

An interview with Sir John Parker, Chairman, National Grid

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Scandal, shareholder activism, ever greater governance demands, risk considerations, the vexed question of the extent of corporate responsibility, and concern for the enhancement and safeguard of corporate reputation, have catapulted the role of Chairman of the Board to public prominence and scrutiny.

- What does it mean to be a Chairman of today's medium to large sized organisation?
- Is the role understood?
- Is it adequately rewarded?
- What sort of people become Chairman?
- Is best talent attracted to this ever more important role?

These and other questions are addressed by one of the UK's most experienced Chairmen and Board Directors, with a track record currently boasting Chair of the Court of the Bank of England as its Senior Non Executive Director, Deputy Chairman DP World, as well as a Non Executive Director of Carnival Cruise Group and his principal role as Chairman of National Grid. He has Chaired many major FTSE companies through transformation and significant shareholder value creation at Babcock International, RMC Group, P&O and the Lattice Group. In addition, he has served on a raft of companies as a Non Executive Director for well over 20 years.

What has influenced you?

I trained as a naval architect and engineer and my mathematical background has helped give me a sense of proportion. I suppose too I'm pretty numerate. I think that's important in business because at the end of the day you have to put dimensions on issues and you have to make judgements based on such facts. The engineering mind is quite a disciplined mind. Try to get the decimal point in the right place if you can – that's a very important bit of business!

What then of Chairmanship?

I have some key golden rules that I apply when I'm actually structuring my role as a new Chairman. It starts by debating what is to be the management philosophy of this company and its Board going forward. You then spend time thrashing this out with your Chief Executive. Particularly, when two organisations are brought together in a merger or major acquisition, then you really have to stop and say, what is our philosophy for managing this one enterprise?

It is the principles that emerge from such debate that guide me – but they inevitably start by installing leading governance practices beyond compliance. So when Higgs came along, we at National Grid, for example, had virtually nothing to change. We were completely compliant! Second, we inevitably decide we are to have decentralised operational management decision-making within agreed delegated authorities and well defined responsibilities. Third, whatever the structure, strong central financial controls, that penetrate all the way down the organisation, are essential and there has to be that dotted line, independent financial reporting relationship right through to the Boardroom. But, as one of my friends has put it, “not

too much space between the dots"! And fourthly, and particularly relevant in the world we live in, sound administration. By that I mean the good documentation of how we do things via our policies and procedures including the documentation of authorities and responsibilities. Keep the documentation as simple and streamlined as possible and disseminated widely on the web, so that people working in any role know precisely what their authority is and they know how to get "sign off". Well documented records of decisions and the advice taken by a Board are also critical in today's Boardroom.

The same applies to Board committee structures, membership, terms of reference and then something not often talked about is high level Board and committee interactions. The key responsibility for ensuring a good interface between the committees, which is done outside the Boardroom to make sure nothing drops between the floorboards. This is what I call "joined-up governance" part of Board administration This explains why the role of the Company Secretary and the General Council has grown in important over recent years.

Is clearly structuring the organisation and roles the way to lead people?

It's only the first step. Next is to empower the Executive to be creative, to constantly exercise how to create value. The Executive have to have a clear vision of the future and the Non Executive Directors need to have a large breadth of skills in the Boardroom that can challenge and debate to add value, and minimise risk. At every Board meeting we devote time to strategic debate but the first Agenda item is Safety, Health and the Environment. What's the nature of our business model and where are you trying to take this model? I always say to the Executive, you should keep the Board "warmed up" about where you're trying to take the business – minimise the surprises and be consistent in strategic direction and focus.

How important is debate between the CEO and the Chair?

A very important stage in setting up a new Board is defining the role of the Chairman and that of the Chief Executive. It is critical to get that right. I think the role of the Chairman, in its simplest form, is leading the Board, managing governance and oversight of strategy. The Chief Executive, with his team, is responsible for managing the business day by day and for formulating and executing strategy for subsequent Boardroom debate. Strategic direction is a key matter for the whole Board. The Chairman should really be the CEO's mentor, his sounding Board, the guy that the Chief Executive will naturally turn to discuss things. For the Chief Executive here at National Grid, I have a formal slot every week with him. Beyond that we will wander in and out of each other's office if there's something on either of our minds. Informal debate is highly valuable and something I think should be encouraged in the CEO/Chairman relationship. The CEO goes back to the Executive with some of my views and I to the Non Executive Directors with his. The Chairman is the bridge between the Executive and the Board as a whole.

