Preface

This third edition created two main problems for me as author. First, it is written at a time of major public demands on, and criticism of, corporate governance. Corporate governance is seen by many as a magical silver bullet when the consequences of the global credit and debt crises are still developing and unnerving. It is not. However, it has a major role to play, so legislative and conduct code responses are proliferating internationally and fierce unresolved debates are in progress. There is a growing body of opinion that whatever the specific national response, corporate governance must be a necessary element in creating a healthy civil society. To achieve this it must apply to all organizations within that society – private, public and not-for-profit. The problem with publishing in such a turbulent environment is that because there is always a deadline this book must be a photograph in time of an evolutionary process within which the concept of sustainability is growing rapidly and globally.

Second, how would I deal with the management writer's curse? Over time the selection of a company as a good example seems to damn it forever. With 15 years of examples published in previous editions of this book I have chosen to keep the good stories and give them a date, regardless of what happened to that company. But I have added many current examples knowing that I was helping myself but not necessarily them.

But the good news is that the eternal values of effective corporate governance – accountability, probity and transparency – keep on shining as brightly in this naughty world.

Bob Garratt
November 2010

Introduction

Directing not managing

Where was the board of directors?

One of the few positives to come out of the continuing global financial crisis is the final awakening in the public's mind that there is a strong possibility that those elected or selected to guide our organizations in the private and public sectors may not be very good at their job. Indeed, a joke going around the UK at present asks: 'Who is the odd man out in this list of well-known bankers – Tom McKillop, Fred Goodwin, Victor Blank, Andy Hornby and Terry Wogan (the presenter and comedian)?' The answer is obviously Terry Wogan. But the reason is not so obvious. He is the only one with banking qualifications. Similarly, following the crash of AIG, the world's largest insurance company, a cursory examination of the great and the good on its board of directors shows that the latest experience any of them had directly with insurance was some seven years previously, all of them were over 70 and one octogenarian had been a distinguished ballet dancer. In this book I shall argue strongly for both competence *and* sufficient diversity around the boardroom table. It seems that many major corporations have taken these ideas to the point of absurdity where either there is so much technical expertise that any connection to the wider world is missing or at the other extreme expertise in the core business is no longer considered important. This way madness lies. This book addresses the necessary balances, competences, evaluations and learning needed to ensure more healthy organizations in future – to stop the fish rotting from the head.

The general public is right to be angry about board and senior management incompetence because they have lost significant wealth. They are right to keep asking whether the board knew what it was doing. Weren't they selected and trained specifically to direct? Weren't they assessed regularly as others are when offering professional services? Indeed, is being a director really a profession at all? To all these questions I argue that in the majority of cases the answer is a resounding 'no'. This may make the public even angrier but at least it is now airing the issue and demanding remedial action. And things will never be the same again. There are now the stirrings of a movement that seeks to differentiate carefully between managers and directors to allow the regular assessment of boards and individual directors to ensure effective corporate governance. We know a lot about managers and their effectiveness. But we know little about directors and their effectiveness. That is what this book is about.

The uniqueness of being a director

Director is a unique role protected by law in most national jurisdictions. It is not management. It has onerous responsibilities and consequent liabilities that are quite unlike those of a manager. Indeed, it is a surprise to many people, including directors, just how bounded by law their roles are and how little are those of managers. Yet the majority of people who become legal (statutory) directors of their organizations have no formal induction process to explain the different knowledge, skills and attitude required in the role, nor is there a rigorous development and regular performance evaluation process to ensure they devote the necessary amount of time, care, skill and diligence needed to become an effective director.

So most directors are directors in title only. We see this clearly in the present crisis of capitalism and in the demand for major directoral and organizational reform in the public services. This lack of acceptance of the specific direction-giving role, as distinct from the operational executive role, may shock both business owners and the wider public, but it is so. Most people carrying the director title are successful executives who simply continue with their well-honed executive experience around a boardroom table requiring quite different skills. As they know little better, they often feel that they must be doing a good job. But as the recent banking crisis and subsequent global credit crunch have shown only too starkly the short-term, mission-orientated mindsets and behaviours of executives are often in direct opposition to the long-term legal duties of the directors. However, as few directors are aware or willing to fulfil their critical oversight role, they convince themselves frequently that their short-term gains are always for the benefit of the owners. This is rarely so and thus it is hardly surprising that we are in the mess we are.

