

So what actually does a director do?

(This article develops some themes of a seminar given to the Norfolk and Norwich Law Society in October 2015, so if you were there read no further!)

The law (Anglo Saxon at least) is very straightforward – the board of directors represents the owners of the company and directs its affairs in their interest. (Germanic tradition is slightly different – there any director is regarded as the embodiment of the company and decides and acts for it). The board acts collectively – a UK director has no power as a director, only as a member of the board which together is the mind of the company. The board can delegate its powers to officers but it is only the board which determines company policy and strategy. The doctrine of collective responsibility rests on and reinforces this concept of the company as a legal person who has a single directing mind. I explore below how this can, and does, lead to severe practical difficulties. But first I will deal with how this collective decision making works, and how the decisions are recorded and communicated to those on whose behalf they have been made and the practical issues which arise.

Making your mind up

The basis for a decision by a natural person will usually be on the basis of whatever feels best, and feelings could be influenced by material considerations, but equally well by prejudice, family, reputation or religious feelings. When the board comes to decide for the company it is almost true to say it must only be influenced by material considerations. Of course directors have prejudices of their own, and it is hard for them to leave them outside the boardroom door – but when they are wearing their director's hat it is solely the interest of the shareholder which should influence them. This does not mean they should not be deeply concerned with staff welfare, with fair dealing with suppliers, with public reputation and with social mores and local traditions. They should be, because to ignore any of these would not be in the long term interest of shareholders.

And it is the term “long term interest” that in practice some of the biggest conflicts arise, particularly in large public companies. Here, more often than not, directors make two fundamental mistakes – first they mis-identify the appearance of short term profits as a reasonable proxy for “interest of the shareholder” and worse still they give hugely disproportionate influence to share price and stock market and newspaper analysts' views in their decision making. In a well-run company neither should influence decision making – indeed as an investor you should look for firms where management ignores analysts and where accountants add up numbers rather than decide on what they want them to be.

The very worst decisions for most boards result from another conflict – that between personal ambition, personal reward and personal advancement and the longer term interest of the shareholder. This is because the one thing most directors around the board table can agree on is that they should all be paid much more – and the best way of achieving this in most companies is by expanding turnover. Takeovers very frequently reduce shareholder value but they almost invariably lead to higher salaries for senior executives.

The Role of the Chairman

In almost all companies the prime responsibility for channelling the minds of the directors in the right direction falls to the Chairman. It is he who must try to get directors to leave their

personal or departmental loyalties behind when they enter the Boardroom. It is he who must try to distil the debate into a decision. It is he who must try to maintain harmony whilst avoiding consensus decision making.

There are an infinite variety of dysfunctional boards but it is generally true to say that on top of every dysfunctional board sits a poor chairman. There are many good chairmen who lead and direct the boards they chair – who set the course and steer the company ship – but the classic good chairman does none of these things. He helps others to do so; he understands who among the directors has relevant talents or knowledge and helps that director to exercise them. He supports (or gets rid of) the chief officers and helps them garner support from and deliver information to their co-directors. He presides, not decides. The truly excellent chairman will often be the one who decides how the decision should be made and who should make the decision; he will also be the one who, once it is made, ensures the board agrees and supports whatever action follows. (Readers who wish to follow through the logic of this argument further may wish to look at the February 2014 edition of Cambridge Business).

Recording and Accounting

Every board decision must be minuted and recorded and the form in which this traditionally occurs is for a consecutively numbered record to be made of every substantive decision the board has ratified. The extent to which the preceding discussion is recorded and the detail varies from a near verbatim record to a very short summary but good practice is to record sufficient to show what the discussion was with some hint as to how it was reached. When a problem arises the minutes and board papers are all that record what the company was trying to do; what its collective mind had decided. They are extremely important to an individual director because he has a responsibility to support and implement whatever is in them to the best of his ability. It is here that any disagreement he has must be recorded – and really this touches on the most sensitive part of being a director – what to do when you are in a minority. There are three courses – first, to fall in line but ensure your dissent is minuted, second, to ask permission to publicly dissent and third, to leave the board. All of these should be recorded in the minutes which form the most fundamental account to shareholders of how the directors have discharged their duty. The minute book is also the first defence of the director against any question as to whether he has been derelict in his duties.