Is it important to define the roles of Chairman and CEO or are they, by nature, self-evident?

No, one of the good things to come out of the Higgs Review is the requirement to set down and define the role of the Chairman, and the role of the Chief Executive and debate that at the Board. At National Grid we had already done that in advance of Higgs. It was a prerequisite of the merger because I had been Acting Chief Executive of the other Group, and suddenly I was the Chairman dealing with the new CEO who was the guy with whom I had negotiated! I believe it's important to write down duties and responsibilities.

How does the Chairman add value?

The Chairman can ensure there is a disciplined framework in the Boardroom for conducting business. That leads in time to having a clear discipline right through the organisation. People knowing exactly where they stand and what the processes for key decisions are. I don't like to see people running around like headless chickens fighting for their corner. So the discipline that emanates from the Boardroom, the drumbeat that you set from the Boardroom is a very, powerful influence on the organisation as a whole. Here at National Grid, we also as a Board have a significant interplay with and knowledge of the next layer of management.

The value that the Chairman and Chief Executive can both add is to organise the Board visits, etc. in such a way that a dynamic relationship exists between the people who are just below the Board and also are not only key managers but the future talent bank.

Also, getting to know the team of people is fundamental in the succession planning process discussed at the Board. Unless you know people, it's a pretty meaningless discussion. People put up names and say this guy was at Cambridge and he's done five years here and five years there. What about his/her personality? What about emotional intelligence and his/her fit with other people? How good is he/she at managing across functions? I haven't a clue unless I know him/her. The Board members haven't a clue and so they can't add value unless there are opportunities to meet and see people in action. Adding value on the people front is vitally important. Setting up a disciplined framework is critical to the smooth and safe running of the business and for the development of key people.

What makes the Chair/CEO relationship work?

It has to be based on professionalism and care and concern for the success of the business being more dominant than the personalities. Equally, it doesn't need to be too formal. I shake the hand of every executive that comes into my office. It's a small thing but when I came here we did not normally do this. So, every time the Chief Executive comes through my door, the hand's out. Shake hands, sit down and then relax. The signal is, we're in this together! We're professionals. It's not about both of us having to go out together regularly and socialise at Rugby or over regular dinners. I don't generally do that. As it is, we go out to dinner with the whole Board once a month. We often have a presentation before dinner especially if we have a tough subject the next day. We invite the Executive or the management to come in for that. They will join us for dinner – the buzz is really good. If we have an awkward subject, then over the main course, we'll open up the debate. I'll ask the CEO where are the Executive on this? Sometimes we have quite heated debates. But next day at the Board, what looked before like a mountain of an issue, you've eaten two-thirds of it.

Can informality get in the way of assessing the performance of the CEO?

Yes it can. I've had situations where the Chief Executive is not doing what he should. He's not delivering what the Board asked him to do. And that's where the Chairman has to act. I say we committed to deliver on this, so I and the Board expect to see progress. Then you find that excuses are being made. But the moment you sit the Chief Executive down, especially if you have a relaxed but grown up relationship, then you really must come out of your box and confront him/her. I say, "the reality is you are not delivering. You're going to have to get your skates on because I expect the Non execs at next month's Board are really going to be very challenging. Some of them have already been on to me." In that sense I'm the bridge between the Board and the CEO. I'm also the conduit for the Non Executive Directors to express their personal views. The Chairman must keep lines of communication open with the Non

Executive cadre. That bridge is quite important. But the Chairman must deliver the message, however difficult.

Do you have Non Executives who hold a specialist functional role?

Yes, we do! And they “buddy” with the appropriate executive!

This comes again down to a discipline framework. Apart from the Nominations Committee which I Chair, all other Non Executive Director's interface with the appropriate Executive Director. The leader of the Audit Committee is a Finance Director from a FTSE company. He will interface with the Auditors. He will interface with the Finance Director and the Internal Auditor and go meet them, off line, if there's something that concerns him. He will not necessarily talk to me about it. He doesn't have to. I don't require it. If it were a major issue, I would expect, via the CEO and Financial Director, to know and be well informed of it. The Chairmen of the committees of the Board invite the appropriate management to attend and the duties of committees are well spelt out including that of interfacing with each other. All this ensures that the Board has ultimate transparency via reports on risks and compliance, integrity of management systems, health and safety, the environment, CSR, internal and external audit, human resources, legal company secretary issues, financing issues, etc. Chairmen need to ensure the processes are in place to ensure so far as is humanly possible for complete transparency on the company and its operations.