Inevitably, politicians and the public seek silver bullets, short-term solutions amongst which corporate governance, which I advocate, along with much tighter financial regulation are front-runners. Neither will do much good until our economic and political systems are reformed to accommodate a more sustainable future. However, in the short term directors need a crash course in understanding both the financials and the political, economic and ecological – both the short-term bottom line and the long-term trend lines – what needs to be in the hearts, minds and behaviours of those elected or selected to provide effective direction and prudent control of our organizations. This book seeks to clarify and encourage agreement, and then commitment, to this hearts-and-minds approach to corporate governance and director development. This needs monitoring externally and internationally before we can build on the deeper political-economic reformation needed to create sustainable corporate governance at a global level.

Most management consultancies and business schools do not help. The preference for anything US-derived is still paramount, despite the weight of evidence that US corporate governance is close to becoming a basket case as it is not addressing its fundamental problems. From Enron onwards through the crash of Bear Stearns, Lehman Brothers, AIG and GM we see the chaos that is created when the directoral and managerial systems are combined rather than separated, especially through having long-term combined chairman and chief executive roles. Added to this, most US corporations are registered in the business-friendly state of Delaware where the corporate governance laws became so distorted that the Law of Plurality was passed. Here a slate of directors proposed by the existing board allows the shareholders to vote for the proposition, or abstain, but does not allow the owners to vote against it. So self-perpetuating oligarchies abound. What price business democracy now? The Delaware Court of Chancery acknowledges that this and other laws need revision, but even in these dire times new legislation is not being rushed through, despite the understandable anger of shareholders of many US corporations.

The learning board process

Indeed, it is this general lack of forward momentum even in the biggest financial crash since 1929, mixed with directors' stark ignorance of what the law of their own country is concerning their roles and duties and their relationships with managers, which has caused me to make a major revision of this long-selling book. Over some 14 years I have seen its central thesis and model – the learning board – adopted in many places, especially in the UK, Asia, Africa and Australia. In the United Kingdom it has been central to the intellectual development of the Institute of Directors' Chartered Director examination system; it is found in the UK's Department of Business, Innovation and Skills' *Building Better Boards* and in the not-for-profit Association of Chief Executives of Voluntary Organisations' *A CEO's Guide To Board Development*, 2007; and it has been central to the developmental programmes of the National Health Service's Finance Directors, Non-Executive Directors and Company Secretaries programmes at Cass Business School.

I have used my experiences around the world to illustrate and reflect upon the ideas contained here. Because of both the UK's over-stringent libel laws, and the need to focus on specific issues in each case, I have simplified numerous examples throughout the book to stress the key points. These sanitized versions of the story do not reflect the full complexity and occasional absurdity of the business and human issues involved. Whilst the book is not designed as an instruction manual, it does attempt to bring together best practice internationally, and then asks intelligent readers to reflect on the appropriateness of these for their own corporate issues.

The ideas and the models used have had sufficient testing to demonstrate that they work in many contexts and are as applicable in the private, public, governmental and parastatal sectors as in the not-for-profit sectors. The acid test of the central learning board concept comes now with the global shock to our social, political, environmental and economic systems. Many more boards are trying to use it for their development and for board evaluation benchmarking. I am interested in having any feedback from those trying it as they push towards professional boards and skilful directors.

Although I can claim ownership of the learning organization, learning board and ten directoral duties ideas, most of the information in this book comes from my own continuous environmental scanning of the changing external political, trade and social environments, through travel, consulting, personal coaching and mentoring of top people, and using my intelligent naivety to question media reports and academic papers. I find these processes both productive and enjoyable, and would commend anyone who wishes to be an effective director to budget time for starting along the same path of personal development. It helps me 'hear the baby cry'. If you want to know what that means, please read on.

PART ONE

Corporate Governance: The Framework for Board Effectiveness

1

Corporate governance words and history: passing fashion or a key to building civil society?

CASS BUSINESS SCHOOL in London is unusual as it insists that entrants to its MSc programme in Management Studies must pass a module led by the redoubtable Clive Holtham on 'The History of Management Thought'. Sadly this is so exceptional that I mention it here. It gives the participants some historical perspective on how and why some business ideas developed, flourished and died. And it helps kill the prevalent public notion that management consultancies and business schools dream up buzzwords and phrases to sell their wares regardless of the historical, social and environmental contexts evolving around them; or are willing simply to jump on a bandwagon late and then flog it to death expensively.

