Speeches by the Governor of the Bank of England

Given at the Lord Mayor's dinner to the bankers and merchants of the City of London on 19 October 1978.

This dinner is traditionally an occasion for stocktaking. The Chancellor has followed that tradition by setting his account of our present position in the context of five arduous years in his present office. I propose likewise to follow precedent, but—the hazards to which Governors are subject being different from those which confront Chancellors—I will try to look beyond present events to a longer-term perspective. I am persuaded to this course by the conviction that the true significance of monetary policy and exchange rate policy is to be seen in their medium-term effects and that in the medium to long term there is a close relationship between these apparently purely financial matters and the industrial health of our economy. Taking a longer look, it is in this latter area that the country is confronted with obstinate and deep-seated problems. I think people sense that we must face up to them much more seriously.

But first I touch on recent experience.

This has been a year of both worry and achievement. We are now at the beginning of what we might hope will be an expansionary phase for the economy. This is a welcome change, but the economy has been given some powerful boosts—from the Budget, and from increases in earnings heavily outstripping prices. In the second quarter of the year we have seen an expansion of output substantially faster than envisaged earlier. That pace may moderate. But we should remain cautious. I am concerned that the economy should enjoy expansion at a rate which is sufficiently temperate to be sustainable. In particular we should not be thinking that there is room for relaxing the constraints on public spending. Considerable efforts have been made to get it under better control: in my view the economy does not have room for any relaxation of that control. Indeed for the longer term, public spending needs to be contained so as to permit the progressive reduction of direct taxation which seems so widely desired.

This clearly is also important for the conduct of monetary policy, which occupies first place among my particular responsibilities. I believe—and indeed scarcely need to reiterate to this audience—that the importance of monetary stability for healthy economic development cannot be overrated. Monetary policy is and must remain central to the restraint and ultimate defeat of inflation. Over recent years we have sought, to this end, to keep up a steady pressure. Since 1974, the growth of the broadly defined money supply has remained year by year fairly close to 10%. And I do not judge it wholly coincidental that over that period as a whole inflation fell from 20% and more to about 8%.

But monetary developments need constant and careful vigilance.We went through a difficult phase last winter and spring, when events once again demonstrated how increases in the public sector's borrowing requirement can produce adverse effects upon the market confidence needed to finance it. Since then, and against the background of a welcome recovery in the private sector's demand for credit, which we have had to restrain but not throttle, we have recovered lost ground, thanks in part to success in selling gilt-edged and other government securities outside the banking system. The corset control has caused some distortions in the figures, but our performance in relation to our current target has been satisfactory. We shall not relax our vigilance. Furthermore, over the time-scale of years which steady perseverance in our fight to reduce inflation involves, we shall need not merely to keep monetary growth steady: it ought to be reduced.

We have managed to get inflation down to 8% over the last year. But the growth of incomes has been considerable, and inflation has slowed down largely because we have been helped by other powerful factors: in particular, exchange rate stability, North Sea oil and little increase in world prices. And there should be no doubt that continued wage settlements far in excess of productivity growth can only lead to an acceleration of inflation, further erosion of our competitive base and further unemployment. This connexion is more widely perceived than it was a few years ago, but the awareness needs to be carried much further. The only route to a continuing increase in real incomes is by way of increase in the growth of productivity.

In a world where some exchange rates have fluctuated very widely, ours has been remarkably stable. Apart from a short period of particular strength last winter, the effective exchange rate index has stayed fairly consistently within the narrow range of 61 to 64 during the last twenty-two months.

A continuing stability in the exchange rate would be an essential feature of the proposed European Monetary System. It would not be appropriate for me to dilate upon this subject on a day when the Prime Minister has been discussing it with Chancellor Schmidt. I permit myself therefore simply this observation. In or out of such a scheme, we are in my judgment bound to follow policies of prudence in both fiscal and monetary policy—policies aimed at the progressive reduction of inflation, policies in short which not only underpin the domestic value of our currency but also the stability of its external value.

Successful pursuit of such policies will provide some, but not all, of the conditions required for maintaining and improving our standard of life. For they cannot of themselves ensure industrial health; and it is to this which I now turn.

In many respects our economy is well endowed. We are an inventive people. We are blessed with very large reserves of indigenous fuel. Our living standards are as high as ever before.

