

BECOMING A COMPANY DIRECTOR – Part 1

Jeremy Thorn, an experienced company Chairman and Director, looks at many of the requirements of becoming a Company Director.

COMPANY LAW

Most of us will view our first appointment to the role of a Company Director as an exciting enhancement in our career status. Indeed it is! But it can also be quite an onerous role which is not always well understood: many of the duties will be covered by a wide range of detailed legislation in the UK which you need to be aware of.

Apart from Employment Law, Health and Safety at Work, Environmental Law and many others, there is also the much wider Companies Act and all their updates - all of which need to be respected. And do note? Ignorance of the law is no excuse for failing to comply!

Most importantly, the key point for all directors is that they have a **'fiduciary responsibility'** to:

- Show the highest loyalty to the company and its wider interests; ie above and beyond their personal interests!
- Act in good faith, honestly and diligently; and ignorance of the law is no excuse!
- Balance both the long and short term interests of the company; so not just to plan for today and hope tomorrow will be OK, or to plan for a long-term future without detailed regard for the short-term!
- 'Have the attributes of Trustees as regards company property', such as cash, tangible assets, intellectual property, trade-secrets, know-how, etc; and to be personally liable for their reinstatement if misapplied however honestly!
- Declare any conflicts of interest – for example in trading with another business you may have an interest in.

This three-part article is intended only as a broad, practical introduction to being a director <in the UK>.

This is not a legal treatise! You should always seek professional legal advice before accepting the role of a director in any business, as part of your essential due diligence, and indeed on any other matters that might cause you concern or if you are in any doubt.

We will return to the very important matter of fiduciary duties in Part 2.

THREE COMMON MISCONCEPTIONS - and COMPANY OWNERSHIP

The first most common area of confusion for many directors is the relationship between being a director and a shareholder. Many presume one role goes with the other.

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In small companies, this may often be the case in practice, but in fact, these two roles need not formally be related at all. In any company, you can be a shareholder and not a director, and *vice versa*. In many companies, it is of course common for at least the major shareholders also to become directors (or be represented by a director), not the least to protect their investment. It is also just as likely that directors may also want to take a stake in the company as shareholders, if they have the opportunity to do so, or even if it is a requirement of their appointment. But shareholders don't *have* to be invited to join their board, and directors don't usually *have* to buy shares.

However, a director does have a duty to represent the shareholders' interests, and it is the shareholders who will, at least nominally, appoint the directors – or fire them.

The second most common area of confusion surrounds the legal status of a company. If you set a business up and you own all the shares, you might think you can do just what you like with the business. Right?

Well actually, no you can't! Shareholders have 'property rights', of course, and usually have the right to vote in General Meetings, to appoint and dismiss directors, receive a dividend if agreed in proportion to their shareholding, and even liquidate the business and receive any assets. But a 'company' is a legal entity in its own right, constrained by its **Memorandum and Articles of Association**, and directors have a duty to safeguard the best interests of the company accordingly.

Before you ever agree to join a Board, you need to make sure you have read and understood these as part of your due diligence. In particular, you will want to understand all matters relating to shareholders' '**Pre-emption Rights**', which will govern who can sell shares to whom and how, most especially in a private company. These could be especially relevant to you should you or a fellow shareholder decide to leave – or even be asked to leave.

Thirdly, many new directors understand the term 'Limited Liability' to apply to them. It does not: it applies to the company. Directors run the company on behalf of the shareholders and are responsible for their actions.

So you may well want to investigate '**Directors' and Officers' Liability Insurance**, which I strongly recommend, if only to protect you and your fellow directors against any malicious and spurious claims which can still be very time-consuming even if you are quite innocent, and take you away from running your business.

COMPOSITION OF A BOARD

Under current legislation, a company only needs one **Director** "who is a natural person" (so not your dog or goldfish!), aged at least 16. There is no legal maximum age and there is no formal requirement for private companies to have a **Company Secretary** - although the duties of such a person will still need to be discharged, either by a Director or, for example, a suitable adviser.

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In practice, there will usually be a **Chairman**, who may be either a full-engaged 'Executive' Director or a part-time external 'Non-Executive' Director, appointed by the Board to chair meetings and ensure its smooth running; and a **Managing Director** who should preferably be someone else other than the Chairman in all but the smallest companies, responsible for the company's operations within the strategic guidelines determined by the Board.