So as most directors, managers and consultants are unaware of the origin of the words and systems they use daily, I shall give a short explanation of the linguistic basis of modern business life. In systems thinking terms we need to go back 300 years and in word terms well over 3,000 years.

I have based my legal comments here on common law as practised in the UK, the US and most of the 54 Commonwealth countries. Therefore I have included the US and India as two massive nations. As it is likely that the evolving Chinese company law will have a strong Hong Kong-based common-law element (regardless of any political rhetoric to the contrary), nearly 70 per cent of the commercial world's population will be affected by these words and phrases.

Governance

The concept of governance evolved around 3,500 years ago from the ancient Greek word *kubernetes*: the person giving steerage/direction to a ship. The notion that organizations need a person or a small group to be competent at seeing the way ahead and thus directing their slim resources effectively and efficiently to achieve a distant goal derives from this and has stood the test of time. We recognize easily the problems of organizations run by just one dominant person, and of those run by committees. The word itself moves through human history, evolving through the Latin *gubernare* and the Old French *gouvernance* and flowing into Middle English via such writers as Geoffrey Chaucer in his *Canterbury Tales*. The notion of single all-powerful direction-givers, whether regal or military, fitted well into medieval hierarchical society and created a long-lasting mindset.

Cybernetics: governance as a learning system

But there is another root to *kubernetes* which jumps 3,000 years and appears in almost the same form in modern English: cybernetics, the science of control and information systems. I translate this into organizational life as the development of fast feedback and learning systems that tell you whether the direction in which you are being steered is appropriate for your needs. 'Are we nearly there yet?' the kids in the back of the car always ask, very much like shareholders. This learning and fast feedback aspect of the governance concept seems to have bypassed most consultancies and business schools. Yet from my experience of directing organizations and consulting, regular and rigorous learning is the key to corporate success. But do most organizations have the systems of fast learning to see whether the broad deployment of their scarce resources is achieving their purpose? Are the directors competent in being able to both guide and control prudently their organization? Rarely.

In this book I have combined these two meanings of governance to form the basis of the learning board model. At the centre of the model is the director's irresolvable dilemma: how to drive the organization forward whilst keeping it under prudent control. The balancing and frequent rebalancing of this dilemma is the essence of effective directing. It is why boards were invented, to add sufficiently diverse wisdom to counter a single leader. In an unstable and fast-changing environment, direction-givers need honest feedback on both changes in the external environment (the uncertainties) and the performance of the executive systems controlling the deviations (the risks) in the day-to-day operations of the organization. That is why effective organizations have monthly board meetings.

The board

The board was originally the table around which the direction-givers did their work. Having evolved as a notion in the Italian nation states, it came to full modern fruition in 1601 with the development of royal chartered companies: the East India Company in England and the Dutch East India Company in Holland. These early exponents of globalization were in a new and very different corporate legal form from those that had gone before. Individual entrepreneurs began to give way to companies, a word derived from the Old Italian idea of coming together to break bread, although sharing ownership and risks was more pertinent than bread. The granting of and paying for royal charters to incorporate was one thing, but the law then evolved to allow the company itself to be seen as a separate legal entity. This was revolutionary as it meant that companies, rather than individuals, could sue and be sued in their own right. Many directors still do not grasp this concept and become embroiled in conflicts of interest when faced with issues of primary loyalty and independence of thought.

What drove this radical legal concept was that as the merchant venturers' projects became so big that individuals could no longer fund them individually, so did the risks. To offset some of the risk, other capitalists needed be involved to take a share on the likelihood of a profit. Such shareholders needed oversight of the performance of their ventures and so the notion that owner-directors would meet regularly around a board was developed. In parallel to these rational and legal developments one must never underestimate the madness of crowds.[1] This was as prevalent in the 17th and 18th centuries as in the recent dotcom boom and bust. There is a direct line of mass greed, and little rational thought or understanding of a financial system, from the Darien adventure in Scottish Central America, tulip mania and the South Sea bubble to railway mania in the 19th century, and to subprime mortgages, Ponzi schemes and some bankers and accountants losing all professionalism in the 21st century.

Sadly, greed and fear are characteristic human drivers. As ventures became even larger and as industrialization emerged, the owner-directors began two allied moves. First, because of the growing number of shareholders they needed a way of both encouraging and controlling them. So they sought another revolutionary legal change: to have a limitation of liability for members of the company. This was, surprisingly, agreed as a limitation on the share capital paid up by the shareholders only, not on the directors. So to this day directors are not covered by limited liability. Directors have unlimited liability, and pray that their directors and officers liability insurance cover is adequate, even though it refers only to their legal costs.