How many Executives sit on the Board?

We have six, the Chief Executive, Finance Director and four Divisional Heads. This is matched by six Non Executives and the Chairman, 13 plus the Company Secretary and General Council. The Company Secretary and General Council is not a Board member but in today's world of high expectation on governance, a very important person, particularly in the Sarbanes-Oxley era. The amount of documentation that we have to write up and go through is just enormous. We will see greater emphasis on the role of the General Council, Company Secretary on Boards in the next decade.

Will Sarbanes-Oxley really make a contribution?

This is the question we all keep asking when we hear of the significant, extra costs of the Audit. We have a very large project team working on it at National Grid. Our estimate running down on the whole programme we're embarked is some £10 million extra. Every year we have got to walk through every single IT system and then test it against “what ifs”. If you find any error, we have to correct it and then re-test everything again. It's an iterative process, which means we cannot at any point in the programme define the total resource required or the timescale to complete. So even in the last weeks of the audit, you still may not fully know that we are going to be able to tick all the boxes. Auditors cannot now leave any loose ends. When you sign off, you've got to sign off and leave no loose ends. This is producing enormous pressure on Auditors as well as on us. But, Auditors are short of the right resources and clearly have Lawyers sitting on every key decision. It can be rather paralyzing. I think the entrepreneurial spirit is being dampened. So, what are the benefits? And I keep pressing; come on – there must be benefits! Probably being forced to better document the systems and being forced to introduce more rigour and discipline. Being forced to sign off and certify this is a true and correct record at various micro levels probably gives a few extra hours sleep at night. In my view, the US has used knee jerk legislation that now needs refining.

How to become a good Chairman?

The best Chairmen I've ever had when I was a CEO were strong, who knew what they wanted to do in their Boardrooms. What makes a good Chairman? In my view one can't become a good Chairman unless the individual has done a good apprenticeship as a Non Executive Director. You occupy the same Boardroom but you occupy a different space in the Boardroom from the Executive. I judge a Non Executive's effectiveness by – does he/she influence events? Does he/she influence strategy? Does he/she influence the behaviour and response of the Executive? I consider one of the best development opportunities of my life has been to serve in other Boardrooms as a Non Executive Director which I have now been doing for some 23 years. I learnt more there than in any business school! And the reason is very straightforward. It is a live, dynamic, real experience and you are forced to learn about the creation of value in a company. You are forced to engage in a strategic debate that's not all academic debate. Now, not everybody can have that experience so that's why we have good business schools and there should be a closer interrelationship between us all, in the education of good management. So I believe to be a successful Chairman, you have to learn from others and learn from Boardroom colleagues especially in Chairing important committees of the Board. You can learn from excellent companies as well as companies going through a lot of challenge, e.g. I learnt a lot from the British Coal Corporation which was a nationalised company. They had management development formalised in a way I'd never seen in the private sector. They had their own Management Training College. I used to go and lecture there and meet all these guys from all over the UK. They really invested in their people in a way that we at that time didn't in the private sector. One can learn in all sorts of places and in unexpected ways.

A particularly sensitive issue for the Chairman is executive remuneration! What is your approach?

First of all, I believe in keeping an oversight and join the debate about the overall framework and philosophy of compensation but you must leave it to the Remuneration Chairman and the independent Directors to determine the remuneration profile for each Executive Director. I sit in on all of the Remuneration Committee meetings because it's clearly an important part of corporate life. I start from the simple principle that quality people in the Boardroom make the difference. That applies to the Chairman and the Non Executive Directors. It certainly applies to the Chief Executive and the Executive team. I believe that you should reward well for performance, in line with your peer group and you should reward very well for outstanding performance. Reward, however, should not be excessive, nor should there be award for failures. The other point I make is that I'm suspicious of complex formulas by which awards are arrived at. I think there has been, over the last decade, considerable complexity injected via remuneration consultants that some Remuneration Committees have bought into. The more complexity there is, the less visibility there is to shareholders and, indeed, to company management as to how their Directors are rewarded, whereas if it's straightforward, let us say earnings per share or TSR, the situation improves. TSR is of itself not the easiest thing to explain internally in a company because it's not something individual managers can work out every day of the week. Earnings per share (EPS) is something you can see every quarter, return on capital measured on a consistent basis is as well. I have to say after so many years in Boardrooms that in reality there is no perfect system of measurement. But taken over time, I feel that tangible measurements, like earnings per share, will for most companies be an important, consistent measure of shareholder value creation coupled with TSR.

