Composition of company boards

This article reports the results of a new study of company board structure, updating those published in 1983 and 1985.[1] The main findings are:

- *The trend towards an increasing number of non-executive directors on the boards of large companies has apparently slowed and, indeed, in certain categories been reversed—although the changes may be accounted for in large part by changes in the sample. On this occasion, it was made the aim to circularise all companies in the* Times 1,000, *with the exception of subsidiaries without boards of their own, rather than, as in 1985, only the smaller sample of companies who were (a) quoted and (b) had featured on the 1983 survey. Of the 549 respondents to the current survey, 57 (11%) had no non-executive directors on their board: in the 1985 survey the equivalent figure was around 5%. However, it remains the case that, for 60% of respondents, the board includes three or more non-executive directors. Similarly, in 60% of cases, non-executive directors constitute over 30% of the board.*

- *Slightly less than one quarter of the non-executive directors identified in this study were either former executives of the company or professional advisers to it—an appreciable change from the situation detailed in the 1985 report, where non-executive directors of such a background comprised almost one third of the total.*

- *It remains the case that one in three of the largest 250 companies still does not even indicate in its annual report whether directors are executive or non-executive and less than half give a short biographical note on them: this should be remedied as a result of a change in the listing requirement in September 1987.*

Background

The March 1983 *Bulletin* reported the results of an investigation into the size and composition of the boards of companies in the *Times 1000* list, highlighting changes in the composition of company boards in the three years to 1982. Evidence emerged that a growing number of companies, especially quoted companies, were appointing non-executive directors to their boards. This was thought to be a welcome development and one meriting continued monitoring and a further study was duly undertaken in 1985: this concluded that the trend was continuing. Although it was not suggested in the article, it could reasonably be assumed that this reflected, at least in part, the influence of 'Promotion of non-executive directors' (PRO NED) a body established in 1982 by a number of City organisations to exercise the function suggested by its title. In 1987 PRO NED published a code of recommended practice on non-executive directors[2] and it is instructive on this occasion to compare the results of the survey with the PRO NED recommendations. As a related exercise in 1985, the reports and accounts of most of the largest 250 companies in the *Times 1000* list were scrutinised to see how much information was published about the qualifications and experience of directors for purposes of comparison: that process has been repeated on this occasion.

Information provided by companies on their boards

Despite the inevitable and obvious effect of a company's chief executive and board on its performance, companies are not required either by law or (in the case of quoted companies) by the Stock Exchange to disclose details on the functions, skills or experience of board members to those who stand to be materially affected by a company's performance: viz shareholders, employees, customers and creditors. A significant minority—particularly those at the larger end—choose to do so. In future, companies will be under an obligation to do so.

The main published source of information on a company's affairs, its annual report and accounts, is required by law only to name directors, indicate their remuneration and show their financial interests in the company. In addition, every company has to maintain registers of its directors, of their own and their immediate families' interests in shares and debentures of the company and of directors' service contracts. However,

(1) 'The composition of company boards in 1982': March 1983 *Bulletin*, page 66. 'The boards of quoted companies': June 1985 *Bulletin*, page 233.
(2) See the May 1987 *Bulletin*, page 252.

while the first two registers may be inspected by members of the public, the register of service contracts is required to be open only to members of the company. Listed companies must, in addition, meet the requirements of the Stock Exchange on disclosure but these are little more onerous than the law prescribes for all companies. Moreover, disclosure of detailed information on directors is required only at the time that a company seeks a listing and there is no continuing requirement for listed companies to provide shareholders with information about qualifications, backgrounds and duties of directors.

The examination of the reports and accounts of most of the top 250 companies in the *Times 1000* list showed that only a minority of these disclose *significantly* more information about their boards than is required by law (figures from previous survey in brackets):

- 64% (48%) indicated which directors are executive/non-executive;
- 25% (20%) described executive directors' individual responsibilities (as distinct from merely identifying the Chairman and Deputy Chairman);
- 20% (13%) provided biographical information on directors (such as principal occupation and other directorships);
- 12% (6%) gave details of their audit committee and 11% (2%) details of their other board committees.

The implication thus remains that, despite a perceptible improvement, companies' reports and accounts may in most cases be an inadequate guide to the level of skills and experience on companies' boards—which, as stated in the past, may work not only against the interests of existing and prospective shareholders but also against the efficient operation of the capital markets.