Management

The second move by the owner-directors was to devolve some of their power to ensure better control of the day-to-day operations of their business. The role of manager evolved. The word 'management' also has two forms. It derives from the Old Italian *managgiare*, which originally meant the breaking of wild horses and their subsequent domestication. This macho notion is still around in many managers today as the only way to manage. However, in the English language it was moderated in the 18th century by the introduction of the French *ménager*, which referred more to the domestic economy of a household, as did the original word 'economics'. I use the term 'management' in this book to refer to the appropriate blend of 'hard' and 'soft' management for the work in hand to get control of a potentially, or actual, dangerous situation and to nurture simultaneously the people and systems needed to bring it into balance. Managers, or executives, are there to design, install and maintain the prudent control systems of the organization and to capture and use the learning flowing from them. They are not there to develop policy and strategy on behalf of the directors, but they should provide much of the hard data and alternatives on which the directors must decide.

Policy

Policy entered the English language from the ancient Greek as 'polity', which gives a huge clue as to what it is about. Policy concerns the political will of the organization in relation to its ever-changing external environment. That environment will contain combinations of the political, physical environmental, economic, social, technological and trade worlds. Policy is the highest level of organizational thought and action to achieve the fundamental purpose of the enterprise. The board must lead in the formulation of policy as it, not the managers, is legally responsible for this – pointing the ship in the direction required given the many uncertainties that are beyond the horizon. This is indeed part of common law in the UK, US and most of the Commonwealth countries. Directors have a fiduciary duty to ensure the long-term health of their organization and must, if necessary, counter any unreasonable short-term demands of both their shareholders and their executives. This is why the UK's 2006 Companies Act has strengthened this aspect through the annual statement from the board that the enterprise is a going concern, which is not easy to do in a recession. In 2010 was added the duty of explaining to the owners the business model used.

Policies are the core of the business. They both set the purpose – why the organization exists – and allow the development of rational strategies and appropriate cultures. Policies do not have to be always exciting but they are the bedrock on which everything else in the organization is built. Policies are not, as taught in some business schools, the rules of the organization. Such teaching shows a lack of classical training among professors. Rules are an essential but operational aspect of prudent control systems. This is not to demean them. All organizations need rules, down to the lowest levels of who gets to park where and holiday when. But these are not policies. They are just rules.

Strategy

Strategy takes us back again 3,500 years to ancient Greece. Strategy was the province of the military general. In many business minds it is still used in this way. I take from the Greek the key concept that strategy is the broad deployment of scarce resources to achieve a purpose. This is the role of the board of directors. This is a concept based on having a suitably varied group of independent thinkers around the board table capable of scanning the murky horizons of continuous change in the political, physical, economic, social, technological and trade environments and then linking the data in broad deployment terms to deliver the organization's fundamental purpose – the reason it exists. Whether this is to deliver shareholder added value, increase the family's wealth, deliver health gain to this region or increase life chances through better housing is for the owners to agree. The board then delivers at this higher level, delegating the execution to the managers. It must work closely with the executives to ensure the best horizon scanning it can as this is still, and will always be, full of uncertainties. And it is for the executives to ensure that the day-to-day operations have the tested organizational capabilities to deliver the evolving strategy.

Strategies are flexible. They are not set in concrete. The uncertainties shown through continuous horizon scanning must allow for fast learning and the consequent adapting, or rejection, of the current strategy. Directors rarely understand this, especially if they have become overinvolved with the executives in micromanaging their operational plans. It is always difficult for a board, especially if full of executives from other organizations, to not micromanage the executives. It requires a strong and confident chairman to ensure this does not happen. But many boards confuse the different processes by insisting on using the idea of strategic planning.

The dangers of strategic planning

Strategic planning is an oxymoron, a dangerous contradiction in terms, which frequently leads boards into confusing two distinct and separately important processes: the prime board roles of policy formulation and its associated strategic thinking; and the executive roles of planning and delivery. If they are combined, little real strategic thinking is done systematically because human frailty means that any strategic planning process degenerates quickly into an interpersonal power fight as to who gets which projects, budgets and formal organizational power. As my colleague Henry Mintzberg points out in his excellent book *The Rise and Fall of Strategic Planning*,[2] the phrase is a dangerous oxymoron. I liken it to those weasel phrases 'fun run' and 'friendly fire', and on a bad day to 'military intelligence'.

