

# ARE YOU REALLY A DIRECTOR?



*There's no such thing as a non-executive director – or indeed an executive director. That's the view of Criticaleye Associate, **Bob Garratt**, who explains how and why boards must work harder to encourage independent judgment*

A curiosity of the UK's approach to corporate governance is its fixation with the Combined Code but a seemingly total ignorance of the Companies Act which underpins it.

The 'compliance cottage industry' that has been built by consultants has reached a point where if you are pronounced compliant on the regulations then you have 'done corporate governance', and boards can then get on with their 'real' business. As this often involves micro-managing the executives it is not a wise role for a board.

The problem is that the 'real' board roles are not easy to deliver. Most directors have been executives, so it's much easier to stick in the executive mindset and never graduate to that of an effective director. Is this because of an underlying but fundamentally incorrect assumption that there are two types of directors – non-executive and executive?

There are not: under the 2006 Companies Act it is crystal clear that there is only one type of director – the statutory director. To use the title 'director' one must have signed the appropriate contract and be registered at Companies House. Indeed, it is unlawful to call yourself any other type of director.

#### SEVEN DEADLY SINS

Despite this primary requirement, few people seem to have read the Companies Act and even fewer current directors seem to take seriously the 'Seven Non-Exhaustive Duties of Company Directors', which were the first part of the new Act to come into being in 2007. Neither 'Non-executive' directors nor 'executive' directors are mentioned in this primary legislation. Sadly, these terms have slipped into the recommendations of the Combined Code which has created confusion.

To explain, the seven duties of directors are to:

1. Act within their powers
2. Promote the success of the company
3. Exercise independent judgment
4. Exercise reasonable care, skill and diligence
5. Avoid conflicts of interest
6. Not accept benefits from third parties
7. Declare interests in proposed transactions

Duty 1 is defined by the company's Memorandum and Articles of Association.

Duty 2 is now mandatory and needs constant attention in recessionary times. Duties 5, 6 and 7 now have a lot more board scrutiny since the Bribery Act went live in 2011.

The difficult ones are duties 3 and 4. These can be seen as 'soft' and difficult areas in which to

## Can an executive who is also a statutory director on their own board ever be able to provide truly independent judgment?

ensure compliance. Yet, for board directors, the 'soft stuff' is often the hardest because it has to ensure that it addresses the continuous dilemma of driving an enterprise forward while keeping it under prudent control.

This needs a strong element of dispassionate oversight from the 'directors' combined with a strong sensitivity to the coming uncertainties of the future. Few boards manage this balance well. Fewer still regularly assess their duties of care, skill and diligence – despite the regulatory demand to do so.

#### GENUINE INDEPENDENCE

It's the duty 'to exercise independent judgment' which causes huge problems with boards that insist on using the titles of non-executive director (NED) and executive director. While there is general agreement that you need a sufficiently diverse board – so that it can constructively criticise its own policies and strategies and the operational effectiveness of the executives – can an executive who is also a statutory director on their own board ever be able to provide truly independent judgment?

All statutory directors receive a full-time contract for services as a director. They are always on duty and have full personal liability regardless of what they are paid. Admittedly, NEDs often find this aspect of their statutory duties easier to deliver than their executive

director colleagues; an executive director might perceive it as a career-threatening decision to put a counter-argument to the CEO at a board meeting. And if the executives agree a 'stitch-up' before a board meeting, how can they think independently when the NEDs propose better ideas and information?

Still, it's no excuse. One solution is to have two contracts of employment for 'executive directors': one for their operational work as an executive and a second for their specific services as a statutory director. If statutory directors are required to have a separate contract it does avoid some messy role confusion. Naturally, it will require a little training – and a tough Chairman – to make it work.

© Criticaleye 2012



**Bob Garratt**  
Associate, Criticaleye

Bob Garratt is advisor to KPMG LLP on board effectiveness and corporate governance. He has Visiting Professorships at the Business Schools of Cass, London, and Stellenbosch, South Africa. His book *The Fish Rots From The Head: Developing Board Effectiveness* is now in its third edition.

Contact Bob through [www.criticaleye.net](http://www.criticaleye.net)