CONFESSIONS OF A COMPANY DOCTOR

WHY THE CORPORATE GOVERNANCE DEBATE MAKES SENSE

For the past 25 years, except for a five-year interlude in the public service, I’ve been rescuing companies in trouble – all of them UK-based companies but several with interests outside the UK. Two had some Australian connections, most especially Borthwicks, the international meat business.

My job has been to recover and repay borrowings (mostly bank borrowings), to retrieve as much value as possible for shareholders, and to preserve the entity. I’m glad to say that in each successive rescue the banks have been fully repaid (often to their surprise) and in almost every case the rescued company is today out of recovery and performing for its shareholders.

This has been strenuous but interesting, varied and fun. The range of activities has been very wide, from golf clubs to heavy muck-shifting to meat, from casinos to storefitting to fine printing. And in personally tackling these companies, as well as studying and advising on around a hundred more, I’ve seen pretty well everything there is to see in the way of bad management and bad corporate governance.

In the UK we have had for three years and more a great deal of public concern about corporate governance – boards of directors, corporate controls and so on – and a tremendous amount of media discussion, much of it very superficial. The concern, in its origins, was reasonable and sensible enough, fuelled by a number of very prominent, spectacular cases: Maxwell, Polly Peck, Bank of Credit & Commerce International and others, and recently Barings.

Were these disasters caused by feeble boards, weak controls and defective financial reporting? Are there rules, guidelines or attitudes that can be put in place to prevent another wave of corporate disasters?

Superimposed on the debate on governance, the area covered by the Cadbury Report, there has more recently developed a furore over boardroom pay, share options and so on. In one sector, the privatised utilities, there is substance in this, but across industry as a whole it is less reasonable, more emotional, and very much fed by the media, for whom the earnings of footballers and pop stars are matters for admiration and approval, while the (usually far smaller) earnings of chairmen or chief executives of major companies are pilloried and made the objects of silly personal comment and whipped-up envy.

The “governance” and “boardroom pay” debates have coincided with and are blurred by a few cases of questionable propriety on the part of MPs and other politicians. A large, damaging degree of cynicism, even contempt, has consequently got into the public mind, and it will take considerable time and patient effort to restore a sense of proportion. This cynicism or contempt is not good for industry, it’s not good for business, it’s not good for the economy; and anything that can be done to avoid creating or fuelling such a public mind in Australia must be worth doing.

WHAT WE MUSTN’T LOSE

Business will only succeed if it is led by people who drive: drive their companies,

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drive their team, drive themselves. And whatever we do, say, prescribe or regulate, we have to leave room for the driver - the entrepreneur - to operate. Any board set-up, any board and management relationship and for that matter any chairman and chief executive relationship, has to encourage enterprise, initiative and ideas. There has to be enough questioning, enough accounting, enough challenge to spotlight possible problems; but the system must not confine, discourage or cramp the growth-minded. The balance between dictators and ditherers, management scope and management sleaze, is not easy to strike, but we have to try.

THE BOARD
Separation of functions
There should generally be a separation of chairman and chief executive - and you in Australia have on the whole gone further in adopting this than we have in the UK.

But, having said all that, there will be phases - in the growth of an enterprise, in the development of an entrepreneur himself and, I would add from long personal experience, in the early stages of corporate recovery when one individual needs to fill both roles. And then, the counter-balance is a good non-executive element, independent, experienced, sympathetic to what the entrepreneur is attempting but weighty enough to civilly, rationally ask the sometimes penetrating questions.

Non-executives - many, few, enough?
In Australia the average board is not the same as in the UK but the principles are similar. In any board (with exceptions in the very smallest private companies) there should be non-executives; and there must be enough of them, both in weight and in number, to influence management, to debate among themselves, to bring various viewpoints to bear on company policy.

Except in insurance, banking and a few other areas, non-executives are seldom in a majority in the other areas, non-executives are seldom in view. And, if there should be enough of them, both in weight and in number, to influence management, to debate among themselves, to bring various viewpoints to bear on company policy. And then, the counter-balance is a good non-executive element, independent, experienced, sympathetic to what the entrepreneur is attempting but weighty enough to civilly, rationally ask the sometimes penetrating questions.