But the world environment is tough, and perhaps getting tougher. We not only face competition from the developed countries, but also a surge of efficient low-cost competition from the newly-developed ones. This would matter less if we were more adaptable and efficient. It is in the nature of a modern economy that firms and industries wax and wane with the march of time. But in our case the decline of old industries has not been sufficiently matched by the growth of new ones.

So in terms of income per head we have now fallen behind the EEC countries save Italy and Ireland, by a margin that appears to be widening. In terms of output per employee, our productivity in 1955 was 15% above that of France and Western Germany. But, by 1973, both countries were 30% ahead of us, and their lead must have increased further since then.

For long some have tried to comfort themselves by saying that this is all a relative matter—that we can still be content if we do not look at other countries. But it becomes increasingly clear that it does not stay as merely a relative matter. Our relative decline is creating absolute difficulties in managing our affairs, which unless reversed could threaten the continuance of even modest economic expansion.

Notwithstanding recent welcome advances, we have over the years lost shares in export markets and seen a rising scale of import penetration. This comparative failure to compete in international trade reflects the same weaknesses as our failure to improve efficiency at home and, in turn, exacerbates them. Though the balance of payments constraint has been mitigated by favourable terms of trade and the benefit of North Sea oil, it has not been eliminated.

Nor would the route of strengthening competitiveness internationally by a depreciation of the exchange rate afford an escape from this constraint. For this route is seen to be increasingly dangerous: it certainly brings inflation and, quite likely, accelerating inflation.

Our falling behind other countries is thus not something that we can merely accept, or safely adapt to. To put it at its simplest, we are unlikely to be able to make real inroads on unemployment unless we improve efficiency.

It is clear that the problems are ones which are deep-seated. Governments and others over many years have sought remedies to increase productivity, with generally disappointing results. It is unlikely then that there are simple answers; and indeed the remedies must lie deep in human attitudes and behaviour. The problems are in a sense too familiar to us, but they are problems of considerable severity and we do not always seem to realise the consequences of not acting to solve them. The Bank, in their ordinary preoccupations, cannot fail to observe how inflation and inadequate competitiveness affect the state of our domestic and external finances, and how this in turn reacts upon inflation and competitiveness.

I thus venture to offer the following observations.

I ask first what governments can do to help. Governments can play an important rôle in stimulating or frustrating economic activity; the appropriate rôle seems sometimes hard to get into balanced perspective by reason of sharply divergent political attitudes. For my part, I should like to suggest the following.

First and foremost, governments should aim to maintain a stable financial environment. It is the underpinning of a robust and successful economy. I need not re-emphasise this, and I take some comfort from the broader consensus which this view now commands.

Second, governments can seek to ensure that the need for industrial success and what this implies—and I do not exclude the need for increased profitability—is widely understood, as well as its relevance to the employment and welfare of ordinary men and women. In particular governments can see that the needs of industry are consistently assigned a higher place in our national priorities; they can also resist measures which, desirable in themselves, make the task of industry harder.

Third, governments can help to promote an environment which is conducive to enterprise, skill and responsibility. It was Professor Arthur Lewis who said that the greatest growth occurs in societies where men have an eye to the economic chance and are willing to stir themselves to seize it. Rather than the discouragement of high marginal tax rates, people at all levels need incentives which—as surely must be right—offer greater reward for effort, skill, responsibility and risk.

I ask next what industry can do to help itself. It is within individual companies and organisations that production is organised and where men and women spend their working lives. It is here that many of the remedies will in detail be found.

There is a strong presumption that we could obtain much more from our resources if we used them more efficiently. The rate of capital investment in this country has been high in comparison with the increase in our output. But it is not only a question of becoming better at doing what we now do, for the biggest advances in productivity and output have in the past decade been secured by industries which were poised to exploit world demand for relatively new high value-added products and processes. I ask whether management and unions alike should not be readier to exploit and to accept these new products and techniques which are the employment opportunities of the future.

Is it visionary to ask that those working together in an organisation should feel a common involvement in its success? Here is an objective which could surely engage the energies of all those to whom authority is confided. My limited observation suggests that one vital

factor is the quality of communication and consultation. Part of what is needed may be a better understanding of the rôle of management. For authority, always necessary in an enterprise, can no longer in our society be imposed, but has to rest to an increasing degree on trust and confidence. I have no illusions about the claim this can make on management time, but in some cases this may in part reflect a legacy of inadequate contact in the past.

