



SOME THOUGHTS ON CORPORATE GOVERNANCE (PART 1)

Corporate governance is currently getting an enormous amount of attention. There is generally a feeling that in the last few years something went badly wrong and that in the future some major changes need to take place.

In the past I have written a number of opinion pieces that touch on this subject. All my opinion pieces on Japan cover my concerns in relation to Japanese style corporate governance and in Opinion Piece 13 I wrote about the mad world of executive compensation. In that I talked about the need for the shareholders/owners of companies (primarily the big institutions) to vote for change.

This month I want to focus in on Ireland and the composition of boards of directors. In particular I want to look at the independence of members of the board. I want to concentrate on this because I feel that the current crisis has highlighted the need for directors that are independent and strong enough to ask questions of dominant personalities. I say this because my gut instinct is that the directors of Anglo Irish Bank and Irish Nationwide Building Society allowed Sean Fitzpatrick and Michael Fingleton to run their respective organisations with a fair amount of freedom. I guess that it would have taken a particularly strong personality to question Sean Fitzpatrick while the bank appeared to be so successful. The fact that he was prepared to go on the Marian Finucane radio show and speak in such a confident way highlights to me just how difficult it would have been to ask those difficult questions and not just blindly accept his apparently confident replies.



Sean Fitzpatrick

So who does have the power to shape the board? How do we determine if someone is independent? In theory the rules governing this area have been set out in what is called “The Combined Code”.

The Combined Code sets out a series of recommendations and it also has a whole section looking at the independence of directors:

The board should identify in the annual report each non-executive director it considers to be independent³. The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director’s judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;
- has close family ties with any of the company's advisers, directors or senior employees;
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.

Out of curiosity I went back to look at the Anglo Irish Bank annual report of 2007 to see what it had to say. Naturally enough it said that they followed the Combined Code:

The Directors of the Bank are committed to maintaining the highest standards of corporate governance and, in particular, have regard to the principles set out in 'The Combined Code on Corporate Governance' published in July 2003 and revised in June 2006.

This Corporate Governance statement describes how the Bank applies the principles of the Combined Code and comments on its compliance with the Code's provisions. Except where stated, the Directors believe that the Group has complied fully with the provisions of the Combined Code throughout the financial year ended 30 September 2007.

I then looked at the section that deals with members of the board to see which members were listed as being independent. I was surprised to find the following:



 **Sean FitzPatrick (59)** was appointed Chairman in January 2005. A Chartered Accountant, he also serves as Chairman of Smurfit Kappa Group plc and is a Non-executive Director of Aer Lingus plc, Greencore Group plc, Gartmore Irish Growth Fund plc and Experian Group Limited.

In other words Anglo Irish Bank claimed that Sean Fitzpatrick was an “independent” member of the board. The Combined Code as shown above says that you are unlikely to be independent if you have been an employee in the previous five years. Sean Fitzpatrick had been Chief Executive!

I was not as surprised to see the following:

 **Gary McGann (57)**, who joined the Board in January 2004, is Group CEO of the Smurfit Kappa Group plc. He is Chairman of the Dublin Airport Authority. He is also a Director of Aon McDonagh Boland Group and United Drug plc. He holds a BA degree from University College Dublin, a Masters degree in Management Science and is a Fellow of the Association of Chartered Certified Accountants.

Sean Fitzpatrick was chairman of Smurfit Kappa and Gary McGann was (and still is) chief executive of Smurfit Kappa. I would have thought that this might impact upon independence given the Combined Code comments on cross directorships and significant links with other directors but sure if Sean was independent surely Gary was independent as well!

 **Michael Jacob (62)** has been a Director since 1988 and is a Fellow of the Chartered Institute of Management Accountants. He is Chairman of Slaney Foods Limited and the Lett Group of Companies, Deputy Chairman of SIAC Construction Limited, a Director of REOX Holdings plc, Dolmen Securities and other companies.

In 2007 Michael had been on the board for nine years and the Combined Code states that after nine years you are unlikely to be independent.

In the annual report they do mention the following about Michael Jacob:

One third of the Directors are required to retire at every Annual General Meeting. Consequently, every Director must submit themselves for re-election at least once every three years. New Directors are proposed for re-election at the Annual General Meeting following their appointment.

Whilst not strictly in line with the Combined Code, Michael Jacob, who has served more than nine years as a Non-executive Director, was not proposed for re-election by the Board in 2007 as he had been put forward for re-election in both 2005 and 2006.

This is the only time I can find any mention in the annual report of not following the Combined Code. I cannot find any other reference to it. The minimum I would have expected was an explanation as to how Sean Fitzpatrick was deemed to be “independent”. Instead all we get is the following:

Independence of the Board

The Board is satisfied that each of the Non-executive Directors is independent. In reaching that conclusion, the Board took into account a number of factors that might appear to affect the independence of some of the Directors, including length of service on the Board and cross-directorships. In each case, the Board is completely satisfied that the independence of the relevant Directors is not compromised.

I am perplexed by this statement because it suggests that they knew that there were question marks over some of the members in terms of their independence and yet they did not explain in the way that I think the Combined Code suggests they should. (This is known as the principle of comply or explain)

At the moment I do not know whose job it is to police these matters. I want to find out. Is it the Irish Stock Exchange or the London Stock Exchange or the External Auditors or the other directors? Is it possible that legal action could arise?

I feel that this subject needs further work and I intend to return to it next month. In fact there are a number of issues in relation to corporate governance that are worth looking at, so watch this space for Part 2.