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Nigel Peace
Secretary
Committee on the Financial Aspects
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29 July 1992

Dear Mr Peace

Comments on the Draft Report -
The Financial Aspects of Corporate Governance

Every four months 3i publishes "plcUK", a survey of more than 600 Finance Directors drawn from the top 1000 UK quoted companies. The 7th and, recently completed, 8th survey focus on issues pertinent to the Draft Report on the Financial Aspects of Corporate Governance issued on 27 May 1992.

You may be interested to see the views of this important group of executive directors on the matters covered in the draft Code of Best Practice together with some more general points they make regarding corporate governance issues. You will also be pleased to see that they are already tackling a number of areas addressed by the Committee and that there is general agreement on the need for a code of practice.

I have included copies of the reports together with a summary which relates "plcUK" findings directly to the draft Code.

3i's interest stems from our involvement in two areas. First, as an investor in 4,000 businesses we are dependent on board effectiveness to drive these companies forward. Even though the majority of our investments are in unquoted businesses the philosophy of corporate governance is no less relevant. Indeed we see the large company sector as a role model for the independent business and welcome visible standards being set.

Secondly, our "Independent Director Resource" is a pool of over 300 non-executive directors with particular skills at working with company boards, mostly in the unquoted sector. Since 1986, 3i has introduced over 650 non-executive directors to positions on the boards of investee companies. Promoting good financial corporate governance is one aspect of their role.

However, we would caution against too much emphasis being placed on the non-executive's role as 'corporate policeman'. We are very strongly of the view that non-executive directors should, as far as possible, be supporters of the executive board and contributors to policy development. Indeed, one of the reasons we use experienced non-executives with relevant experience rather than place our own people on the boards of investee businesses is so that it is clear that they are there to benefit the business - not to police our investment. Our investment will benefit from a well run business.

As far as 3i Group plc itself is concerned, we have Remuneration and Appointments, and Audit Committees comprised solely of non-executive directors. Because of the nature of the business we also have other committees, for Treasury and Valuations, which comprise both executive and non-executive directors.

The 3i Group plc board consists of ten directors of which five are non-executive, four are executive, and the Chairman is part-time executive. The functions of Chairman and Chief Executive are separate.

I welcome the opportunity to give some feedback on the Committee's draft report.

Yours sincerely

Ewen Macpherson
Chief Executive, 3i Group plc

The findings of plcUK and their pertinence to the draft report - The Financial Aspects of Corporate Governance

The following findings were taken from plcUK 7 published April 1992 and plcUK 8 due to be published September 1992. The comments are referenced to the Code of Best Practice and the appropriate plcUK survey.

Backdrop

The April 1992 survey, plcUK 7, strove to determine the importance of the corporate governance issue to Finance Directors in some of Britain's largest companies. These Finance Directors were asked their views on the UK's system of corporate governance. The importance of the issue to these executive directors is evident. Over half said that the comment "There are flaws in the system (of corporate governance) that need to be remedied if the UK's economic performance is to improve" was closest to their view. The major criticisms they levelled at the UK's system of corporate governance were the bias towards short term results, agreed or partly agreed by over 90% of the respondents, and the failure of the system to deliver adequate results, agreed or partly agreed with by 70%. Additionally, 27% thought that there were insufficient sanctions for under performance by management.

Further issues were investigated in greater detail against this backdrop and the findings that are particularly pertinent to the draft code of practice are described below.

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The Code of Best Practice

Overwhelmingly, 75% of FDs agreed that there should be a code of practice for corporate Governance. [plcUK 8]

1. Board of Directors

1.1 With regard to frequency of board meetings almost two thirds of companies hold board meetings at monthly intervals or ten times a year. Quarterly meetings are favoured by a further 14%. These tend to be the smaller companies - 70% are companies with annual turnover of less than £100 million. [plcUK 7]

1.2 Over half (51%) of the respondents thought that the separation of the roles of chief executive and chairman was desirable whilst this was only the practice in 39% of the companies surveyed. [plcUK 7]

1.3 The number of non-executive directors making up the boards varied. Over two thirds of companies had between three and six non-execs. [plcUK 7] Overall board size is between seven and ten in 53% of the companies (21% had fewer than seven and 25% had more than ten) and 70% of companies with turnover > £500 m had boards of more than ten directors. Non-executives, therefore, appear to be sufficiently represented for their views to carry weight. [plcUK 7]

82% of FDs said that a plc board should have a minimum proportion of non-executive directors. **[plcUK 8]**

Asked for their views on the ideal, rather than actual, size of board and the proportion of non-executives, respondents clearly favoured a higher proportion of non-executives as the size of the company increased. For the largest companies with turnovers above £1 billion nearly half of respondents favoured a board consisting of 50 percent or more non-executive directors. For companies with a turnover of between £100 million and £1 billion a majority of respondents favoured boards with a 30-50% ratio of non-executive directors. **[plcUK 8]**

