

The composition of company boards in 1982

The contribution that non-executive directors can make to company management is increasingly recognised. This note discusses the role of the non-executive director, and reports the results of a recent survey by the Bank of the 1,000 largest industrial companies.

There is encouraging evidence that more companies are appointing non-executive directors.

The December 1979 *Bulletin*⁽¹⁾ reported the results of a Bank survey of the board structure of the 1,000 largest industrial companies; it showed the extent to which non-executive directors were represented on company boards, and how this had changed since a previous enquiry conducted by the Bullock Committee⁽²⁾ in 1976. Estimates prepared for the 1979 article were derived from an examination of company accounts; because non-executives were in most cases not clearly identified, this involved a number of arbitrary assumptions. The Bank has now undertaken a new enquiry into the number of non-executives, on this occasion seeking information directly from the companies on the latest *Times 1000* list. The results are described in this note. They reflect the ready co-operation of a large majority of the companies approached, and are more soundly based than those previously reported. First, however, the note discusses the growing interest in the role of non-executive directors, and the recent establishment of a specialised agency to draw attention to this role and to assist companies in making suitable non-executive appointments.

The role of non-executive directors

It is increasingly recognised that non-executive directors, properly chosen and used, can make an important contribution to the management of a company. A suitable non-executive director will generally be able to offer detached and independent advice that full-time executive directors may be less well placed to give, and he may also be able to provide additional expertise in specific areas, such as finance. The wider perspective that a non-executive director can bring to bear may be particularly relevant in decisions involving company strategy, or when events of special importance to the company's future, such as mergers and acquisitions, are under discussion. Additionally, he may play a special role in advising the Chairman on particularly sensitive questions such as succession planning. But if he is adequately to fill this role, the individual appointed to a non-executive directorship clearly needs to have the right qualities not only in general but also for the particular board. Specifying these qualities and identifying suitable

individuals, and encouraging them to accept non-executive appointments, can be a difficult and sensitive task.

With these concerns in mind, and in the light of their common belief that increased use of suitable non-executive directors will in the long run lead to improved company performance, the Bank and a number of City institutions, together with the Confederation of British Industry and the British Institute of Management, agreed to form an agency known as Promotion of Non-Executive Directors.⁽³⁾ PRO NED has four main objectives:

- To promote the wider use of non-executive directors, and to provide general guidance for non-executive directors on the discharge of their duties.
- To be available for consultation with company chairmen to discuss the potential value of non-executive directors on their boards and the advantages which a board might expect from their appointment.
- To be in contact with the chairmen and chief executives of companies who might be ready to make available themselves, directors or senior personnel, to take on a non-executive directorship on the board of another company.
- To compile a register of candidates, and to be ready to provide a company which seeks its help with names of suitable non-executive directors of the appropriate quality from which a choice might be made; and to this end to give help wherever possible on the assessment of the qualifications and qualities of individual candidates and their suitability for particular appointments.

PRO NED operates entirely independently, and individuals appointed with its help to the boards of companies are not in any special sense accountable either to the sponsors of PRO NED or to PRO NED itself: indeed, if they were to be so, this would be inconsistent with the requirements of company law, under which directors are individually accountable to all of the shareholders of a company for their stewardship of its assets.

(1) Pages 392-3.

(2) *The Report of the Committee of Enquiry on Industrial Democracy*, HM Stationery Office, Cmnd 6706, 1977, page 62.

(3) PRO NED was established in February 1982. The sponsors are: the Accepting Houses Committee; the Bank of England; the British Institute of Management; the Committee of London Clearing Bankers; the Committee of Scottish Clearing Bankers; the Confederation of British Industry; Equity Capital for Industry; Finance for Industry p.l.c.; the Institutional Shareholders' Committee; and the Stock Exchange.

In its first year, PRO NED has established a register of more than 600 potential non-executive directors, and more than 120 companies or other organisations have approached PRO NED to offer or seek assistance. Some twenty-five appointments have so far been made with the involvement of PRO NED, an encouraging total given the extreme care needed to match the candidate to the company for which he or she is being considered.

A survey of board structure

The survey was based on the *Times 1000* list for 1982-83; on this occasion the Bank wrote to each of the companies on that list, asking them to indicate the size of their board, and the number of non-executive directors, in both 1979 and 1982. More than 700 companies responded in time for inclusion in this article; the Bank is most grateful to these companies for their assistance.

The previous survey was conducted on a different basis; its results were derived from an examination of the annual reports of companies on the *Times 1000* list. Non-executive directors, where their status was not in some way indicated elsewhere in the report, were identified from the statutory information on directors' salaries: in general, a director earning less than £7,500 per annum was assumed to be non-executive. Although this served to give a general indication of the number of non-executive directors, it was not an entirely satisfactory approach, and the data could not, without much qualification, be compared with that given in the Bullock report, the figures in which were based on direct returns from companies.