Authority, I would add, is not exclusive to management. It lies also with the trade unions, who themselves have a vital task of communication. This is related in part to their ability to further the interests of their members, and in part to their ensuring that agreements on pay, manning and other issues are respected.

The operation of British industry is not a zero-sum game, a game in which the gain for one side equals loss for the other. It is in fact the opposite: the economy could over time yield simultaneously higher profits, higher wages, more investment and more jobs. But these objectives are interdependent: you cannot have one and reject the others. The British people, working with different governments, have since the war tried to foster a civilised, humane and caring society. But no-one should doubt that such a society can only exist on a successful industrial and commercial base. For that we need especially to convert energies which are currently being absorbed by internal conflict and division into a constructive force. If we could do that, we could face the future positively and with hope, confident of our ability to solve our own problems and readier to help solve those of others.

Given to the Institute of Directors on 28 November 1978 as their Tenth Annual Lecture.

Introduction

I have chosen as the title for my lecture 'The joint-stock company—adapting to change'. You may think that my choosing to address you on such a subject is a curious way of repaying the honour of being asked to give your Institute's annual lecture in its 75th anniversary year, with the added distinction of it being the first such lecture to be given in your elegant new premises. Most of you must feel that the business sector in general and directors in particular have been assailed recently from too many sides with criticism and advice. This feeling made itself very plain at the Confederation of British Industry's recent annual conference and is one with which it is hard not to have instinctive sympathy. Nevertheless, the theme seems to me appropriate for a Governor facing this particular audience.

I do not say this just because of my earlier professional interest in company law, but rather because the joint-stock company is one of the principal instruments through which collective economic activity is organised in our society. It is therefore no exaggeration to say that the nation's economic health depends crucially on the health of its joint-stock companies.

On this reasoning the Bank's general concern with the well-being of industry and commerce, and thus of joint-stock companies, requires no further explanation, but that concern is made more direct by two considerations. The first is that the Bank have an overall responsibility for the healthy functioning of at least parts of the financial system, and I like to regard that not simply as a prudential concern for the relevant financial institutions, but also as involving a concern that they are functioning to serve well and sufficiently the interests and purposes of their clients. The second such consideration is that, at the level of their general advice on monetary and exchange rate policy, and in the discharge of their executive responsibilities in these areas, the Bank must be, and seek to remain, alert to the consequences for industry and commerce.

In the fulfilment of these functions the Bank are thus well-placed to observe the inter-relationship and interaction of those involved on the corporate stage and to form a judgment about how the system is working. It is as such an observer that I propose tonight to reflect on some of the major issues which are likely to condition the development of the joint-stock company system during the remaining decades of the twentieth century and to bring new dimensions to the rôles of directors and managers. In what I have to say I shall principally have in mind quoted companies employing, say, more than 500 employees. I hope, however, that much will have relevance to smaller companies and to private companies.

The framework of company law

It is pertinent to begin by recalling why the joint-stock company developed as it did, and why it is continuing to evolve. It began in order to facilitate co-operation in commercial enterprise, so that funds could be raised for large undertakings by means of contributions of individual capitalists ready and willing to hazard their money against the prospect of economic gain but without the desire for close managerial involvement implied in a partnership. Widening the provision of capital spread liability and thus lessened individual risk, even though limited liability of shareholders was not a feature of the early companies.

The essential feature of company legislation, as it evolved in the nineteenth century between Gladstone's pioneering Joint Stock Companies Act of 1844 and the first great Companies Act of 1862, which consolidated the earlier relevant legislation, was the establishment of the principle of limited liability for shareholders. The latter Act may be said in this way to have put company law on the base of its subsequent development. It was an enabling Act, but there was a price in terms of regulation. Initially, that regulation was minimal—and applied in the main to the relations between

shareholders and those they appointed to look after their interests. It was not so much that the interests of other parties were overlooked; it was rather that it was assumed that the public interest, including therein the interests of employees and customers, was best served by the untrammelled development of commercial enterprise under the company system, operating in a highly competitive free-trade environment. The atmosphere prevailing at the turn of the century was epitomised in the following comment made in the Loreburn Committee's Report on Company Law Amendment in 1906:

> The company system inaugurated by the Act of 1862 has given an immense stimulus to commercial enterprise. Under this system British trade has widely developed and the wealth of the community has been largely augmented . . . the number of persons interested as shareholders, debenture holders, stockholders, customers, creditors and employees is legion. . .