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Non-executives - the search
We need non-executives; in fact, if we are to staff up all boards (certainly in the UK) to the numbers recommended, we need a great many non-executive directors.

The finding and appointing of all directors, executive as well as non-executive, has become a more careful, professional business than it used to be, and the days of the chairman's thinking round his own circle of friends and acquaintances are passing.

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Women – we need them

A special feature is the need to get more women into boardrooms. They are, in the UK, still a tiny minority, and this in spite of some real pressure on companies to move in this direction. Chairman and boards still tend to want women directors with much the same kind of experience as the men have themselves, and this results in very few women being seen as eligible. Those that are, are overloaded.

I believe that chairmen will have to broaden their ideas and come to terms with the different kind of contribution that women can bring. Many of the most able women have developed their ability in fields other than industry or commerce – perhaps health care, or higher education – and they therefore don’t have the language of management and the board. Maybe there is room for the Institute of Directors to run special courses not designed to turn senior women into clones of male directors, but patterned so as to preserve their special outlooks and insights.

THE CHAIRMAN AND THE CHIEF EXECUTIVE

Because I am a corporate rescue man, I’ve had more experience than most people of the chairman and chief executive relationship. In two or three cases I’ve had a really strong, good contact with my chief executive, usually chosen by me; in one or two cases I’ve had a very difficult relationship, partly because I tend to choose tough, decisive people, not middle-of-the-roaders. It is a relationship that needs considerable thought by both sides, and a great deal of openness and frankness, with at least some clearly understood guidelines.

The chairman is about running the board effectively and making sure that it works both as governance and as a contribution to policy and growth; and he’s about “patrolling the external frontiers”, keeping contact with shareholders (especially institutions), government, the media, and business collectively.

He is also about the broad lines of policy (on which he should be a close player alongside the chief executive) and the encouragement of growth and the development of people, especially but not only the next chief executive.

Meanwhile, the chief executive is about proposing and executing policy, running the show, framing the budgets, leading the team, delivering the bottom line. There will always be a grey, partly unmapped area between them, and the boundaries can and should flex according to personal strengths and abilities. What they must each have is respect for the functions of the other, total openness (I say to my chief executives: “I am always totally open with you about everything – everything except the run-up to removing you”) and a great deal of flexibility.

REGULATION

The corporate governance debate has been rolling around now for a few years, stoked at intervals by one or another high-profile collapse or other disgrace. The leading UK example was the dramatic failure of the Maxwell empire, although I have to say that I doubt if any amount of “governance” will cope with outright, totally amoral, lies and sustained misdoing.

But we have had several others: Polly Peck, BCCL, in a sense Lloyds of London, lately Barings, and it’s understandable (though perhaps simplistic) to find the public crying out that there should be governance arrangements that would have prevented or at least lessened these.

It was as a reflection of this that the Cadbury Committee was set up. It reported more than a year ago. Everyone probably knows the main lines of the Cadbury Report: separation of chairman and chief executive functions, statements required of directors as to compliance, auditor verification of those statements, remuneration committees, audit committees, a proper proportion of non-executives and so on. The report was deeply thought-through and coherently assembled and was a real step forward in our corporate culture.

Implementation of it might not catch the blatantly dishonest like Maxwell and some others, but I believe it will improve the honesty and realism of public statements, strengthen the checks and balances within boards and enable shareholders, if they use their chances, to look below the glossy surface and see further into “their” companies.

The Cadbury Report was well received and there was a surge of support; we all settled down to analyse what we were doing and how to change it or to restate it in Cadbury terms. But there was, too, a body of sceptics who disagreed with one or more of the recommendations.

It was not surprising that hard-bitten bosses who had been combined chairmen and chief executives for a number of years would cast doubt on the strongly recommended separation of functions. And there was at least one prominent, and successful, company head who had never had a non-executive director, was not going to have any and denounced them as expensive and useless passengers. Many others reckoned, some of them rightly but by no means all, that
they were already doing the kind of thing that Cadbury recommended.

