

## WHY HAVE A NON-EXECUTIVE DIRECTOR?

### WHAT DOES A NON-EXECUTIVE DIRECTOR DO?

As you might expect, I am firmly convinced of the benefits of having a Non-Executive Director, even for very small companies. Indeed, the consultancy company I helped to found appointed its first NED when we had less than £1/2 million sales pa, and by the time the company had reached £1m, we recruited another. And wonderful value they were!

Nevertheless, when people ask what a NED does, the answer is that for much of the time, seemingly very little! That is a flippant answer, but the point is that NEDs come into their own most especially in times of major change or business challenge, when frankly I wouldn't ever want to be without one as a small business owner myself.

Incidental examples of near panics rescued by a NED that I have either observed or actually been engaged in, have included:

- resolving a major fall-out between shareholding directors (a not uncommon occurrence!);
- facilitating appropriate exit strategies and mentoring new directors;
- offering courage and support to continue to trade through difficult times, by cutting more non-essential costs for example;
- persuading busy directors to attend properly to cash-flow management;
- facilitating a second-generation family management buy-out;
- persuading a founding owner and MD to let go a little, become Chairman, hire a professional Managing Director and enjoy life outside more;
- supporting a request for a business-expansion loan from a reluctant bank;
- helping a family resolve internal share-ownership debates and succession plans;
- proposing equitable means for dealing with a very large and unhappy major customer;
- advising on how to recruit the most suitable staff;
- adjudicating highly sensitive reward schemes for board members;
- using the NED's own network of contacts to find new business, new suppliers, new technology and even new recruits;
- establishing clear goals and objectives for a business and its owners, not as a stick to beat them with but to ensure they were quite clear where they were going, how they might define 'success' and how they might measure their progress.

In each and every case above, the objectivity and impartiality of a Non-Exec Director (or Chairman) was critical to reaching a successful conclusion, even if with a very light hand and gentle touch. (I do *not* think it is helpful for a NED to be directive or to act as a substitute 'boss' – even if representing an external investor as many NEDs do. Intelligent questioning and listening, gentle if probing challenge, relevant counter-proposals and broad facilitation and coaching skills are usually *very* much more effective!)

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A key role for a NED in organisations of any size is corporate governance, and of course Non-Executive Directors have just the same fiduciary duties as any other Director. So they are legally obliged to know what is going on, to ensure good practice with accurate reporting and budgeting systems, legal compliance with company and employment law for example, and the rest. In addition, for smaller companies especially, a good Non-Executive Director can also offer much more by way of additional hands-on experience, practical business judgement and other professional skills that may be in short supply.

## SHADOW DIRECTORS

Many NEDs of smaller companies effectively act as quite intimate business advisers. This is a very important role but, because of the fiduciary duties that any Director undertakes when joining a Board, many prospective NEDs prefer to act as just arm's-length business or board advisers and avoid these responsibilities.

In fact, they may be fooling themselves, because if they can be shown to have any decision-making or other executive role, they may be classed as 'Shadow Directors', even if not formally appointed to the Board, with all the legal liabilities of any other director.

Quite often, smaller companies do not hold regular board meetings (but they should! – it is an essential business discipline, even if only for a couple of hours a month, to stand back from day-to-day tactical issues to review the bigger picture). This is very often when a helpful 'business adviser', accountant or consultant can very easily drift into being a Shadow Director, often unwittingly.

In my judgement, it is far better to constitute a formal Board with regular board meetings and, if the business adviser is any good, make them a formal Non-Executive Director so there is no ambiguity. But if this appeals to you, expect your NED candidate to insist on access to full company records for his or her own due diligence, under a Non-Disclosure and Confidentiality Agreement if you wish, and also to require cover under a Directors' and Officers' Liability Insurance policy if appointed. (NB This is to cover malicious claims, by disaffected employees for example, just as much as any more realistic ones.)

## WHAT SHOULD YOU LOOK FOR IN A NED?

The relationship between a NED and the rest of the Board and shareholders needs to be very high on both mutual trust and respect, and some 'personal chemistry' is vital. (Owners and their NEDs don't necessarily have to 'like' each other – but it certainly helps!) So solid inter-personal skills and emotional maturity are critical.