Directors

Organizations around the world use the term 'director' to indicate a member of their governing board – someone with the ultimate statutory legal accountability and liability for the performance and behaviours of the whole organization. In most jurisdictions this appointment must be registered, for example at Companies House in the UK. It is an onerous undertaking of unlimited personal liability for what many see as a part-time, low-paid or voluntary job, however prestigious the appointment. I do not intend to discuss directors' pay here but rather to reinforce my argument for systematic and detailed induction of directors so that they at least know what they are getting themselves into. This is the chairman's role, as is the subsequent personal development and annual evaluation of all directors. But many directors are there under false pretences and even with the best intentions can expose themselves and their families to unnecessary risks. How can this happen?

Abuses of the term director

The title being awarded incorrectly

The title director has been used indiscriminately and thus, over time, its precise legal meaning and status have become devalued in public usage, even though the legal obligations remain onerous. One of the problems with such abuse is that the title is often given without statutory status in both private and public enterprises as a reward in relation to promotion or bonuses, especially when cash is not available. This is dangerous as the use of the title director under common law lays the individual open to the same liabilities as any statutory board member. Not many people know this, even HR departments that should know better. Many legal departments are mealy mouthed on the issue. Even such titles as finance director, HR director or director of production carry the same liability because individuals are 'holding themselves out to be a director' if they do not have statutory status. Thus a great number of directors sail through life oblivious to the large potential liabilities they have and that they have exposed their personal wealth to risk, for which they do not usually carry any liability insurance. If you want to be a director, get elected to the board as a statutory director and in the UK sign your form 288A or AP01 (or its equivalent elsewhere), and make sure that there is a suitable and valid directors and officers liability insurance.

Misusing the terms 'executive' and 'non-executive' director

These titles do not exist at law. They create a lot more trouble than they are worth. For example, nowhere in the UK's 2006 Companies Act will you find them. But they are wrongly used in common parlance and have crept into secondary legislation like the Financial Reporting Council's 2006 *Combined Code on Corporate Governance*. They are also creeping into South Africa's primary legislation. This is dangerous, especially as the UK and South Africa are seen by many as world leaders in the development of effective systems of corporate governance. There is no need to contaminate or complicate a fundamental legal concept that a director is just that and only that without qualification – a director. This has stood the test of time and been accepted by the courts for centuries. Either you are a statutory director or you are not, and the proof is having signed form 288A or its equivalent.

Executive directors and their two employment contracts

Confusion arises when executives are promoted to a board as statutory directors, but then use the title executive director. They usually continue to operate as though they were still executives for 100 per cent of their time. They are not. As statutory directors they must show independence of thought on each agenda item before the board, demonstrate their primary loyalty to their company and, under the new UK Companies Act, demonstrate the necessary care, skill and diligence required to do their directoral job effectively. This is tricky for a busy executive. It can be done, but it means that at least 10 per cent of their work must then be committed to learning how to become an effective director. The acid test of whether an executive director will ever become a true director is if the individual can take an independent stance on a board item and be seen to disagree with the chief executive. As most executive directors meet the chief executive beforehand so that they appear at the board meeting mob-handed with a fully agreed set of proposals on which they will allow no dissent amongst themselves, you can see the problem of any of them trying to become a true statutory director.

However, there are ways of achieving this. Executives who become statutory directors must have two employment contracts: one for, say, 80–90 per cent of their time as an executive under a normal contract of employment; and one, a contract for services as a director, for the other 10–20 per cent of their time, including the development of the necessary care, skills and diligence needed to deliver their independence of thought, primary loyalty and fiduciary duty. Some boards have achieved this through rigorous induction, appraisal and development processes. The beauty of such an approach is that all directors join the board as equals, with the same contract for services, which allows them to behave as equals as required by law. UK Company Law states that a board is a collegial process with each director having one vote and, depending on the company's constitution, the chairman having the casting vote. The chairman needs to come down heavily on any chief executive found guilty of taking action against an executive director who speaks against him or her in a board meeting. Executives are there in part to add diversity to board debate through their detailed operational experience. They are not there to act as ciphers of the chief executive.

