

## Chapter 8

### Board Appointment, Structure and Composition

Here, basic guidance to the end-of-chapter questions will be provided.

**1. Define the following terms:**

- **unitary board structure;**
- **two-tier board structure;**
- **quota.**

Term	Definition
unitary board structure	A board structure under which all directors (e.g. executive and non-executives) operate on a single board
two-tier board structure	A board structure where different types of directors (e.g. executives and non-executives) are separated into different boards
quota	A legal rule that provides that a certain proportion of a group of people (e.g. a board of directors) must consist of a specified group (e.g. women)

**2. State whether each of the following statements is true or false and, if false, explain why:**

- **all companies must appoint at least two directors;**
- **the company appoints a director by passing an ordinary resolution;**
- **all companies must keep a register of directors;**
- **directors are not entitled to be remunerated unless the articles so provide;**
- **two-tier boards are not permissible in the UK;**
- **only public companies are required to appoint a company secretary.**

- **All companies must appoint at least two directors:** This statement is false. Generally, a private company only needs at least one director.
- **The company appoints a director by passing an ordinary resolution:** This statement is false. The manner in which a director is appointed is a matter for the articles, with the model articles stating that a director can be appointed by a decision of the directors or a resolution of the members.
- **All companies must keep a register of directors:** This statement is false. Private companies may elect to have Companies House maintain, on the public register, the information that would be contained in the register of directors.
- **Directors are not entitled to be remunerated unless the articles so provide:** This statement is false. Whilst it is true that a director is only entitled to remuneration that has been expressly authorized, this authorization can derive from several sources (e.g. the articles, a resolution of the members, a service contract).
- **Two-tier boards are not permissible in the UK:** This statement is false. Two-tier boards are permissible in the UK, although they are extremely rare.

- **Only public companies are required to appoint a company secretary:** This statement is false. A private company will be required to appoint a company secretary if its articles so provide.

**3. 'Whilst the Davies Review into board diversity has improved gender diversity in FTSE boardrooms, it cannot be regarded as a success'. Discuss this quote.**

### **Introduction**

- Every essay should begin with a succinct introduction that demonstrates that you understand the essay question. Briefly explain what the essay is about and set out what the essay will discuss and how it will be structured.
- This essay requires you to discuss the effectiveness of the Davies Review in terms of terms of improving boardroom gender diversity.

### **The setting up of the Davies Review**

- You may want to begin by briefly looking at the background to why the Davies Review was set up, namely that in 2011, women only accounted for 12.5% of FTSE 100 directors and, at the then rate of increase, it would take over 70 years to achieve gender-balanced FTSE 100 boards.
- Point out that the Davies Review rejected the imposition of a quota and recommended a business-led approach under which companies would aim for a series of voluntary targets, of which the principal one was that FTSE 100 companies would aim for a minimum of 25% female representation by the end of 2015.
- This 25% goal was reached by the 2015 deadline, so the number of women on FTSE 100 boards doubled during the period of the Davies Review. This is to be welcomed, but it does not tell the whole story and there are two areas where development was weak.

### **The executive pipeline challenge**

- The purported benefits of greater boardroom diversity are dependent on women having a significant influence on boardroom discussions. A notable issue highlighted by Lord Davies himself was what he referred to as the 'executive pipeline challenge.' This basically indicates that the significant majority of new female directorial appointments were being made to non-executive roles and not to executive roles that have greater influence.
- When the Davies Review was launched in 2011, there were only 18 female executive directors in the FTSE 100. By 2015, this had only increased to 24.

### **FTSE 250 progress**

- The progress seen in the FTSE 100 was not mirrored in the FTSE 250. In 2010, women accounted for only 7.8% of FTSE 250 directors. By 2018, this had increased to 18%. In 2011, there were 27 female executives in the FTSE 250. By 2015, this had actually decreased to 25.

## **The Hampton-Alexander Review**

- The above weaknesses strongly influenced the recommendations of the Hampton-Alexander Review, notably (i) the principal recommendation that boards should aim for 33% female representation by the end of 2020 applied to FTSE 350 companies, and; (ii) the recommendation that FTSE 350 companies should aim to improve female representation on the Executive Committee, with FTSE 100 companies aiming for a minimum of 33% female representation by the end of 2020.

## **Conclusion**

- Every essay should end with a conclusion. Briefly summarise the main points/arguments and, if possible, come to a conclusion regarding the essay topic (i.e. which of the opposing views has the stronger arguments).

