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Don't do away with non-executive directors

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The IOD's 2002 convention in London was a juicy target for protesters. It was an opportunity made in heaven.

The theme was globalization – perfect for the times, and hugely provocative. Henry Kissinger was the keynote speaker; perhaps he could be arrested in Britain for "crimes" committed when he was U.S. Secretary of State 20 years ago. The Enron/Anderson scandal was boiling. And every day, press and TV reports told of a widening gap between the world's "haves" and "have-nots", of economies and businesses in trouble, and of corporate misdemeanours and directors' deceits.

What more could anyone with a can of spray paint, a sheet of cardboard and time on their hands want?

And what more could the advocates of good corporate governance want? With media interest at a pitch, and an audience of powerful people, this was a moment to be seized. This was a chance to shape the conversation about the challenges, roles, and duties of directors.

But what should have been a good start to the convention quickly turned odd.

Up to the microphone stepped Lord Young of Graffham, President of the IOD for the past decade, with a statement that made headlines for days afterwards.

In his message in the conference brochure, he'd noted that "the business world has grown more complex and challenging: the pressure on directors has grown ever stronger, not simply to deliver results in the face of tough competition but to operate under even greater public scrutiny." No one could argue with that. Hopefully, he and the speakers who followed him would offer some solutions.

He not only failed to do that, he also sowed the seeds of confusion and set in train a debate that most people thought to be long dead.

In his opening speech at the event – and his last one before stepping down as President – Lord Young called for the end to non-executive directorships.

"The biggest – and most dangerous – nonsense," he said, "is the role we expect non-executive directors to perform…. The idea has come about that in some manner non-executives can second guess the executives. Of course they can't. If management is not forthcoming, they can never even know, until it is too late."

He went on: "How do you separate the board from the business? If you do, how much does the board actually *know* about the business?"

Heads in the audience nodded as he spoke. He'd put his finger on a real problem. It's easy for managers to pull the wool over the eyes of directors who aren't in a company 24 hours a day; and *all* directors are vulnerable when things go wrong.

However, Lord Young had a second reason to advocate that all directors be full-time insiders. Only that way, he said, would entrepreneurship have a chance. For current trends in corporate governance are putting a noose around directors' necks – and thus the necks of their companies.

But his recipe for success – "Let all the directors in a listed company work in the business" – was so startling, so contrary to everything the IOD advocated, that it was hard to tell if he was being serious.

My immediate thought, shared, apparently by other members of the South African delegation, was, "I wonder if he told anyone at the IOD he was going to say this?" Apparently not, because the organization later distanced itself from his comments.

Had Lord Young gaffed?

Not likely. He must have seen the risk in making such a statement at such a time. He must have known that what he said would make news. Champions of good governance may choose to ignore what he said, but they'd be better to fight it hard and fast.

Corporate governance is a very hot topic. The real debate it has barely begun. For all the thought that has gone into it so far, there's far more to come.

The fact is, companies are the most important organizations in society. They provide opportunities for employment and personal development. They contribute to the communities in which they work. They have great power to do good – or to do harm. While free enterprise is a positive thing, it allows space for unprincipled or careless behaviour.

And many companies have behaved badly. Many directors have been careless and even criminal in their duties. Abuses of company funds and facilities, as well as obscene pay and perks, have raised hackles everywhere. Too often it seems that the worse a company does for its shareholders, the better its top people do for themselves.

Recent months have seen the fall of many corporate celebrities. Ken Lay went down with Enron. Bernie Ebbers fell with WorldCom. Dennis Kozlowski had to resign from Tyco, and faces charges of tax evasion.

Percy Barnevik flamed out when he arranged fat pensions from ABB for himself and Goren Lindahl. (Both men had to pay back half the money, and Lindahl took himself out of the running for the job of chairman of Anglo American.)

The day after Young spoke, Sir Roger Hurn resigned as chairman of the Prudential insurance company ahead of a Financial Services Authority report on losses at Marconi. (He had been chairman there too, but was forced to resign after two profit warnings.) And in the same week, directors of Equitable Life were sued (by the current board) for alleged negligence over losses of £3 billion 15 years previously.

Young's comments might have been prompted, in part, by the fact that a week before the IOD convention, Patricia Hewitt, the British trade secretary, announced a government review of non-executive directors. Her brief to Derek Higgs, a former merchant banker, was to look at "how more independent and more active non-executives drawn from a wider pool of talent can play their part in raising productivity."

This might turn out to be a very bad thing. At a time when many voices are calling for firms to be tied, gagged, and otherwise controlled, regulators may be tempted to kill the golden goose. Once they get started, it's not easy to stop them. Undoing laws is never quick.

Worldwide today, there's growing pressure for more effective corporate governance. Public trust in corporate affairs is eroding.

Practices are being reviewed everywhere. There is no doubt that extreme views will get plenty of attention. But when all is said and done, those looking at further change must consider two questions:

1. What must governments do to create an environment in which companies can do the good that only they can do, while at the same time protecting the interests of their many stakeholders?
2. What must firms do to make the best use of their resources, while at the same time acting responsibly?

As Alan Greenspan, chairman of the U.S. Federal Reserve Board has pointed out, any attempt to tighten regulation must be tackled with extreme care. It's easy to go overboard – and the effects would be catastrophic. In these uncertain times, balance is vital.

Besides, regulation is only part of any answer. Societies need trust in order to work well. They need a critical mass of people to volunteer to do the right thing. When trust is missing and lots of people are on the take, things quickly come unstuck.

As the Financial Times pointed out in a June 8 editorial, "Managing big companies unethically can produce gain but usually it is short-lived. Long-term success demands ethical behaviour that encourages the trust on which all social endeavours ultimately depend."

Lord Young promoted an idea without merit. To kill the practice of employing non-executive directors would be to kill an invaluable source of insight and advice, to cut off important connections, and to take the leash off insiders. It would be no guarantee of a surge in entrepreneurial energy, nor would it end dodgy or shoddy behaviour.

Corporate governance is clearly an idea whose time has come. The challenge now is not to get non-executive directors out of the system, but to make them a more effective part of it. They are too valuable to lose. Pissing inside the tent, to use Lyndon Johnson's phrase, is in no one's interests.

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