Non-executive directors

Using external, experienced people to work with an organization's executives as equals around a boardroom table has been successful over the years. The problem is that as soon as people are labelled non-executive directors (NEDs) they are treated by the executives as permanent outsiders, visiting policemen or worse. Once this split is established between the misnamed executive directors and the non-executive directors it takes a lot of energy and time to create the necessary trust and behaviours needed for an effective board. These two titles are disabling for any board. So let us take a deeper look at what such externally experienced people should bring to the collegial board table. They should lighten board debate. They are seen as necessary to bring in wider and diverse experience of the outside world, of the sector or of the stakeholders, including the shareholders. They should have a wider oversight of the total organizational performance, help broaden the board's horizon scanning and give constructive criticism of the executives' performance. They are worth their weight in gold if they can both help show the way ahead through helping the board formulate strategy in uncertain times, and ensure oversight of the operational performance of the executives and their impact on total organizational performance.

However, there are often problems when using external people who are not employed full-time in the organization. At director level they arise from two main sources: an overreliance on selecting executives from other organizations; and a predilection for selectors or electors to want representatives of special interest groups to become their directors on the board, rather than choosing individuals who will demonstrate independent thought, critical ability and judgement based on the best interests of the company as a whole.

There is little evidence that choosing an executive from another company to sit on your board is necessarily a wise thing to do. Admittedly it is done all the time, but why should just being an executive make a person a good director? For many years research has shown that successful executives are action-driven and highly focused, and that effective chief executives have psychometric profiles verging on the sociopathic. As directors need to be reflective, patient, able to horizon-scan, able to think strategically, open to new ideas and information, and capable of rational debate and decision-taking in areas of great uncertainty, these executive traits do not seem ideal in a board director. Executives need more than a simple induction programme to turn them into effective statutory directors. They need a six-month minimum conversion programme. There is also the hazard that executives recruited from other organizations will have a tendency to micromanage if they decide that their way of doing things is better. Inducting a non-executive director is tricky at the best of times, but it is necessary as there are currently few truly experienced independent directors.

Representative directors

A statutory director cannot be a representative of any other grouping. This astonishes many directors, investors and politicians, who often want their person on the board to represent exclusively their holdings, financial or emotional. Indeed, in many shareholder agreements the right to nominate one or more directors is part of the contract with the implicit assumption that they are then the investor's for life. Many government ministers and some politicians have the power to nominate one or more directors to a government agency or a parastatal organization, and in the UK's public sector one sees the rise of parallel boards of governors, patients or tenants, who can be elected or selected for a board. There is nothing wrong with this. Indeed, it is laudable that the diversity of boards is being encouraged through the appointment of some of the users of the goods and services provided.

But what is this political and social trend towards representation meant to achieve? If it is truly to diversify the experiences around the boardroom table to improve the quality of debate and decision-making, then all is well. However, many owners, whether public or private, have in mind more the control, monitoring or even direct influencing of notionally autonomous boards. And there's the rub. It happens all the time and, again, a strong chairman is needed to face down the investment group, minister or local interest group if the board is to do its work properly. This is an issue of primary loyalty writ large. It can be hard for someone appointed a statutory director by an investor, minister, local council or interest group to come to terms with the fact that, no matter who elected them, at the moment of their election their primary loyalty must switch away from those electors and to the company itself as a legal entity. Some find this impossible to grasp, putting themselves in an exposed personal position legally. Others cannot take it and resign, often angrily. But the majority accept slowly their new position and adapt their mindset and behaviour to fulfil properly their role as a director. This needs careful coaching by the chairman and the company secretary.

Politicians and senior civil servants seem particularly prone to announcing new forms of corporate governance, especially in board design and roles, which suit their purpose at the time but may not respect the existing law. They then insist that this will have to be accepted regardless of any criticism or the board will be replaced. This reinforces my thesis that governments do not understand governance. In particular they are rarely aware of the way common law has evolved, and why. It is essential that ministers and boards are aware of legal precedence over the centuries. The case of Boulting v Association of Cinematograph, Television and Allied Technicians (1963) 2 QB 606 is usually the most quoted and used in many business schools. Lord Denning talked about nominee directors:

> Or take a nominee director, that is, a director of a company who is nominated by a large shareholder to represent his interests. There is nothing wrong with that. It is done every day. Nothing wrong that is, so long as the director is left free to exercise his best judgement in the interests of the company which he serves. But if he is put on terms that he is bound to act in the affairs of the company in accordance with the direction of his patron, it is beyond doubt unlawful.

