Good governance trumps focus on boardroom pay

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Believe what you read in the newspapers, and the priority in establishing effective standards of corporate governance is to rein in excessive executive pay.

But this obsession with remuneration masks the real issue: the challenge for companies and investors to deliver good, transparent governance. Pay is a distraction from deeper flaws in the way UK public companies are governed, especially when embarking on transformational activities.

This is not simply a function of the need for more sophisticated handling of inherent conflicts of interest, but the whole process of decision-making where the pace of events and volume of information have been allowed to overwhelm the players.

The Salz Review, the independent survey of Barclays' business practices led by former Freshfields senior partner Sir Anthony Salz and published some four months ago, targets the broader governance challenge.

Although the report was produced only for Barclays, its recommendations apply to all public companies. Looking beyond the pay debate, it makes recommendations on how boards should process non-routine corporate events.

Two years ago, the Higgs review of the role and effectiveness of non-executive directors highlighted similar issues. Companies have been slow to embrace its recommendations, but revived attention to the issues, coupled with an increasing threat of personal liability has added fresh impetus to concern over governance and conflict management. Non-executive directors have been held responsible for errors in detailed financial disclosure and for complex provisioning computation errors embedded in group restructuring proposals promoted by management. The fact that the errors may have been buried in bulky documents provided no excuse.

One of the principal roles of non-executive directors is to challenge management proposals. This is not simply about their having the experience and status on a personal level to weigh executive initiatives, but the need for a platform on which they can properly discharge their obligations. Access to the right information, presented without spin in digestible form, and with enough time to allow considered assessment, are essential if they are to be effective.

Almost any material transaction will have a personal impact on the executive directors, which may be different from the implications for investors. Executive compensation arrangements are linked to performance. Transactions affect performance. Personal status will alter whether through changes in position, responsibility or by accolade.

It should not be enough that the board-level sub-committees of independent directors review only so-called “related party transaction” proposals in which executives have direct personal interests. Any decision, promoted by an executive and which could have an impact on corporate performance, should be given independent attention.

The way in which board process is undertaken has to change. Information needs to be better presented. Extra time needs to be built into the review timetable to allow non-executive directors to do their job effectively, and to show that they have done.

The Salz report refers to the “quality, timeliness and level of detail” of information, and the need for flexibility to cater to individual needs of board members. Higgs also directed that non-executives should insist on receiving high-quality information sufficiently in advance so that thorough consideration may be given to it to allow informed debate at board meetings.

Non-executive directors face a new landscape of risk and pressure from investors to act in line with the guidance. The burden placed on them to prove they could and did perform their role effectively dictates changes in practice to reinforce their ability to meet the standards now expected.

The weakest link in decision making, which will dictate the outcome for executive, non-executive and investors alike, has to be strengthened. Adequate process and independence, hallmarks of good governance, are about so much more than executive pay.

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