It is, I think, instructive to note that the catalogue of the interested parties contained in that Report of 1906 omits no group that we would wish to include today. Even the public at large is potentially embraced by the concept of the wealth of the community. Today we look at the interests involved with greater particularity and are inclined to a more regulatory stance. But it is certainly false to argue that the interests of customers, consumers, and employees have been overlooked because company law has no explicit reference to them. In so far as it was felt necessary to protect other interests by statute, this was done by legislation outside company law that was of general application and not specifically directed at joint-stock companies. What has changed recently has been people's perception about how some of these interests are best looked after, while at the same time there has been a drastic change in the economic and social framework into which the concept of the joint-stock company is fitted.

It is for this reason that we are today engaged in an active discussion of a number of questions which are fundamental to the health of the company and its place in society. These questions concern on the one hand the rôles and responsibilities of all the major groups involved on the corporate stage—the shareholders, creditors, boards of directors, managers, non-managerial employees, customers and the public at large. And on the other hand they concern the brutal facts that in order to survive at all a company has to be able to produce its product, to sell its product and to derive a sufficient return from its operations to be able to maintain its productive potential in a rapidly changing and competitive world. Survival may not be all, but unprofitability can be desperately final. In promoting changes we need to ensure that they will bring new vigour to our enterprises and make them better able to flourish in the modern world, never forgetting that they have to be productive units not debating societies.

The Companies Bill currently before Parliament requires that in the exercise of their powers and duties directors should have regard to the interests of companies' employees generally as well as to those of shareholders. At the same time much current discussion emphasises that shareholders, especially institutional shareholders who have somewhat more concentrated power than personal shareholders, should play a more active rôle in the companies in which they invest. It is also argued that those who make loans to companies should similarly take a more active interest in them. Others argue that companies should operate in some way more directly in the national interest. So far, however, there has been little public discussion about what would happen to the concept of the joint-stock company if we were to move in all the recommended directions at the same time, because while the shareholders' interest, the employees' interest and the national interest may well converge over time, there are bound to be many questions of vital importance to companies on which there are substantial divergencies of interest (or apparent divergencies of interest) which have to be settled in the short term. It is idle to suppose that this is simply a question of finding an appropriate number of tiers of company boards, an algebraically-determined composition of a board or a new voting formula. The original concept of the joint-stock company depended on the close identification of interest of all the shareholders and one of the reasons it replaced earlier and looser associations of individuals with similar objectives was that such associations proved insufficiently cohesive when difficulties arose. As we widen our views as to the interests with which a company should concern itself, the problem becomes one of achieving sufficient understanding among all concerned in the company to achieve an identity of interest in the future. Without this the company would become paralysed.

In our changed and changing society, the continuing health of the joint-stock company as an institution depends on finding the right balance of interests, rights and responsibilities of all those groups associated with the company. Only two of those groups can legitimately be regarded as having extensive rights and minimal duties, namely the general public and the customers, though once the latter group have entered into contracts they have clearly defined specific obligations. Current discussion appropriately focuses on shareholders, creditors, boards of directors and employees, and it is to these that I now turn.

Shareholders and creditors

I have described the origins of the joint-stock company, when there was a close association between ownership, responsibility and control. As ownership became diffused over a widening circle of private shareholders, making it difficult for them to act collectively and thus effectively, so came about what has been described as the managerial revolution, which represented the divorce of ownership and effective control. The stance of company law in this situation has been well put by Professor Gower in a dissent to the 1962 Jenkins Report:

> The business corporation is a device for enabling an expert body of directors to manage other people's property for them. Since these managers are looking after other people's money it is thought that they should not be totally free from any control or supervision and the obvious persons to exercise some

control are the persons whose property is being managed. Hence the basic principle adopted by British Company Law (and, indeed, by the laws of most other countries) is that ultimate control over the directors should be exercised by the shareholders. This control cannot be exercised in detail and from day to day, but shareholders retain the ultimate sanction in that it is they who 'hire and fire' the directorate.