1.4 There was widespread agreement about the main functions of the board with over 75% of respondents ranking the setting of overall corporate objectives as either the first or second most important function. Monitoring management performance was seen as the next most important ranked in the top two by 52% of FDs. **[plcUK 7]**

45% and 43% ranked the selection of top management and overall financial and audit supervision in the three most important functions. **[plcUK 7]**

2. Non-executive directors

2.1 With regard to non-executive directors bringing independent judgement to bear on board issues, plcUK respondents described the situations in which they felt non-executives made the most valuable contribution. Over 75% ranked a major acquisition or divestment in the top three situations followed by an offer being made for the company (70%) and the appointment/departure of the chairman (69%). **[plcUK 8]**

2.2 FDs are split 50/50 on the question of whether a non-executive director should have an equity stake in the company. Comments from respondents would seem to indicate that this split reflects the contrasting views between avoiding a conflict of interest and demonstrating commitment to the company with a modest equity stake. **[plcUK 8]**

2.3 Comments have not been sought on term of office. With regard to reappointment, virtually none of the companies surveyed formally reviews the performance of non-executive directors. In the few cases where there is such a review it is performed by the chairman acting alone or in consultation with other board members. **[plcUK 8]**

2.4 Although no views have been sought on the ability or procedures for non-executive directors to take independent advice, three quarters of FDs felt that the non-executive directors should be entitled to any information that they asked for. However, only a third said that non-executives should be given unrestricted access to all levels of management and about a quarter said that the non-executives should only be entitled to basic monthly financial data and management reports. **[plcUK 8]**

2.5 With regard to the selection of non-executive directors, views have not been elicited on how non-executive directors should be appointed, however, FDs do have an opinion on the most important qualifications for a good non-executive director which are: the ability to ask the right questions of the CEO and executive management (79% ranked in top three) closely followed by a track record of proven success as an executive director (78% ranked in top three). The FDs were also of the opinion that it was of much less importance for the non-executive director to have direct experience of the industry concerned or to provide business contacts. **[plcUK 8]**

3. <u>Executive Directors</u>

3.1 Directors service contracts have not been discussed in the surveys.

3.2 Opinions on the disclosure of directors emoluments has, likewise, not been surveyed.

3.3 Across the survey, 83% of all companies already have a remuneration committee and non-executive directors sit on 85% of these. As the size of the company increases so does the proportion with a remuneration committee - 93% of companies with turnover >£1 billion have such a committee. **[plcUK 8]**

4. <u>Controls and Reporting</u>

4.1 On average 62% of companies surveyed have an audit committee with non-executive directors represented on two-thirds of these. However, the proportion with an audit committee increases with company size - less than half (47%) of companies with turnover < £100 million have an audit committee rising to over three quarters (77%) in companies with turnover > £1 billion. **[plcUK 8]**

4.2-4.7 No survey questions have specifically addressed the reporting requirements of boards.

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<u>Other issues of note</u>

<u>Involvement of shareholders</u>

Chapter 6 of the Draft Report discusses the formal relationship between the shareholders and board of directors and raises the issue of how to strengthen the accountability of boards to shareholders.

PlcUK respondents were strongly against more direct institutional shareholder involvement in the business. For example 82% were against institutional shareholder representation on audit committees, 78% were against representation on compensation committees and 78% were against their involvement in board appointments. Nevertheless, despite this understandable resistance on the part of FDs to what many see as 'interference' by institutions, it should not be overlooked that about one in five were prepared to support even these methods of ensuring greater management accountability. **[plcUK 7]**

Many accepted that the trend towards forming closer links between management and institutional shareholders would probably continue and that this was desirable. (Over 60% of plcUK 1 respondents perceived that institutional investors were gaining influence.) However it did pose certain problems including the growing risk that the interests of individual shareholders might be sacrificed. (Individual private shareholders represented 25% of the ownership of plcUK 4 respondents companies compared with 62% in the hands of institutional shareholders.) 55% of the survey respondents agreed that this was a risk.

The May 1991 survey, plcUK 4, investigated the attitudes towards shareholder relations programmes. The major objectives for these programmes were seen as securing support for management objectives and helping ensure that the company's share price fully reflected the value of the company. (In plcUK 1, over 60% of FDs felt that their company was undervalued.) Both of these were regarded as being of major importance by over 80% of the respondents. Additionally, a significant minority, 40%, said that a third important objective of shareholder relations programmes was to help ensure the rejection of possible takeover bids. **[plcUK 4]**

When asked about the most effective means of communicating with shareholders, face to face meetings were considered to have a major impact on shareholder relations by over 95% of respondents. Analyst meetings were considered to have a major impact by a further 66%.

With regard to the role of non-executive directors, plcUK FDs do not think that it is, or should be, the role of non-executive directors to monitor the interests of these institutional investors. [plcUK 8]

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Conclusion

The Financial Directors of Britain's largest companies are well aware of the importance of good systems of corporate governance and exhibit a large degree of open mindedness about the measures that need to be adopted to raise overall standards. The Committee on The Financial Aspects of Corporate Governance can be heartened by the general levels of both awareness and acceptance of these issues in board rooms across the country.