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BOARD

“A BOARDROOM CONVERSATION WITH JIM LENG”

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Bvalco hosted a conversation with Jim Leng as part of the ‘Boardroom Conversations’ series of targeted discussions with experienced Chairmen enabling them to share their insights and learning experiences of boards and corporate governance.

Jim Leng is Non-executive Chairman of HSBC Bank Plc and also European Chairman of AEA, an American private equity partnership. He sits on the Boards of two listed companies as a Non-executive Director: Alstom SA (French Engineering company) where he chairs the Nomination and Remuneration Committee, and as Senior Independent Director of Genel Energy PLC, an oil and gas company with its principal interests in Turkey and Kurdistan. From 2001-2009 he was Chairman of Corus Group plc, a global steel company sold to Tata Steel of India in 2007 and where he was also Deputy Chairman until July 2009. In an executive capacity, Jim was CEO of two public companies including Laporte PLC.

The following paper is a summary of the conversation including questions and comments from the floor.

1. GEOGRAPHIC DIFFERENCES

Leng has sat on various boards in different countries and different industries. In his view, the UK has the best governance structures and frameworks, although he stressed that “the best governance doesn’t always equate to the most effective board”. An effective board is also dependent on the culture, behavioural patterns and the input of the individual board members, as well as a robust framework of governance.

To Leng, a board is best built around the collective knowledge and experiences of the directors; he said that it can be detrimental to a board’s functioning when individual board members are appointed solely because of their specific individual area of expertise because the board can become overly reliant on this one person’s view on that subject. Leng mentioned that this can sometimes happen with, for example, lawyers. Rounded lawyers, who take on non-executive roles, understand the

importance of breadth and don't get pigeon-holed in this way. Every director on a board needs to be able to discuss debate and contribute to each major topic, albeit broadly.

On the topic of CEO as Chair as is still frequently the case in the USA, Leng was clear. "The most critical board member is the CEO this adds to his belief that it is difficult to combine the role of CEO and Chair – "they are totally different roles, each requiring a different skill set". Whilst combined roles can work, his belief is that America will ultimately move towards role separation.

2. BOARD DYNAMICS

The Chair and CEO cast a long shadow. Leng believes you can tell early on if a dynamic works well - people spark off each other and get good debates going. The CEO and Chair must complement each other, "the sum of the whole should be greater than the sum of the parts, 1+1 must equal more than 2" he says. Regarding dominant CEOs, Leng acknowledges that whilst this in itself does not mean they are not extremely capable and high performers, he advises that managing this is a critical Chair's role. A good chair will manage this in all its dimensions.

Leng suggested board members, in their annual review of the Chair's performance, should question whether the relationship between the Chair and the CEO is a healthy one. The Chair is there to support the CEO, be his mentor, having a relationship of trust and respect and not a 'cosy' relationship. Leng warns that "an all-powerful CEO will generally come a cropper". The Chair must work on their relationship with the CEO and vice versa; it should not be a battle for power.

From a Chair's perspective it is important not to outstay your welcome, "one cannot be a man for all seasons" Eight years, maybe a little more or less, is enough in any organisation. Beyond that a CEO or Chair becomes very difficult to challenge. Leng cites politicians, who after ten years tend to lose touch with their constituents: their accumulated experience means they always "know" more than their advisers and become impossible to challenge. It is the same with Boards, he said. There always comes a time when fresh eyes and fresh minds are needed.

3. INDEPENDENCE

Jim Leng is often described in the press as being a 'strategic and independent thinker'. Leng's comment on this topic is, "if you have a strategy that you can't execute, then it's not much of a strategy in the first place". This is a fundamental problem – the board can also be too far away from the daily running of the business to know if the organisation is capable of executing their strategic thinking and decisions.

Of the term “non-executive” director Leng says “it describes a job you don’t do - if you’re not executive, what are you? You’re independent. This means having the best long-term interests of the company in the front of your mind – not just thinking about pleasing the shareholders all the time. Realising this can avoid all sorts of conflicts and difficulties.”

Leng suggests that whilst some boards are independent, others say they are but in reality they are not. More rounded boards enjoy the challenge of debate and being truly independent. From the executive perspective, some find it hard to deal with a really challenging board. Others, probably more often than not, bemoan that they don’t get enough independent challenge. Independence, he says, is a state of mind as much as anything else.

4. JOINT VENTURES

Leng has considerable experience of joint ventures. He noted that joint ventures typically run their course; some longer than others. The key is to watch for the signs that the joint venture has reached the point where it is no longer beneficial to the company or to either party. Ending joint ventures can be painful and disruptive. Reflecting on his experiences at TNK-BP, Leng explained that it became clear the partnership was no longer fit for purpose – “the marriage was over” – and it was in the best interests of the company for the partners to “get divorced. The Board had become irrelevant and the company required new ownership and long term clarity over its future which it now has.