These require not only the ability to disagree and challenge others productively and constructively when appropriate, but also to influence and inspire without either being 'everybody's friend' or having to win every argument. This in turn requires a rather rare commodity: modesty. Quiet, under-stated self confidence is good, but self-centred 'ego-maniacs' are definitely to be avoided!

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Independence and impartiality are essential. So I think 'courage' is also a vital requirement, to be prepared to challenge accepted wisdom productively, to identify the dangers of 'group think' and be willing to disagree intelligently even if standing alone, to play the 'Devil's Advocate' and to say when the 'Emperor has no clothes'. These qualities apply to all Directors of course, but often it is an NED who may need to take the lead.

In addition, a NED must be prepared to commit to the business, to prepare adequately in advance of meetings and still be willing to hold their fire until they have the full picture. This means great questioning skills but, even more important, great listening skills. (That is why the answer to the question 'What does a NED do?' can sometimes be: 'Very little'! It may not always be immediately obvious, but a good NED should always be listening and observing, intently.)

Other than that, you need to find someone who can demonstrate sound business experience, preferably in both depth and breadth. At the very least, you need someone who is financially-literate, who really understands how business and companies work. In my view, it is *not* essential that a NED already knows your business sector – and indeed knowing 'too much' can result in a closed mind! But NEDs do need to be able and willing to grow their understanding.

And then, you need someone who can be both highly analytical and visionary, able to communicate clearly and concisely, who is also open to feedback from Board colleagues.

## SOME PRACTICALITIES

You might think that finding such a paragon of virtue must be almost impossible! But interestingly, there seem to be far more would-be NEDs around than smaller companies looking for one. Many are on second or third careers; quite a few have made their money in their own businesses and want to give something back; some want to wind down gently towards progressive retirement; others may even be looking for an investment opportunity.

### a) Where to find candidates?

Your legal or accountancy advisers can be helpful sources for candidates and many recruitment companies will also be keen to find good NEDs on your behalf. Organisations that offer mentoring or coaching to senior executives can also be a rich source, as can your local Business Angels organisation (your local Chamber of Commerce will give you the contact details) and all your other formal and informal business networks.

I can also warmly recommend dedicated organisations such as [www.non-execs.com](http://www.non-execs.com) and [www.amplifigovernance.co.uk](http://www.amplifigovernance.co.uk) who have substantial data-bases of registered NEDs as very helpful sources of candidates.

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## **b) How many candidates?**

As with any senior appointment, it is only common-sense to have *at least* a choice of two or three candidates.

However, don't do as some have in my experience and see too many candidates? (I know of one company that saw at least 50 prospective Non-Exec Chairs! None of the extended 4<sup>th</sup> generation family shareholders could agree what they wanted.)

## **c) How do you make your selection?**

Because most NEDs are very experienced people with self-evident track records, and because getting the personal chemistry right is so important, the interview process is almost always informal and can be quite extended.

It is clearly important for all Directors and major shareholders to be involved, although it will often be the Chair of the Board who will make the final decision and manage the process. It is also important to have a carefully-prepared check list of required attributes, for all to share the feedback after meeting each candidate. But don't forget – just as you are assessing your candidates, good ones will be assessing you too!

## **d) Terms and Conditions**

The 'going rate' for a NED seems to be widely variable. At one extreme, charities (who have Trustees, bound by Trust Law) may only pay reasonable expenses and no fee; large companies may pay many tens of thousands of pounds. Some companies only expect to see their NED for half-day a month at a Board Meeting, while others (especially in the public sector) may require at least a day a week. Some smaller companies may often pay an hourly rate depending on time spent, but may forget that a significant amount of any NED's time is (or should be!) spent in reading board papers, catching up with other Board members and staff and even networking on the company's behalf. A further complication can be if a company requires its NED to attend an Audit Committee, Remuneration Committee or even an Appointment Committee; or offer additional professional services - for which an additional fee may well be payable.

Nevertheless, for a successful medium-sized business requiring an experienced NED to attend one nominal day a month on average, plus associated board-preparation time and incidental *ad hoc* support between meetings, NED fees seem generally to fall in a band of £15-36k pa plus all reasonable expenses, with a median fee of c. £24k pa.