A re-examination of company boards

The Bank on this occasion sent a questionnaire to the great majority of companies in the *Times 1,000* list, again on the assumption that non-executive directors have a more active role to play in larger companies. This is, of course, particularly true of quoted companies, which are characterised by a wide spread of shareholders. The sample, large though it is, should not, however, be regarded as representative of medium-sized companies not in the *Times 1000* nor of small companies.

Table A provides details of the sizes of the boards of the companies which returned questionnaires and of the number of non-executives on their boards. Company boards varied in size from two to over twenty but, of the 549 respondents, 212 (39%) had a board size of between six and eight, and 160 (29%) had a board size of between nine and eleven. At the extremes, less than one company in seven operated with a board of fewer than five, and fewer than one in twenty had more than fifteen directors.

Table A
Board size and numbers of non-executive directors

Number of companies

	Non-executive directors					
	0	1	2	3–5	6+	Total
Board size						
2–5	33	22	18	9	—	82
6–8	16	33	62	97	4	212
9–11	6	10	29	98	17	160
12–14	2	2	5	28	32	69
15+	—	—	1	12	13	26
Total	**57**	**67**	**115**	**244**	**66**	**549**

As regards numbers of non-executive directors, there was a similar disparity: 44% of respondents had fewer than three non-executive directors, although the inevitable bias of these towards the smaller board sizes implies that the divergence from the PRO NED code is not so marked as it might appear at first sight. Rather more than 10% had no non-executives, more than 12% only one and 21% only two. The apparent deterioration from the results of the 1985 survey may stem from the larger sample on this occasion and the inclusion of rather more smaller companies with, presumably, smaller boards.

The correlation between board size and the ratio of executive to non-executive directors seems to have changed since the 1985 study, when it appeared that companies at the extremes of board size generally had fewest non-executives, again probably reflecting the change in sample. In the current study, the ratio for all companies rises as board size increases but, for companies in the top 250 of the *Times 1,000,* those with either very large or very small boards continue to have fewest non-executives.

Table B
Board composition classified by size of board and size of company

Number of directors; *percentage in italics*

	Number of directors					
	2–5	6–8	9–11	12–14	15+	All companies
Times 1000 companies (549 replies)						
Average board size	4.52	6.96	9.78	12.68	16.62	8.91
Non-executive directors:						
Average number	1.21	2.44	3.56	5.43	7.08	3.18
Percentage	*27*	*35*	*36*	*43*	*43*	*36*
Times top 250 companies (144 replies)						
Average board size	4.29	6.96	10.12	12.72	16.53	10.90
Non-executive directors:						
Average number	3.14	2.20	3.82	5.26	5.63	4.17
Percentage	*73*	*32*	*38*	*41*	*34*	*38*
Times bottom 750 companies (405 replies)						
Average board size	4.55	6.96	9.62	12.62	16.86	7.76
Non-executive directors:						
Average number	1.03	2.48	3.44	5.73	11.00	2.82
Percentage	*23*	*36*	*36*	*45*	*65*	*36*

Table C shows the continuing prominence of non-executive directors on the boards of the companies studied: see also Table D. It remains broadly true that, as in 1985, for only three companies in five do non-executive directors comprise between 20% and 50% of the board, ie roughly in accordance with the PRO NED guidelines. Again as in 1985, in less than one company in five do non-executive directors constitute a majority—and a 60% majority in only one case in ten.

Table C
Proportion of non-executive directors on company boards

Non-executive directors as percentage of board	Number of companies	Percent of responding companies
0–10	62	13
11–20	75	14
21–30	90	16
31–40	115	19
41–50	107	19
51–60	50	9
61–70	26	5
71–80	12	2
81–90	8	2
91–100	4	1
	549	100

Table D shows that, overall, the average number of non-executive directors has remained stable but has increased slightly as a percentage of total boards, although the change in the size of the sample makes drawing too precise comparisons somewhat hazardous.