The verdict is powerful and persuasive and applies to all directors. However, until the UK and many other countries have legislation defining the roles and rights of directors in the public sector, where at the moment no one is able to give a definitive statement of the roles and liabilities of directors or the legal status of their organizations, the situation will remain unstable and messy. Having a Civil Service Act to define roles and relationships with ministers would help greatly. It is noticeable that the UK government has gone a little way towards resolving this problem, creating the UK's Shareholder Executive as a halfway house for spun-out but wholly owned government agencies. In a few cases it has gone further and created its own precedent by allowing both the Financial Services Authority and the Financial Reporting Council to register as companies limited by guarantee (no shareholders), thereby bringing them under the auspices of the Companies Act. It will be interesting to see, for example, if autonomous NHS Foundation Trusts or schools seek this remedy to a continuing problem.

All directors have a fiduciary duty to ensure the continuing health of their organization. It is almost impossible to deliver this if they are acting purely as representative directors for a narrow grouping.

Directors of subsidiary companies

This role can be fraught with danger, especially if the companies are overseas subsidiaries. Even if the subsidiary is wholly owned and in the same country as its group headquarters, matters can become messy. If the subsidiary is simply a trading division of the group but not a legal entity in itself, things are relatively simple. Often executives are wrongly titled director, but the chances of this causing them or their company any real headaches are small, although they are open to charges of misleading the public by purporting to be statutory directors. However, if the subsidiary is a legal entity, there is the issue of how executives, who are also statutory directors under the Companies Act, should behave in relation to group instructions.

Remembering Lord Denning's legal ruling, should they simply obey group orders and use this as a defence if matters come to court? 'I was only obeying orders' has never been a satisfactory defence. Or should they fulfil their fiduciary duty to ensure the continuing health of the subsidiary even if this means sometimes saying 'no' to the group? This is a tricky dilemma for any director as saying 'no' can be a career-threatening move. As more stakeholder groups consider taking action against local subsidiary directors over their competence and behaviours, this will become a bigger issue.

It is worse for statutory directors of overseas subsidiaries. As more countries begin to appreciate the importance of corporate governance and the control of companies registered under their legislation, so the problems will increase. What if a group board decides that for the benefit of the group a unit needs to be reduced or shut down; or if the local owners want a significant share of the equity or want to put their own nationals on the board; or if the national government passes tough environmental or community laws which the whole group must obey? It is all very well for the group to tell you to ignore such requests or to give you the assurance that it will never affect you or the company directly 'and that we will always protect you if it did'. But if you end up in jail in, say, Russia or the US or Nigeria, not much protection will have been given. If you are a director facing permanently the reality on the ground, the issue looks very different than from the group's global strategy perspective. This problem is often hidden in discussions between the group and the subsidiary – it is the elephant in the room. But it will not go away, and as countries become more assertive, as the European Arrest Warrant is now in force, and as the US tries to extend its Law of Extraterritoriality to all countries with the active agreement of the UK government, life for directors of overseas subsidiaries will not become easier.

US directors

I said in the Introduction that US corporate governance was becoming a basket case (see Chapter 10). The much-hyped Sarbanes-Oxley Act of 2002 has tightened up some accounting practices but at a ridiculously high cost and with draconian criminal liabilities attached. Never let politicians near corporate governance practice as their only tool is legislation and they always add too much to their prescription, as we saw when the 2010 Dodd-Frank Act came into force.

In US corporations, confusingly, two director titles are in common use simultaneously. First, director is used as a title for a member of the board of directors, which is, sadly, usually regarded as an emasculated bad joke in many US corporations. The frightening phrase 'oh, the board of directors, that's ten friends of the chief executive, a woman and a black' is just too common. But this is hardly surprising as directing from the boardroom is not rated highly in the US. This partly explains the huge problems at AIG, Lehman Brothers and GM. Managing, or being an executive, is much more important; so much so that over 90 per cent of US corporations have a combined role of chief executive and chairman. Many chief executives insist that they must have the chairman's role as well as their own (and the double remuneration and perks that go with it) to do their job properly. Few US investors query this, so absolute power resides in the CEO/chairman and we know what absolute power does without sufficient critical directoral comment: it corrupts. This is especially true as the chief executive is often the only executive on a US board, so the directors have little chance to question the others. The high percentage of US chief executives derailing after a few years of unbridled power even before the credit crunch was noticeable. Equally noticeable was that the 1992 Cadbury Code of Corporate Governance insisted that the default position for UK listed companies was to split the roles of chairman and managing director/chief executive. This is now the case in over 90 per cent of companies (see below).