All appointments should be covered by a formal contract of course and, after an initial probationary period perhaps, it is not unusual to offer 3 months notice of termination, with an expectation that a good NED might stay at least 3 years, but probably no longer than 5-7 years at a maximum to bring in fresh thinking and new ideas. Most companies will expressly want to confirm in the Contract of Appointment that the NED is not an employee, to avoid any possible problems with UK Employment Law which would then apply. Note, however, that as far as the Inland Revenue is concerned, HMRC bizarrely requires all NEDs to be treated as if they *are* employees (whatever the Contract might say), so that payments go through the company's pay-roll and are subject to National Insurance Charges.

Some NEDs may want to invest in shares, or even be paid by results. But unless you desperately need new share capital which only they can provide, I don't recommend this.

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NEDs need to be totally independent, not just in business judgement but also financially. If they need to make a stand on any critical issue, they should never be prevented from doing so because they were financially dependent on their involvement.

## SO WHY HAVE A NED?

Good NEDs offer:

- invaluable support, objective oversight, a strategic conscience, essential board discipline and often business experience that may far outweigh their fees;
- knowledgeable independence, to help resolve disagreements impartially and make sure difficult decisions are taken wisely;
- wider horizons and enhanced shareholder value.

I wish you good fortune!

<This article has also been published by the Daily Telegraph Business Club, The Non-Executive Director, FreshBusinessThinking.com and QED Consulting.>

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## **POST SCRIPT – PUBLIC SECTOR NEDs**

The article above was first commissioned to encourage smaller companies to consider the merits of appointing a Non-Executive Director.

Since then, several readers have asked me about NED appointments in the Public Sector, as part of their own professional development. These can be very fulfilling posts professionally, but I would counsel some warnings. Following the closure of the Appointments Commission which used to be responsible for handling many public-sector NED posts, especially in the NHS, some of these warnings may slowly become redundant. But I personally suspect old habits will die hard! The public sector does some things amazingly well, but appointing NEDs is not (in my experience) one of them.

- First, the appointment process may be nothing like anything you have ever experienced in the private sector.  
All posts are likely to be advertised, rather than left to the private networks of the Chairman or third-party recommendations, and will almost always entail the completion of lengthy, bureaucratic application forms, driven by HR Departments who may have little idea of what the duties of a NED really are or how to judge the qualities required (even if guided by a quasi 'competency framework').  
If you haven't ever had to complete an application form in recent decades, don't see this as an unnecessary waste of time! Every element of the completed form will be scored to determine who may be called for interview and open-ended questions will need particularly careful thought (and possibly some helpful tutoring) to know what answers are really required.

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Then, don't expect an interview process to be based on any experience you may ever have had in the private sector. It will most probably involve a panel of interviewers (and although this will surely include the Non-Exec Chair, s/he may actually be the least influential member); all questions will be often pre-scripted and each one will probably have a pre-ordained 'model answer' that may not necessarily be at all apparent; and you may well have less than an hour for the whole process from start to finish.

You might be well do well to talk to the Chair and CEO informally beforehand, if you can, but be warned – they may have little real influence on the outcome.

You will also be offered feedback after the interview if you want it, which you may find to be amusingly inaccurate in some of its judgements, but remember, those offering it may rarely have any idea what a senior executive does outside their own known world – if that.

- Second, if you are appointed, never believe the time requirement advertised. To do the job properly, you can probably safely double or treble it, unless you are only there as a 'figure-head representative' of a related stakeholder organisation perhaps. And you can expect the remuneration offered to be less than you might pay a junior free-lance book-keeper.
- Third, do offer your services to put something back into your community. This work can be utterly absorbing, but don't let it damage your day job!



**Jeremy Thorn** is a Non-Executive Director, business adviser, leadership coach and workshop facilitator for a wide range of organisations internationally.

Author of several prize-winning business books and a frequent speaker on challenging business matters of the day, Jeremy has been the founding Chairman of a successful nationwide management consultancy, Managing Director of a world-wide international engineering company which was one of the first ever accredited to the Investor In People standard in the UK, and Deputy Chairman of a large Training and Enterprise Council.

After a first degree from the University of Leeds in Materials Science, Jeremy's post-graduate development includes studies at the European College of Marketing, Cranfield Institute of Technology, the London Business School and Oxford Psychological Press.