But the Cadbury recommendations were certainly a positive stride forward, and if they were not exactly given teeth, they had the power to make themselves felt, because the stock exchange made statements of compliance or failure to comply a condition of listing.

Auditors

What was not foreseen, perhaps even by Cadbury, was the extent to which all this would become an auditors’ bonanza, because auditor confirmation was required for virtually every compliance statement (especially regarding the effectiveness of internal controls). Auditors are nowadays nervous of litigation and increasingly apt to shelter behind guidelines issued by their professional institutes instead of relying on judgment, so the processes have become rather mechanistic, and enormously cumbersome and expensive.

Cadbury’s consequences are only one aspect of a general tendency, in audit and control generally, to over-prescriptive-ness, checklists, guidelines and standards, at a big cost in intelligibility and commonsense – and certainly in money.

Smaller companies

Another negative aspect of Cadbury was, I think, a perhaps inevitable failure to tailor requirements for smaller companies as well as for big. Once again the sledge-hammer is painstakingly fashioned, and brought down with a crash on a butterfly. Many a government or similar committee has demonstrated how little “the great and good” know about the small, but still good.

In the UK the remuneration row has for the moment pretty well elbowed the rest of the governance debate to the edge of the stage, but we can expect things to liven up again soon, for a “son of Cadbury” follow-up committee is about to be launched.

Lessons and Questions from a Rescue Chairman

SOME LESSONS

In the field of regulation, what lessons do I draw from Cadbury and post-Cadbury?

• it’s better to achieve consensus on corporate practice than to wait for the government to impose what is likely to be too rigid a structure;
• transparency and disclosure should be the cornerstones;
• institutional investors have to pick up their responsibility for studying “their” companies and reacting sensibly, patiently but in the end firmly to what greater disclosure enables them to detect and diagnose;
• scrutinise any draft rules to limit, so far as possible, the need for expensive and often “overkill” auditor verification procedures;
• be aware that all of this greatly increases, indeed multiplies, the work expected of non-executives;
• whatever committee is used to draft new rules, make sure it is broadly representative, of small as well as large.

SOME MORE LESSONS

And, from Greenbury and otherwise, what lessons as to remuneration?

• attempts to control boardroom pay partly legislation, even by regulation, or by stock-exchange sanctions, are ill-advised, almost impossible to draft and bound to cause distortions;
• transparency and disclosure are the way forward on remuneration, as on governance generally;
• there are many alternatives to stock options, and boards should keep their eyes open for coming changes in methods of remuneration and incentive;
• as with governance, always remember the needs of smaller companies as well as big ones.

BOARDROOM PAY

The origins of trouble with directors’ pay in the UK go back more than 20 years, to the early 1970s, when there was misguided Labour government interference in pay differentials and unwise complicity on industry’s part with voluntary pay freezes.

These things built up a compression of differentials and a “coiled spring” effect that was almost bound to cause difficulty when a market economy returned. And this is now taking place within a pretty general “envy culture”.

The severe issue of directors’ pay and perquisites was triggered by a number of cases in denationalised utilities – gas, water, electricity – where the government had priced the companies too low, in order to be sure of attracting investors. As a result, the executives in place at the time, who had been granted options reflecting their strong positions in handling the sales rather than (in some cases) their proven abilities, received very rapid and considerable stock option gains. Some of these gains have seemed unusually excessive and unmerited and public feeling has been sharpened by the fact that these same executives were (perhaps rightly) at the same time severely reducing workforce numbers.

All of this led, predictably, to a committee, this time set up by the Confederation of British Industry (CBI) and chaired by the chairman of Marks & Spencer, Richard Greenbury. It worked fast, maybe too fast.

The committee brought out a number of quite reasonable recommendations, particularly as to transparency and full disclosure of earnings and the basis of calculation of incentive payments. Unfortunately they over-simplified as to the taxation of share options, unintentionally hitting middle and lower-level staff (but they should have known, and it shows again that the great-and-good have no idea how the small-and-good live). The political she-mozzle that resulted rather obscured the better bits of the committee’s work and we are certainly not at the end of this debate.