5. BOARDS OF BANKS

Leng reflected on his experience at HSBC saying “banks are complex – they are immensely complicated, and they’re big”. Leng described that in nearly every aspect of size, structure, product and geography they are complex. It is this that makes them difficult to understand and manage well. Leng therefore believes that banking specialists are needed, for example on risk committees, who will be intimately acquainted with the issues and the products, and it may be less on the audit committee. . The need for these specialists makes it a real challenge to achieve diversity in the make-up of a bank board.

Executives of FTSE 100 companies are largely unavailable to bank boards because the time demands are too great; this means a huge talent pool maybe 2,000 executives are lost to the boards of banks, having an adverse effect on the availability and diversity of talent. In Leng’s view, executives are an asset on boards because they can more irreverent challenging and resilient. “The fact that they are off limits to banks, means the banks’ boards are poorer for it”. Diversity of experience, background, gender and industry are ultimately needed. This is a paradox for regulators and boards of banks.

Leng is the first non-independent chair of HSBC and has been on the Board for three years. Leng joined HSBC because he liked and respected the people at the top and on the Board. He explains that he always looks at the combination of the Chair and CEO and likes to invest a lot of intellectual capital in the people he'll be working with.

When asked what he does before taking on a role, Leng commented that you only see what's on the inside when you get there – "it always is more challenging than you observe from the outside before you join a board". In his experience this is true of all boards. For example, when Leng first joined HSBC, regulation hadn't begun to show its hand as it has now and he admits he had no idea how it would play out or the time commitment the role would require. He adds that it is a fascinating time for boards of banks.

6. BOARD FUNCTION

Leng advises that in order to ensure you get things done on the Board you have to understand the business, the people, and the product; even if you are brought in for your existing expertise. In his view, executive reports don't work for boards; they are designed as executive to executive information, which is not Board information. You've got to work hard to get the information presented to the board in the right form, and this takes time, effort and understanding.

Leng explains that previously, Boards primarily had oversight but little strategic input - now they have as much more of the latter., To be able to perform this reasonably well requires some detailed and current knowledge of the business and the markets in which it operates.

In fact, Leng believes that new NEDs need time, maybe a year on a board before they're effective. They need to take time to really get to understand the business. NEDs need to get the executive directors, to help them gain this understanding and so aid the process of building the process of effective and positive challenge.

Leng encourages NEDs to ask the blindingly obvious when they feel something is not quite right and here again the culture of the Board is important. To do this, NEDs must have financial and commercial understanding of the business environment. NEDs could ask the executives to boil down the information they are given, he suggests. According to Leng, there aren't many issues that can't be boiled down to a few fundamentals, say around growth and break-even points; for example he has a golden rule that in a cyclical industry it is important never to over-borrow because you never know when you're about to enter a new adverse cycle, how deep this would be and how long it would last. Once you know the fundamental of the business and the overall picture, the role becomes clearer, he says.

When Leng joined the Board of TNK-BP as one of three independent directors, he asked the Chair what he wanted from him, to which the Chair replied, 'good advice'. Leng had a marvellous experience on the Board. He voted six or seven times,

something he hadn't experienced on other boards. He says that the big attraction of being on different boards is the variety of diverse experience you get meeting fascinating people from all over the world and dealing with interesting problems. When Leng becomes an NED he thinks, what will I take away from this that will keep me learning and engaged?

Leng chaired Corus until it was sold to India (Tata Steel). Leng explained that they had a controlled auction, where the two bidding companies could bid over nine rounds. The bidders were from Brazil and India – their style of bidding, in some way reflected how they played their national sport. Brazil, football, played with flair and unpredictability, and India, cricket, strategic, clear sighted with a laser focus on winning. There was an hour between each round and it took place in one evening. This was a fantastic and totally unique experience.

7. REMUNERATION

Leng forecasts that there will be an increase in remuneration for non-executive directors. He thinks that every Chair must have the flexibility in their diary to deal with the unpredictable and unexpected – they have to be on call all the time. It's a conflict of interest if you have to choose between two companies because you haven't got time for both. The role is more demanding, more time consuming, more challenging. The rewards for this will have to rise.

8. THE CHALLENGE OF BEING CHAIR

Leng believes that one of the joys of being Chair is the challenge of dealing with human nature. People in times of corporate stress can view the issue in terms of, "what does it mean for me?" "People can get caught up in providing evidence that fits the solution they want" he says. He also has seen boards not deal with balance sheet issues appropriately. "Balance sheet issues require balance sheet solutions and some Boards sanction irrational deals just because it carries kudos." The job of the board and especially the chair is to keep the long-term interests of the business front of mind – not the reputation of the chair or CEO