The methods adopted for the present survey might be expected to produce a more accurate classification of directors, but, even so, some difficulties were experienced. Not all companies, for example, could provide directly comparable figures for both years, often because of reorganisation or merger. Additionally, in some cases it was still difficult to distinguish very clearly between non-executive and executive directors; this was a particular problem where a company was controlled by another, and where some of the directors were executives of the holding company. While the functions of such directors, and their salaries, may appear to equate to those of non-executives, such individuals cannot realistically be described as independent. So far as possible the data has been adjusted to avoid classifying such individuals as non-executive;⁽¹⁾ these adjustments will tend to produce a lower estimate of non-executive directors than the method apparently used for the Bullock report's figures, so comparisons still need to be made with some care. A further problem is the possibility that responses to the Bank's enquiry may be biased, in the sense that companies which have non-executives might be more inclined to respond than those which do not. However, a limited examination of the annual reports of non-respondent companies indicated that the proportion of non-respondents having no non-executives on their boards

Table A
The spread of non-executive directors

Number of non-executive directors	Companies in <i>Times 1000</i>		
	Bullock Survey	Bank 1983 Survey	
	1976	1979	1982
		Percentages	
6 or more	10	10	11
3, 4 or 5	26	33	36
1 or 2	39	34	33
None	25	23	20

was not appreciably different from that of respondents; response bias may not, therefore, be a significant defect.

The results of the survey indicate that the number of non-executive directors has continued to increase. The proportion of companies in the *Times 1000* which have no non-executive directors fell from 25% in 1976 (the Bullock report's figure) to 23% in 1979 and 20% in 1982, and there has been a substantial increase in the number of companies with three, four, or five non-executives on the board, a level probably sufficient to ensure the non-executive component of the board a reasonably strong voice.

The figures for 1979 derived from the present survey differ from those in the earlier survey, which indicated that as few as 12% of companies had no non-executive directors—the present survey gives a figure of 23% for 1979. About half of the difference may be accounted for by the adjustments described, whereby part-time directors who are also executives of a holding company have not been treated as non-executive. But the latest results nonetheless indicate that the previous survey, perhaps by taking too high a cut-off point in distinguishing between executive and non-executive remuneration, may have overestimated the number of non-executives and to some extent exaggerated the upward trend.

The Bullock report did not give an indication of the total number of non-executives (the data was in substantially the form of Table A), so it is possible to make comparisons of aggregate data only between 1979 and 1982. The latest survey indicates that the average number of non-executive directors rose slightly in this period, and with a marginal reduction in average board size, the proportion of non-executives rose from 27.9% to 30.4%. In the same period, the proportion of companies with non-executive

Table B
Effect of company size

Number of non-executive directors	Companies in <i>Times 1000</i> : 1982		
	Top 250	Next 750	Top 1000
	Percentages		
6 or more	20	7	11
3, 4 or 5	44	33	33
1 or 2	24	37	36
None	12	23	20
Ratio of non-executive to total directors	32.6	29.0	30.4
Average size of board	11.1	7.8	8.7
Average number of non-executive directors	3.6	2.3	2.7

(1) Some respondents to the Bank's enquiry suggested that former executives of a company who remained, after retirement, as non-executives, might also not be regarded as independent. However, it was not felt that there was a sufficient basis for excluding these individuals from the non-executive category.

directors comprising more than a quarter of the board increased from 49% to 54%.

As in the previous survey, a greater proportion of larger companies than smaller ones had non-executive directors: only 12% of the top 250 companies had no non-executives, compared with 23% for the remainder of the *Times 1000*. But despite the lower number of non-executive directors on the boards of the smaller companies, their proportion of board size, at 29%, is not markedly different (Table B.)

Non-executive directors may be seen as particularly appropriate to the needs of listed companies, and PRO NED's main, though not exclusive, concern is with companies whose shares are widely held and which will therefore probably be listed. Some difficulties in interpreting the precise status of non-executive directors on the boards of subsidiary companies (which tend not to be listed) have been noted. The results have therefore been reclassified to show separately stock exchange listed companies and other companies (Table C); listed companies account for about two-thirds of the sample.

Table C
Effect of company status

	Companies in <i>Times 1000</i>			
	Listed companies		All other companies	
	1979	1982	1979	1982
	Percentages			
Number of non-executive directors				
6 or more	10	12	8	9
3, 4, or 5	40	45	20	21
1 or 2	35	34	34	32
None	15	9	38	38
Ratio of non-executive to total directors	29.8	33.1	24.2	24.8
	Number of directors			
Average size of board	9.5	9.3	7.8	7.8
Average number of non-executive directors	2.8	3.1	1.9	1.9

The breakdown shows that listed companies tend to have more non-executive directors on their boards than unlisted companies. Also, the fall over the past three years in the number of companies with no non-executive directors is entirely accounted for by listed companies.

Assessment

Although a large number of companies still have no non-executive directors, the results of the survey represent encouraging evidence that non-executive appointments are increasing, especially among listed companies. But while the number of appointments is obviously relevant, it is equally if not more important that they should be carefully planned, that only suitable individuals should be considered, and that, once a non-executive director has been appointed, company chairmen and other board members should make proper use of the talents that thus become available to them.

In preparing this and the previous article, the Bank was conscious of the paucity of information ordinarily provided by companies on the functions and duties of board members. Encouragingly, a growing number (albeit still a minority) of the largest industrial companies now specify in their accounts whether directors are executive or non-executive; but this distinction alone may not be sufficient, particularly in the light of the problems of definition referred to in this note, and companies may wish to consider whether it would be helpful to shareholders and to others to show further information as a matter of routine. This would involve, for the executive director, an indication of the broad area of responsibility that each of them covers. As regards non-executive directors, it would also be helpful to show what other major external appointments they hold.