Enabling such control to be exercised has been a central preoccupation of company law. The main thrust of all the great company law reform reports that have emerged at roughly twenty-year intervals throughout this century has been towards increasing the amount of information that shareholders should receive in order to give them the means of exercising control over directors. By 1945 Lord Cohen and his Committee spoke of this control as 'illusory', and the 1948 Act which followed their Report sought to remedy the situation by clearly delineating the limits within which directors should have a free hand to do what they considered best in the interests of the company, and by laying down the very considerable information requirements in the Schedules to that Act that still largely govern corporate disclosure today. Seventeen years later, the Jenkins Committee considered the word 'illusory' an overstatement, because they thought that the rise of institutional shareholders made the use of the available weapons more likely. Concerning the rise of the institutional investor they were certainly right, but as regards the use by institutions of their proprietorial rights the verdict is less certain.

The problem stems in part from widely differing views on what the responsibilities of share ownership are, regardless of any difficulties in exercising the rights that go with it. There would, I think, be little dispute that the primary responsibility of the institutional shareholder is to the person—be it policy holder, pensioner, unit-holder or shareholder—whose savings are entrusted to its care. The difficult question then becomes how the institutional shareholder should conduct itself in regard to companies in which it invests: where does the interest of the ultimate beneficiaries lie?

Some would argue that it lies mainly in preserving maximum freedom to switch investments, and that therefore it is wrong for an investment manager to put himself in a position where his ability to buy and sell shares could be inhibited by the possession of 'inside' information which would be the almost inevitable consequence of seeking to monitor performance by any means other than analysing published information. Furthermore, the argument runs, even supposing that by direct contact with the management of a company early warning of impending trouble is obtained, what competence or standing has the investment manager to diagnose the cause of the trouble or prescribe a relevant cure?

There is force in these arguments—and I certainly should not dispute the central feature of transferability of shares or the desirability of diverse assessments of performance and prospects by different investors—but the arguments do not seem to me conclusive. In a situation where institutions hold approaching 50% of total listed United Kingdom equities and where in some companies the holdings of the major institutions are sufficiently large for it to be impossible to dispose of their holdings without sharply adverse price movements, it may well be a matter of simple self-interest to seek improved performance, which in turn may well coincide with the national interest.

This is not to imply that in such cases institutional shareholders should seek to intervene in a detailed way, for that would be to negate a basic principle of company law that directors are appointed to manage a business on behalf of its proprietors, nor certainly does it imply that institutional shareholders should harass management. But that ultimate power of hiring and firing, as Professor Gower put it, is an important power. Institutional shareholders should take trouble to ensure that directors of companies in which they have important investments are doing a good job. If they are doubtful or uneasy, they should ask for explanations and expect to receive them. Thereafter the nature of the appropriate action will depend on the circumstances of the case. But if in the end they are dissatisfied, they should, individually or collectively, take steps to change the composition of the board.

No doubt this will involve a greater degree of contact between institutional shareholders and companies than has in practice generally been the case, although not, I suggest, any greater than company law envisages. There is, however, unlikely to be—and should not be—any particular unified pattern about how it is achieved. One line of advance may well be in the development of means of fostering collective action by institutions in appropriate cases.

It was indeed the awareness induced particularly by the Rolls-Royce bankruptcy in 1971 that providers of finance to British companies, equity and loan finance alike, could with advantage monitor their investments more closely that led to the first steps in this direction. The initiative of my predecessor Lord O'Brien resulted in the formation of the Institutional Shareholders' Committee in 1973. A similar preoccupation was a strand in the thinking which made it seem desirable to achieve a less passive rôle for the Finance Corporation for Industry, which in the same year had been merged with the Industrial and Commercial Finance Corporation to form Finance for Industry Limited (FFI), and was provided with substantial additional resources in the winter of 1974/75.

More recently Equity Capital for Industry (ECI) was established with most of the major institutional long-term investors as shareholders. Its prime purpose was to ensure that funds were available for companies which might have an immediate need for equity capital in excess of what could be raised on the market on the basis of current or early prospective profits, but whose long-term prospects appeared favourable. It was always envisaged, however, that it could have a secondary rôle as a vehicle for collective action where necessary.

