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WHY HAVE A NON-EXECUTIVE DIRECTOR?

By Jeremy Thorn

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 company I helped set up appointed its first NED when we had less than £500k sales pa, and by the time the company had reached £1m, we recruited another. And wonderful value they have been!

Nevertheless, when people ask what a NED does, the answer is that 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 amicably a major fall-out between shareholding directors (a common occurrence!);
- facilitating appropriate exit strategies and mentoring new directors;
- offering courage and support to continue to trade through difficult times but cut costs;
- persuading busy directors to attend properly to cash-flow management;
- facilitating a second-generation family management buy-out;
- persuading the founding owner and MD to let go a little, become Chairman, hire a professional Managing Director and enjoy himself 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 very 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, 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-

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proposals and broad facilitation and coaching skills are usually very much more effective!)

In larger organisations especially, a key role for a NED is corporate compliance, 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.

This is true for smaller companies too. But in addition, a good Non-Executive Director can 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 stay 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, and they will have 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 necessary, 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.

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This requires 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!

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 to 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 the 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 good sources for candidates and First Flight Non-Executive Directors is a firm that specialises in providing good NEDs who can really add value to your business.

I warmly recommend: www.NonExecutiveDirector.co.uk who have a substantial database of registered NEDs.

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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 4th generation family shareholders could agree what they wanted.) Again a specialist firm like First Flight Non-Executive Directors will find a good choice of excellent candidates and narrow them down to a "short-list".

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 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) only pay reasonable expenses and no fee, while large companies will 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 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 attendance one nominal day a month on average from an experienced NED, 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, HMR&C bizarrely requires all NEDs to be treated as if they are employees (whatever the Contract might

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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 need new share capital, I don't recommend this. 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 slightly amended has also been published by the Daily Telegraph Business Club, The Non-Executive Director and FreshBusinessThinking.com>



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.

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