Second, in many US corporations director is wrongly used as a title for the rank below vice-president. I do not know why, nor has any US colleague been able to enlighten me. It is part of the US abuse of corporate language, which decided, for example, to create the terms 'president' and 'vice-president'. I have written elsewhere of my historical search to find out when these terms became common parlance. It seems to be around the ending of the Civil War, the opening up of the west and the rise of the robber barons of capitalism. I await my enlightenment.

The chairman

The chairman is the boss of the board of directors, not of the company. Many chairmen do not realize this and behave as if they control every aspect of the organization. This is unwise and brings them into immediate conflict with the executives, who are responsible for the day-to-day operations of the enterprise. Yet the chairman is ultimately responsible legally for the total performance of the organization. He or she is the architect of the board, leading the selection and induction processes, the annual appraisals of the board and directors, subsequent board and director development processes, as well as renewal and deselection. The chairman is also responsible for the board dynamics so will ensure open debate around the boardroom table, the declaration of any conflicts of interest, and the timely running and recording of meetings, working here with the company secretary. The chairman's role is an onerous one for someone who is effectively a part-timer. Yet it is a crucial job for the effectiveness of the organization.

Adrian Cadbury's excellent and succinct book *Corporate Governance and Chairmanship* makes these useful points about the attributes of chairmen:

> One is not to talk too much from the chair. As time goes by it becomes more difficult to resist the temptation to reminisce, or to bring the discussion at the board onto more familiar ground

> in order to be able to take full part in it. The Chairman's job is to listen and not to chatter. Chairmen are there to orchestrate the discussion, so that it comes to a fruitful conclusion. The test is straightforward; how much of the board's discussion time is taken up by the Chairman?
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> … [The Chairman must have] the ability to integrate, to pull together the different threads of a complex issue, so that it acquires coherence. The skills of management are becoming increasingly specialized and so the experiences of directors are tending to become narrower. As a result their approach to issues is likely to be determined in fair measure by their practical expertise. Chairmen, however, have to see the business as a whole, in the context of its environment, and need to integrate the skills and perceptions of all those seated around the boardroom table.
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> … The Chairman's place in all this comes nearest to the conductor of an orchestra; thus it is appropriate to close with Sir Ralph Vaughan Williams's words:
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> All their art and all their skills are valueless without that corporate imagination which distinguishes the orchestra from a fortuitous collection of players.
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> It is for the Chairman to capture that corporate imagination.

The first edition of this book provoked some complaints – mainly from the US – about my use of the term 'chairman', insisting that I use the term 'chair' in future. As the number of women chairmen and directors has grown these complaints have become fewer. And I have had a number of letters and e-mails from such directoral women stressing that they do not wish to have the title chair, which they view as an inanimate object for sitting on – something they are keen to stress that they most definitely are not. I remind them that the 'man' part of chairman comes from the Latin for the hand, and handling, not as an indicator of sex.

Managing directors and chief executives

A managing director is the head of the day-to-day operations of a business. It is a demanding job and needs a highly energized person to do it well – achievers with the ability to take people with them. A managing director is a statutory director who is also head of the daily operations of an enterprise. He or she has a board role as well as an executive one, so two employment contracts are particularly useful. If the person is not a statutory director, the correct title is chief executive. The unfortunate tendency to ape things American means that the title chief executive is assumed by many to be synonymous with managing director. It is not and should be avoided at board level.

Again, the arrogance of government ministers and senior civil servants can muddy the waters. Thinking that the US title is more modern and failing to grasp the legal implications of what they are doing, whilst relying on the fact that 'they are the masters now', they will normally opt for the title chief executive in the public and parastatal sectors. Matters were made worse in the UK with the introduction of an additional title: accounting officer. This is the person responsible directly to the minister. Remarkably this is not the chairman of the board but the chief executive. Having a direct reporting line to the top civil servant and the minister means that the chief executive can always short-circuit the chairman and the board and work with the minister to change any policy or strategy with which they do not agree. What price board supremacy then?

The problem is that many directors, executives, consultants and business school professors think that they are either Tweedledum or Tweedledee. They believe that the meaning of words is optional and that the question is: who is to be the master? Whilst this attitude persists there will always be confusion over the meaning of words in corporate governance and politicians will continue to write bad laws.