The Dysfunctional Board

In my experience the number of times a director insists on his disagreement being recorded is very small and almost all decisions are consensual. The number of times a vote is called for or recorded in minutes is equally tiny, but in each case it would be dangerous to mistake consensus for good governance. Although there are undoubtedly many other different ways of malfunctioning, most dysfunctional boards will be best classified in one of the three main categories below:-

Dominated – the board is a cypher for a chairman or chief executive and never questions his decisions. The mind of the company is actually the mind of one person. This has a huge advantage of clarity and quick decisions. Think Fred Goodwin and you may see a problem.

Democratic – the board gives equal weight to every argument; it tries to implement that which the majority want; rather than consider how decisions should be made and who should

make them it tries itself to decide. Always a disaster and a recipe for interminable meetings. Charities and public sector boards are prone to this problem, not least because volunteers believe they have a right to be heard, at length.

Detailed – this is probably the worst because the entire purpose of the board is lost in the process – directors drown in statistics, reports, position papers and analyses which leave them more uninformed as to what the truly important decisions are that they would be considering. If you are a member of a board where the documentation is so long for every meeting that you are pretty sure no-one has read it all sack the chairman now.

What often lies at the heart of the malfunction is an inappropriate view of the board's role – although it is supreme and the place where shareholders wishes are expressed and recorded, it is not normally the place where decisions should be made and a board meeting should never try to manage the company. The officers and executives are responsible for looking at and considering alternatives – by the time a decision comes before the board there should be a clear recommendation, a paper saying why the decision is right, and the job of directors is to questions, to see that alternatives were looked at, and in an extreme case, to veto. It is rarely, if ever, the place to make a decision – and the secret of good company governance is probably as simple as making sure the right people make the decisions on various difference subjects depending on their qualifications for doing so. The old adage that a camel is a horse designed by a committee is very often ignored; if you are on such a board I recommend always asking the other members “can we decide who is best qualified to make this decision, ask them to make it and all agree we will then back whatever decision they made?”.

Accounting to Shareholders

It is the duty of every board to render an account to shareholders every year of how they looked after their interests during the year. It is fair to say that most boards fail dismally to do this and that their performance has deteriorated hugely over recent decades. In an ideal world the shareholder would pick up the annual report from the Board and know what the most important decisions had been, where the company was headed and any major problems the directors had dealt with on his behalf during the year. Not only is he extremely unlikely to get this but he also is likely to be less informed by larger public companies than by smaller private companies.

The disconnect between their duty and proper performance of it is almost entirely due to the growth of specialist accounting firms who, with government backing, have imposed a virtual monopoly on accounting to shareholders. In the name of providing further and more comprehensive information they have made most reports incomprehensible. Indeed, in most companies the audit process is more likely to remove information or disclosures than to add it. The impact of bad decisions is hidden if uncomfortable rather than brought out into the open. The PR company is more likely to add meaningless hype and dramatic photos than to clarify and expose the activities in the period. Every finance director will have been through a process where his audit firm discourages him from revealing too much – their attitude is always “if you do not have to put it in leave it out.”

But it is unfair to blame accountants and regulators – if a board wanted to try to give a full disclosure of what it had done to further their interests during the years it would do so – but most boards would choose not to as it avoids embarrassment, does not set off awkward

questions or, at worst, being honest and revealing all might encourage the shareholders to think they own the company! Although all directors would claim every action they took was wholly in the interest of those they represent, very few in practice wish to defend this assertion, or at least not in public or on the record.

I cannot claim that I have ever really seen a board at work that was perfect in every way in spite of having over 40 UK appointments according to Companies House. I can say I have watched several really amazingly talented chairmen at work and still look forward to the day when a talented chairman leads a set of directors devoted to doing the best they can for shareholders who receive a full and revealing account of how they discharge their duty. I just have this awful fear that if I ever find such a board their shareholders will entirely fail to appreciate their efforts.

MWJ

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