What of the intangibles? The culture the Chief Executive has created? The redesign of the organisation? All of which will not show earnings per share type of returns until, let's say, 20 months from now. How do you reward critical intangibles?

Well I think you do have an element of your annual bonus that is based on personal targets. So there is a performance element that's probably 70-75 percent, and 20-25 percent would be the personal issues or strategic building blocks that you want to see put in place to support, future years' earnings growth. It is important that these personal targets should be measurable and well-defined.

What then of the options scandal that has been plaguing the USA? Something like 580 companies are under investigation for backdating stock options!

It comes back to one of my four pillars in the Boardroom. You need sound administration, and a strong General Counsel with a good Corporate Secretariat They would not allow that sort of thing to happen – they would and should scream! I just cannot imagine it happening here because we as a Board, receive a regular report from the Corporate Secretary on all administration with regard to share issues. All stock issues are approved by the Remuneration Committee, in the hands of independent Directors with the General Counsel advice available. She, in our case, would administer that under a disciplined administrative system.

If you were to offer advice to a newly appointed Chairman on best practice remuneration, what advice would you give?

Select wisely the Chair of the Remuneration Committee and put in place sound administration for the management of the Committee and ensure good, professional support from your HR Director. I think if you get those three things reasonably aligned you can filter out most of the rubbish.

Do the execs and non execs share a similar view on creating value for National Grid?

We encourage real debate in the Boardroom and amongst Executive and Senior Managers. The top sixty managers in the US and UK had a strategic debate with the Executive in the Autumn at their Annual Conference. They were all buzzing. "We had a real dynamic debate today about strategy". I said, "Well I hope you've influenced it." We gave the Executive quite a tough time. I think that is how you open up the oyster, how you engage with the next layer of management. One of the elements of that debate was how do we actually measure success? Is it growth in EPS over five years and/or is it total shareholder return? And if it's total shareholder return who really are your peer group? National Grid is, in my view, largely about cash generation and EPS growth.

Many non-execs tell us, they don't quite know how to add value. How have you managed to have the Board of National Grid to clearly add value?

It comes back to the debate on the clarity of the strategic objectives, the aims of the business and the consistency focus on a well-defined business model. If suddenly the Board receives a paper that says we're going to open up the Indian market, or we're going to put \$100 million of capital down in Indonesia, well hang on, where does this all fit in? Adding values emerges through debate and challenges and practical suggestions from the Non Executive Directors. How are you going to take this model from here to there? Are we rigorous enough in our control of costs? Are we doing things we shouldn't be doing? Should we be looking for more outsourcing? Could we gain through common business services? That's where good Non execs come in. This is where the struggle to add value takes place.

With such a requirement, where does the new breed of Non Executive Director come from?

The plc, relative to society, is probably shrinking in terms of the talent bank because a lot of talent has gone into venture capital (VC) which now employs approximately twenty per cent of private sector employees. Many executives also do not like the public visibility and transparency of the plc. An AGM of 500 shareholders asking you whatever they please - not everybody can take that. In my view, the leakage of talent will continue because VCs are now competing with the equity market for the best Executive talent. The VCs are now the new conglomerates. This is Arnold Weinstock being reborn in the form of the Carlyle Group, Trans Pacific, CVC, etc.

However, despite the VC influence, there is still a lot of young talent coming through. I have said to our Executive Directors and the Board, that as part of the development of Executive talent we want them to have the opportunity to be groomed, coached and developed to be potential Chief Executive material. So we've developed such a template for our Executive Development Plan. Part of it, at the right moment in their career, is to support them, find an external Non Executive Director role. They are also sent to Business School for specific courses and on courses about the responsibilities of a plc Director, etc. So they are exposed to a range of training and coaching. But the best form of development is to serve on another Board as a Non Executive Director. The new company will benefit from talented, younger executives from another business sector whilst the individual will have a unique experience to grow in another Boardroom and discover the different ground occupied by the Non-Executive Directors.

Thank you, Sir John, for a most enlightening interview.