These moves have been on a relatively small scale. Their importance lies largely in the catalytic effect they may have in helping to convince institutions of the advantages and possibilities of active interest as appropriate in the fortunes of companies in which they invest. It is for the institutions themselves to work out

the occasions and forms for collective action, and a major burden in this respect will inevitably fall on the larger among them. In some cases, there may be an enhanced rôle for the representative body of a particular group of institutions. In others, it may be appropriate to consider ways in which the rôles of the Institutional Shareholders' Committee or ECI might usefully evolve. Such suggestions are likely to commend themselves to some and to be regarded as heresy by others. To those who take the narrower view of shareholders' responsibilities, however, I would like to suggest that shareholders in the widest sense have an interest not only in the performance of particular investments, but also in the efficient operation of companies in aggregate.

Mention of FFI is a reminder that not only shareholders but creditors can have a rôle in monitoring and improving company performance. Banks, like institutional shareholders, have responsibilities to others, their depositors and shareholders, and this provides their direct incentive to efficient lending. As the emphasis in that lending has over recent years shifted from its overwhelming weight on overdrafts in the direction of increased term lending to companies, the need for effective monitoring has correspondingly grown. From the point of view of companies themselves, the provision of the information necessary for banks to monitor performance effectively should be regarded as a natural function. From the point of view of lending banks, the seeking of such information should be regarded as equally natural, and no doubt generally is. Nevertheless, it is noticeable, in a number of problem cases of which we come to hear in the Bank, that banks sometimes do not know how great is the total indebtedness of companies to which they have lent. Such instances suggest to me that there could be room for improvement which might pay valuable dividends in terms of earlier warning of corporate problems and thus facilitate remedial action.

I do not want to suggest that a more active rôle towards companies on the part of suppliers of funds should be purely aimed at the prevention of trouble. There is, as I have suggested, a positive rôle of encouraging improved performance throughout the corporate sector which is very much in the interest of all. What the providers of funds can contribute towards that improved performance is essentially to freshen the wind in which companies operate. The main task, however, lies within the companies themselves.

Boards of directors

And within the companies, the responsibility for good performance lies firmly with directors. Our company law has little to say about how boards of directors should be structured. Consequently, a wide variety of forms has flourished: there are boards containing only executive directors, there are boards of executive directors leavened with a small number of non-executive directors, there are boards with a majority of non-executive directors. There are finally—and perhaps increasingly among large companies—boards of holding companies whose characteristic, whether or not they contain directors with executive responsibilities somewhere within the group, is that they act as a non-executive board and thus *de facto* are analogous to the supervisory board of the two-tier Continental system. Such rich diversity has much to commend it, for it is unlikely that one particular structure would be equally appropriate to companies of widely differing size and activities.

Nevertheless—and however distinguished the exceptions—there are, I believe, dangers for the efficient management of a company where all the directors are either managing or executive directors. Timely monitoring of management's plans and performance can most effectively take place at board level itself, since that is where plans are discussed and decided upon and where the results of their implementation are first thrown up. But if the board is composed wholly or largely of those with management responsibility the check of external and detached scrutiny is absent or weak.

In the United States, the Chairman of the Securities and Exchange Commission has recommended that non-executive directors should be in a majority on the boards of all companies listed on a stock exchange. The principle of a board having responsibility for the oversight of management is carried to its logical conclusion in the system of two-tier boards prevalent in some Continental countries. I do not think it would be prudent or practical for us in this country to move directly to either of these positions. I am clear, however, that the inclusion of a number of non-executive directors on all boards is, as the CBI Watkinson Report of 1973 concluded, a highly desirable goal.

The difficulties are evident. Being a non-executive director should in no sense be regarded as a sinecure. It requires both time and effort. Where do you find enough competent people willing to give both? How do you reward them adequately for doing so? How do you prevent them getting stale? How do you ensure that they are their own men, and not representatives of any particular shareholder or group of shareholders? How do you ensure that they have access to the information necessary for them effectively to perform the functions required of them? In view of the size and complexity of many multi-national companies, how can any non-executive director comprehend the totality of the business sufficiently to be able to make any worthwhile contribution?

But the advantages to be gained from the proper use of well-selected non-executive directors are plain. Management's plans are submitted to critical independent scrutiny. Broader perspectives than those of management alone are brought to the affairs of a company. The choice of management's succession is likely to be more effective because less incestuous. Management is seen to be accountable.

None of the difficulties I have enumerated is insurmountable, given time and the will. Companies themselves might be more willing to release their own senior management to serve as non-executive directors of others if they reflected on the advantages they would reap from the greater experience their man would gain.