Table D
Comparison with the 1983 and 1985 studies

Number of non-executive directors	1983	1985	1988
	Percentage of companies		
0	8	6	10
1	14	12	12
2	22	21	21
3–5	43	48	44
6+	13	13	13
Average size of board	9.4	9.0	8.9
Average number of non-executive directors	3.1	3.2	3.2
Percentage of total board	33	35	36

The PRO NED code stresses the need for boards to include an adequate number of non-executive directors who are independent; independence in this context is defined mainly with reference to financial links with the company or to previous service as an executive. To provide an idea of the numbers of non-executive directors who met these criteria for independence, companies were asked to indicate how many of their non-executive directors were serving or had served the company in a professional capacity and how many were former executives of the company or its subsidiaries. The 1985 survey revealed that 209 companies—three in five of those in the study—had appointed professional advisers

Table E
Non-executive directors who are former executives or have professional connections

Total number of directors	4,886
Total number of directors on boards of companies with some non-executives	4,379
Total number of non-executive directors	1,764
Total number of non-executives who are former executives	235(a)
Total number of non-executives who have professional connections	199(a)

(a) There is an element of overlapping.

or former executives as non-executive directors: such directors accounted for nearly one in two of the non-executive directors of those companies and roughly one in three of all the non-executive directors covered. In the current survey, Table E indicates that at least 75% of non-executive directors covered by the current survey had no present or previous professional relationship with their company nor had served as an executive.

The role of the chairman

It is widely argued that the chairman of the board is better placed if he is not at the same time the company's chief executive or managing director; the position of the non-executives is also strengthened when the two roles are separated. The argument does not, however, seem to be accepted by the majority of UK companies—as Table F testifies.

Table F
Duties of chairman
Numbers of companies; *percentages in italics*

	Full-time chairman				Part-time chairman				Total
	With executive office		Without executive office		With executive office		Without executive office		
Times 1,000	222	*40*	114	*21*	97	*18*	116	*21*	549
Times top 250	64	*44*	37	*26*	24	*17*	19	*13*	144
Times lower 750	158	*39*	77	*19*	73	*18*	97	*24*	405

On the assumption that responsibilities increase with the size of the company, it seems natural that, in the top 250 companies, the chairman should in the great majority of cases be full-time. It is, however, perhaps rather at odds with expectations that the incidence of the chairman's having a major executive role should, for the top 250 companies, be so high as 61%—and should actually be higher (albeit only slightly) than for the remaining 750.

Audit committees

The PRO NED code suggests that the task of the non-executive directors will be facilitated by the establishment of audit committees, composed wholly or mainly of non-executive directors; accordingly the questionnaire for the current survey asked whether an audit committee existed. The results are shown as Table G. A majority of the 144 respondents from within the *Times 250* reported the existence of such a committee but only just over 30% of the 405 respondents from the remainder of the *Times 1,000* had established such a body.

Table G
Audit committees
Numbers of companies; *percentages in italics*

	Companies with audit committees(a)		Companies without audit committees(b)		Total
Times 1,000	208	*38*	341	*62*	549
Times top 250	88	*56*	70	*44*	158
Times lower 750	120	*31*	271	*69*	391

(a) Companies with, or in the process of forming, an audit committee or its equivalent.

(b) Includes six companies whose full board regularly discharges the function of an audit committee.

Issues raised

In comparing the present survey with its predecessors, the increased size of the sample must be borne in mind. That said, it does seem that, numerically, the trend towards a greater total number of non-executive directors, which was detected in the early 1980s and highlighted in the 1985 study, has failed to maintain its momentum. Boards, however, seem to be getting smaller so that non-executive directors now account for some 36% of total board representation—very slightly up on 1985 levels.

Quality of non-executive directors is, of course, at least as important as their *quantity*—but inevitably much harder to measure. Using the definition of independence in the PRO NED Code, however, the picture seems to be improving. Over 75% of the non-executive directors picked up by the survey were neither former executives of nor professional advisers to the company.

The PRO NED campaign, which the Bank has supported since its inception, has clearly made its mark. There must, however, still be a questionmark over the pace of progress (which, in PRO NED's view, is not restrained by a shortage of good candidates). The reasons companies have for not following the PRO NED Code—which is endorsed by all its sponsors, including the Stock Exchange and the CBI—may, of course, vary a great deal. But all of them imply a degree of satisfaction about the place of executive management in the structure of the company which might in some minds raise questions about accountability and which is not echoed in the framework to be found for example in Germany, the Netherlands or major companies in the United States.