Other **Executive Directors** may then also be appointed to the Board who have other, employed functional duties in the business (such as Finance, Sales, Operations, HR, IT etc); along with external, independent **Non-Executive Directors** who need to be fully involved with all board deliberations in order to offer their additional experience, skill and knowledge, to monitor performance objectively, to help over-see proper corporate governance and good practice, and to help resolve any conflicts of interests and disputes between the Board or even with other Shareholders.

Finally, there may also be three other types of director, which you need to be aware of:

- a '**Local**', '**Special**' or '**Divisional Director**', who does not in truth act as a 'director' but may still carry the legal responsibilities of one if they hold the courtesy-title 'Director' – so best avoided?
- an '**Alternate Director**', appointed to perform the duties of a director for a limited period in the absence of another;
- a '**Shadow Director**', who effectively acts as a director even though not holding that title, who also carries the same legal responsibilities as if a director. (This may apply to many external advisers and even senior managers inside the business, if they don't take due care to distance themselves from actually making Board decisions.)

SOME PRACTICALITIES

Directors should not be appointed just because they need a 'pat on the back', are a good friend or are an incidental member of the family! They have important duties to fulfil and they need to be aware of these and be capable of discharging them. (See Part 2 for more detail!)

To guide you on this, any director is expected to have and to exercise:

- the general knowledge, skill and experience that may be reasonably expected of *any* person carrying out that function;
- the general knowledge, skill and experience which that director has *personally*.

Moreover, directors must lift their eyes above their own detailed concerns and interests. Remember, any company is a separate legal entity? A director will need to offer their specific expertise and knowledge to any board discussion, but the wider company's interests must always prevail.

Occasionally, a Board may disagree. Open, healthy debate and exploration of completely opposing points of view within a Board is entirely desirable, but any debate needs to shed light rather than generate heat! An accomplished Chairman (or even a Non-Executive

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Director) can be worth their weight in gold here, to ensure that all points of view are raised and explored objectively and impartially. But other directors need to play their part too.

So note?

- a board decision, once taken, binds all the board. If you don't agree, you must say why and support your case!
- a board has a duty to discuss disagreements and, if these are not resolved, they should be minuted.
- if a major disagreement cannot be resolved, or if a director's disagreement on lesser matters is frequent, that director should consider resigning for all parties' best interests.

Related to this, there are two other points to consider for any director!

First, a notice of resignation from a board, whether oral or in writing, cannot be withdrawn – although reappointment is possible.

Secondly, a healthy company should only very rarely require a vote to settle a disagreement. (Self-evidently? If directors regularly find themselves in dispute with each other, given that they are bound by board decisions collegiately, either the company is not taking the decisions perhaps it should, or directors in dispute may find their they are bound by decisions they cannot support and should resign.)

If a Board vote *is* to be taken, note that each director has one vote, independent of any shareholding. But a Board vote can always be over-turned by the majority of the shareholders, given proper notice of a General Meeting.

Disagreements between directors are far rarer than you might imagine, but there are clear rules for General Meetings, to put your mind at rest should you be a shareholder with a financial investment at stake! They include minimum periods of notice for such meetings as specified by the company's Articles and the Company's Act; and at least some protection for minority shareholders.

Finally, note that you will need to be registered as a Director at Companies House – but you do not have to give your home address if you don't wish to.

NEXT?

In Part 2 of this article, we shall explore some of the further duties of a Director.

In part 3, we shall look at some of the personal skills and qualities required of a Director, in any business.

In writing this article, I gratefully acknowledge helpful information from the Institute of Directors and many other sources. However, I take no personal responsibility for any specific advice contained here and I warmly recommend that you discuss any key points arising with your lawyers or accountants before taking further action.

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Author of several prize-winning business books and a frequent speaker to the Academy for Chief Executives, Vistage and a wide range of other professional organisations on business matters, Jeremy is a past founding Chairman of a management consultancy business, past Managing Director of a large international engineering company which was one of the first ever accredited to the Investor In People standard, and a Fellow of the Royal Society of Arts.

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