There is obvious scope for recently retired executives to act as non-executive directors. It may well be that the pressures of modern corporate life will lead to an increasing desire on the part of senior management to detach themselves at an earlier age from the rigours of executive responsibility, and that the prospect of useful and interesting involvement as a non-executive director would make them the more willing to make the move. In order to make it possible to reward them adequately, fiscal changes may be necessary. In order to retain their interest and freshness, it may be necessary to consider some limit to the period they serve on any one board.

The acceptance of an invitation to serve as a non-executive director is not to be taken lightly. The responsibilities are onerous. But the willingness to undertake such responsibilities seems to me to be part of the commitment to the well-being of the business sector as a whole that members of this Institute should have and that the Institute itself should seek to foster.

Audit committees

It is from this conviction that I approach the question of audit committees, which may provide an answer, although by no means the only answer or a complete one, to the problem of access to information. I was delighted to see that this Institute recently combined with the Institute of Chartered Accountants in England and Wales in sponsoring a conference to consider the subject.

Views about audit committees tend to be polarised. The opponents argue that conditions are different in the United States and Canada, where as you know, they are now mandatory for companies quoted on the New York and certain Canadian stock exchanges, that the variety of types of company organisation in the United Kingdom makes it inappropriate to seek to make them mandatory here, that they provide no guarantee of an independent check on management and that they are wrongly conceived in principle because they derogate from the concept of the whole board being responsible for the financial affairs of a company. The proponents of audit committees—and that would appear to include many in the accountancy profession—would not necessarily dispute the differences between corporate organisation, or for that matter between the current subjects of corporate preoccupation, on either side of the Atlantic. They would, however, argue that audit committees provide a means for improving channels of communication between auditors and boards of directors—which implies a feeling that such channels are not always as effective as they should be; that this would serve both to educate the board as a whole about the financial management of their company and to enhance the independence of auditors from management. Furthermore the existence of an audit committee should give shareholders a further degree of reassurance both about the credibility of financial statements and that a company's non-executive directors take their responsibilities seriously and that a board takes its non-executive directors seriously.

The fact that auditors themselves feel that their efficacy is enhanced where audit committees exist is persuasive testimony in their favour. It reinforces our own experience in the Bank, where, in a number of the problem cases with which we have been involved, the likelihood of troubles being identified in good time might have been increased had an audit committee been in existence to help outside directors perform their function. The real and practical value of an audit committee is, to quote the words of the standard work on auditing in the United States, that 'it forces both auditor and management to take a more aggressive approach toward solving problems that they might otherwise be inclined to learn to live with'.

To say this is not to suggest that they should be made a statutory requirement, or that their existence is likely to be a sufficient condition for pre-empting trouble. I do suggest, however, that they provide a useful mechanism for assisting non-executive directors to carry out their functions, and that every quoted company should give serious consideration to whether an audit committee might not help to improve its performance.

All that I have said so far suggests that concepts of the rôle of directors in companies are undergoing change. Directors must expect—and respond to—a more active interest in the performance of their companies than they may have been accustomed to. They must become more aware of their supervisory responsibilities towards management—in some cases, detach themselves somewhat, perhaps, from the management function itself. None of this depends on any change in company law. Indeed, as I have tried to show, it would in many respects involve aligning practice more closely with some very basic principles on which existing company law is founded.

Employees

But as I have already mentioned, the rôle of directors seems likely to be affected by legislation as well. As well as defining the general fiduciary duty of directors and the degree of care, skill and diligence to be expected of them, the Companies Bill currently before Parliament specifies that directors in the execution of their functions should have regard to the interests of employees generally as well as to the interests of shareholders. The harmonisation of company law within the European Economic Community is bound to have legislative consequences beyond those contained in that Bill, and would have ensured that questions relating to industrial democracy should be on the agenda, even had we not had the Bullock Report. In this area, as in others relating to the organisation and operation of companies, best practice should desirably precede and form the basis for legislation rather than be imposed by legislation. I have suggested that the improvement of company performance is mainly an internal rather than an external task. What then does best practice suggest should be the rôle of directors in relation to their employees?