**4. Dragon Technologies plc's ('DT') board consists of seven directors. Mrs Merigold (the CEO), Mr Keyes, Dr Halsey, and Mr Grant are executive directors, and the non-executive directors are Mr Brute (the chair), Mr Grunt, and Mr Flood. In January, Mr Brute, who has been a NED for 13 years (although he was only appointed as chair two years ago), states that he plans to retire in April. At a March board meeting, the entire board discussed Mr Brute's retirement and drew up a description of the qualities required by the new chair. At the same board meeting, it was also decided that Mrs Merigold would act as chair on a temporary basis until a new chair was appointed.**

**Mr Brute retired and DT advertised for his replacement. At a board meeting in May, the board discussed the applications received and came up with a shortlist. Mrs Merigold and Mr Keyes stated that they were well acquainted with one applicant, Mr Hook, as he acted as a senior manager for DT two years ago and his performance was outstanding. The board interviewed the shortlisted applicants, and decided to offer the job to Mr Hook. Mr Hook accepted and was officially appointed as a non-executive director at a board meeting in June. At this meeting, it was decided that Mrs Merigold would continue to act as chair for two months to allow Mr Hook to complete his induction and to familiarize himself with the company. In August, he took over as chair. At a September board meeting, the board decided to make a further directorial appointment, but has yet to decide the type of director who should be appointed.**

**After reviewing the above facts, Mr Hook is concerned that DT's board appointments processes are not robust enough. He seeks your advice on whether the company and its board have complied with the law and best practice recommendations. He also seeks your advice on the type of director that should be appointed next.**

- There are four main issues to discuss here, namely (i) Mr Brute as chair; (ii) the appointment of Mr Hook; (iii) Mrs Merigold acting as temporary chair, and; (iv) the board composition of DT.

### **Mr Brute**

- Mr Brute was the company's chair. The UK Corporate Governance Code provides that the chair should be independent on appointment when assessed against the circumstances set out in Provision 10 (prior versions of the Code have also stated this).
- Provision 10 sets out a number of circumstances that are likely to impair, or could appear to impair, a director's independence. There are two circumstances relevant here.
- The first circumstance is where a director has, or had had within the last three years, a material business relationship with the company. Mr Brute was a NED prior to being appointed as chair and so had such a material business relationship with the company.
- The second circumstance is that the director had served on the board for more than nine years from the date of his first appointment. When he was appointed as chair, Mr Brute had been on the board for 11 years.
- Accordingly, there is a likelihood that Mr Brute was not independent upon appointment.

### **The appointment of Mr Hook**

- The chair of DT, Mr Brute, is retiring and so a replacement director will need to be appointed. The model articles (and the articles of most companies) will provide that the ability to appoint a director can be exercised by the members passing an ordinary resolution or by a decision of the directors. Accordingly, the directors do have the power to appoint Mr Brute's replacement.
- However, there are corporate governance standards to be aware of. Principle J of the UK Corporate Governance Code provides that appointments to the board should be subject to a formal, rigorous, and transparent procedure and, to that end, Provision 17 states that a nomination committee should be established to lead the process for board appointments.
- Based on the facts, it does not appear that a nomination committee has been established and that the appointment process has been conducted by the entire board itself. This also means that Mr Brute himself was involved in the process for appointing his replacement, which is poor practice.
- Mr Hook could have been the best applicant, but the lack of a transparent process and the fact that he was acquainted with two of DT's directors does not indicate that a formal, rigorous and transparent procedure was in place.

### **Mrs Merigold acting as chair**

- There was a two-month gap between Mr Brute leaving the company and Mr Hook taking up his role as chair. In that period, Mrs Merigold acted as chair, meaning that she was both chair and CEO.

- Provision 9 of the UK Corporate Governance Code provides that the roles of chair and CEO should not be exercised by the same person. This has been breached.

### **Board composition**

- In terms of deciding who the next director should be, the composition of the board should be borne in mind.
- The board consists of seven directors, of which only three are NEDs. Provision 11 of the UK Corporate Governance Code provides that at least half of the board, excluding the chair, should be NEDs whom the board consider to be independent. Accordingly, the next director to be appointed should be an independent NED.
- The board should also consider the gender makeup of the board as Principle J of the Code does state that board appointments should promote diversity of gender (amongst other things) and boardroom diversity is currently a prominent governance topic. Of the seven directors, we know that one is definitely female (Mrs Merigold), possibly two (we are not told the gender of Dr Halsey). Accordingly, the board (notably the nomination committee if DT sets one up) should consider whether the next appointment should be a woman in order to improve the board's gender diversity.