are usually addressed piecemeal. I have written recently about the need to give more weight to remuneration committees (http://next.ft.com/content/9eafda8c-0319-11e6-af1d-c47326021344), the importance of separating chair and chief executive (http://next.ft.com/content/13b9257e-f563-11e4-8c83-00144feab7de), the role of independent voices in improving and safeguarding culture (http://next.ft.com/content/ebd623ac-26f1-11e5-bd83-71cb60e8f08c). But the moment has come to address the root of the problem.

Management

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One former chair and director of a number of small UK companies emailed me to suggest scrapping non-executive directors. "Doing away with most NEDs would make investors face up to their responsibilities," he wrote.

This remedy would appal many (including parts of the FT group) who train, advise, and recruit directors. But investors need the kick. Dodging active ownership responsibility for their cluttered portfolios, "they looked to NEDs to do it for them (at a fraction of [what] they paid themselves)", the same director writes. Largely, that is still the case.

Tiny signs of a coming scandal — and how to spot them (http://next.ft.com/content/ebd623ac-26f1-11e5-bd83-71cb60e8f08c)

Four ways to bring galactic executive pay back down to earth (http://next.ft.com/content/9eafda8c-0319-11e6-af1d-c47326021344)

Carl Icahn and Daniel Loeb can't be shut out (http://next.ft.com/content/97a70b2c-30ec-11e3-b478-00144feab7de)

There are exceptions. Norway's sovereign oil fund is attacking high executive pay (http://next.ft.com/content/aeb270ec-0f63-11e6-bb40-c30e3bfcf63b), the focus of increasing investor protest worldwide, and plans to sue Volkswagen over its emissions scandal. Shareholders have more regulatory weapons and are using them (http://next.ft.com/content/0a58a5e8-e548-11e4-bb4b-00144feab7de). A few are putting their own professional representatives (http://next.ft.com/content/97a70b2c-30ec-11e3-b478-00144feab7de) on boards to influence strategy.

Stripping out non-executives could tempt executives to revisit the bad habits some showed when their power was untrammelled. Even private equity firms — hardly fans of extraneous bureaucracy — like to appoint directors to oversee companies they own. Executives say they prefer private equity's hands-on approach (http://www.egonzehnder.com/leadership-insights/the-private-equity-board-a-good-governance-model.html) to the stifling governance cotton-wool applied by some listed companies.

The US researchers suggest ending the blame game (https://hbr.org/2016/05/boards-arent-the-right-way-to-monitor-companies?utm_source=twitter&utm_medium=social&utm_campaign=harvardbiz) and assembling boards of specialists with relevant expertise to help and challenge chief executives. Tomorrow's Company proposes that directors engage more closely with shareholders who, in turn, should behave more like stewards of long-term growth, rather than traders.

Another director I know strongly supports non-executives and suggests they are the best guarantors of long-termism. She may be right, in theory. Yet in practice, the merry-go-round of board service, well lubricated at the top level with fees and prestige, leaves few satisfied. Making executives, regulators and investors start from scratch — without the ragged safety net that non-executive directors struggle to provide — would force them to think harder about how to do their own jobs better.

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