Best practice in companies for many years has, of course, included, as is only sensible and realistic, taking into account the interests of employees. Not only is there a mass of legislation outside company law itself, such as the Factories Acts, the Employment Protection

Acts, Workmen's Compensation Acts and so on which assures for employees a wide range of rights, but also no conscientious board of directors can, or ever could, ignore the interests of employees, because to do so would impair the performance of the company and indeed, in extreme cases, put in jeopardy the continuation of a company as a going concern.

Nevertheless in many situations the interpretation of employees' interests is a particularly difficult task, and is likely to become increasingly so. Much of British industry is currently overmanned in comparison with our competitors. The short-term interests of employees may be in hanging on to the overmanning in order to keep jobs now, but the long-term consequences may be the total closure of a factory and the loss of all jobs. Moreover, given the high rate of turnover of labour in many of our industries, only a small proportion of today's employees may see themselves as long-term employees of the company. I have no doubt that a greater identification of employees with the company in which they work would greatly ease many of our industrial problems. Recent developments in legislation making it more difficult to dismiss employees may have the effect of making more companies regard themselves as offering a career rather than a short-term job. If a corresponding attitude develops on the side of employees so that they have more care before they take action which damages the company's future then some of our industrial relations problems may ease. The task of directors in looking after the interests of both employees and shareholders would also be easier.

How can this feeling among those working together in an organisation of a common involvement in its success be achieved? The first step towards creating the necessary commitment must surely be to create an information structure for employees whereby the simple economic arithmetic of the financial figures relating to a particular business can be communicated, and the necessary connexion between that business's success and the prosperity and employment of its employees demonstrated. This applies as much to explaining past results as it does to consulting on future plans.

This represents an important challenge to management, which must be met. I do not minimise its difficulty nor deny that in some cases it may seem an uphill and at times unrewarding struggle. Partly this may reflect a legacy of inadequate contact in the past. But such deficiencies, where they exist, must be overcome, for the world in which we live is one where authority is no longer accepted in an unquestioning way. The commitment of employees has to be won by explanation and reasoning and be based on mutual trust.

It is the task of company boards to ensure that management does meet the challenge, and at the same time to give them all the support and assistance they need in doing so. This will involve directors paying particular attention to the problems of managers in the vastly more complex environment in which they must operate in order to ensure that their morale is not destroyed nor their effectiveness diminished. And it also involves, I believe, seeking to bring about an increasing awareness on the part of trade unions themselves that the old battles to secure the rights of workers, which brought them into existence, have been largely won, and that one of their main rôles now must lie in a co-operative effort with management to develop successful enterprises able to meet competition in both domestic and export markets. It is on this that the well-being of their members and of the country depends.

It was of course with the objective of increasing the commitment of employees to their companies that the report of the Bullock Committee proposed the introduction of workers' representatives on to company boards. That recommendation has produced a great deal of argument, and the debate is still continuing.

I do not propose to step very far into that particular minefield of controversy this evening. But there are two obvious points I would wish to underline. The first is that the basic concept of the company board is that all directors have a primary duty to the company; the concept of members of a company can be redefined in various ways, for example to embrace shareholders and employees, but it would be an entirely new concept of the board—and one which I think would prove unworkable—if different directors felt themselves accountable to different groups. I do not therefore see a case for institutional shareholders appointing directors whose only duty would be to the institutional interests nor for worker directors whose only duty would be to the employees. The second point is that in so far as the appointment of worker directors was recommended as a means of changing the attitude and rôle of the work force and the unions and hence of improving the viability of companies, all proposals in this field need to be examined very thoroughly against that primary objective. In this connexion it must not be forgotten that in companies beyond a certain size, there are certain inescapable organisational imperatives. When all the consultation and participation has taken place someone still has to be responsible for taking decisions, and that responsibility lies firmly with directors and managers.

Conclusion

I have not sought to disguise that I foresee a period of change and perhaps some tension for company boards originating in economic and social pressures in our changing society. In such a situation the personalities of people as well as their qualifications and experience become very important. There will be plenty of opportunities for quality and leadership to reveal themselves. You will all readily understand, I am sure, that I am saying, in the words of the old Confucian curse, that directors will live in interesting times. Their ability to survive them will depend in large measure on the imagination and flexibility with which they respond to pressures towards change.

I have emphasised the degree to which our economic fortunes are tied up with companies and the rôle directors are called upon to play in companies. You will I trust therefore be ready to think me sincere, not to say self-interested, when I wish you well.