



*Lighting the Fires of Leadership*

**Response**  
**To The Review of the Role and Effectiveness of**  
**Non-Executive Directors**

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## **Introduction**

The comments made in this document are intended to offer thoughts, observations and ideas on the role of non-executive directors. Changing business practices and issues, legislation, regulation and investor and wider public concern on the running and communication of performance of public limited companies provides a backdrop to the review and an opportunity to harness opinion to bring about change.

The endemic lack of trust of company reporting and management practice may be a result of recent high profile accounting scandals or a factor of the current market turmoil or phase of the equity cycle. However, the clamour for change and the need to take action to restore confidence coincides with this review. Whilst the role of non-executive directors cannot be the sole remedy for the inadequacies of the systems and the shortcomings of accounting or audit practices, the role is critical to improved oversight of corporate activity and communication. The evolution of the role needs to be encouraged. A failure to seize the moment and improve the contribution of non-executive directors would be seen as a major missed opportunity.

Fundamentally, the role is a useful one that has grown out of the contribution to strategy and developed into an element of monitoring and independent oversight of board performance. The actual roles performed and contribution made by non-executive directors varies widely from company to company, usually reflecting the differing needs of industries, board capability or experience and business strategy or requirements.

This paper suggests a re-alignment of the focus of non-executive directors in a manner that achieves an enhancement of their potential contribution to company performance and shareholder interests. Although part time, it should be performed with the same professional endeavour expected of a full time executive director and performance and contribution against responsibilities should be assessed. Such an approach will not sit easy with some existing non-executive directors and may detract from their original concept of the role. A useful strategic input can still be provided but the overall blend of skills and knowledge of the non-executive directors on a board needs to reflect a much wider competence. This needs to be achieved without being so prescriptive that it stifles the flexibility required to create ethical business success.

## **Role**

The role of the board is critical to the role to be performed by non-executive directors. In some companies the board is intended to be the forum for debate and decisions on business strategy and fulfilling the statutory requirements of directors in the general oversight and accountability of running the business. In some of these companies, the real power and decision making takes place at a level down from the public board at an Executive or Business Committee level. In such circumstances the board can be seen as a body to rubber-stamp decisions and whose contribution to strategic debate comes after commitments have been made. In others, there is a more hands-on approach and involvement in key management decisions, where oversight of business performance and practice is more rigorously reviewed.

The differing ways boards operate has merit but it does present difficulties to investors in appreciating who is involved in actually running the company and where oversight of performance takes place. Companies should be required to set out their policy and approach. That would provide a starting point on deciding the role to be performed by non-executive directors.

Historically, non-executive directors' primary role was contribution to strategy and to provide a sounding board to the executive directors when deciding on the strategic direction and opportunities for the company. An independent perspective and experience drawn from within the industry or from an entirely different industry has benefited many companies. However, whilst the value of this contribution can still be extracted, companies can, and many increasingly do, source strategic contribution from consultancies and other advisors on a fee or retainer basis. In addition, there is growing use of executives with experience and skills in advising, coaching or facilitating debate, drawing in particular expertise without entering into a long term contract or direct involvement in the executive decisions of the company. Therefore, the non-executive director does not need to be the key source of independent contribution to strategy.

Some non-executive directors bring particular skills or experience to be applied in the oversight of the company as a whole or some elements of it in particular. This should continue to be welcomed but there should be clarity of individual roles or expected contribution within the company and to investors. This should similarly apply if a non-executive director is to take the lead on behalf of all the non-executive directors on the board in the oversight of certain functions or activities. In the absence of a non-executive Chairman or Deputy Chairman, one of the non-executive directors should be appointed to lead their contribution, which should be achieved within the unitary nature of the board.

Where non-executive directors have oversight of functions or activities they need to be in a position to devote sufficient time to properly carry out their responsibilities. In many cases where there has been serious management malpractice or rogue elements have operated unchecked it has been known or strongly suspected within the company and often the subject of market rumour. Yet the non-executive directors have been 'taken by surprise.' Whilst 'Whistleblowing' legislation has provided some limited opportunity for concerns to be surfaced, non-executive directors have a responsibility to ensure constructive criticism or complaint is properly and effectively surfaced and acted upon. There is a need to guard against the fear of speaking out becoming the dominant culture in an organisation, which tends to be strong where malpractice, or at the least poor practice, occurs.

In one organisation a highly respected and senior executive director was appointed to be the ultimate recipient of a confidential 'whistleblowing' communication process, but his passion for the business and a reputation that "unless you are 110% for us you are against us" meant that even other directors would not raise constructive criticism within earshot. More than one remarked that they would not use the 'whistleblowing' process, let alone expect more junior staff to do so. The company was failing to

benefit from a well intentioned and principled attempt to ensure unethical practices did not occur and the non-executive directors were falsely confident that concerns would be surfaced.

The people aspects of a business often have as big or if not bigger impact on actual performance than financial reporting, yet the skill levels and effort devoted towards the latter often outweigh the former. Many annual reports record some variation on the theme "our people are our greatest asset" and therefore non-executive directors need to ensure those assets are properly managed, with particular emphasis on the key contributors to business success. In heavily people dependent businesses the risk to the business of untimely departures or the delays and difficulties in replacing key contributors should be assessed in much the same way as plant downtime is formerly assessed in industrial companies. If people are the major source of reputational risk that can seriously undermine or damage the value of a company, or a part of it, then effective assessment, action and monitoring should be undertaken. Non-executive directors have an important role in the oversight of the people strategy, risk assessment and practices of the company.

In much the same way as many companies agree the responsibilities, targets and performance measurement of directors and staff, so this should be extended to non-executive directors. This should help clarification of the time commitment needed to perform well in the role and should be the subject of discussion at recruitment as well as on an ongoing basis. This will naturally limit the number of non-executive directorships individuals may take, but this should not be prescribed by legislation or regulation, as the individual should be allowed to build a portfolio of directorships if they so wish. However, clarity on the number of days and contribution should soon indicate to companies and investors the likelihood of an individual having sufficient time to be effective.

In large organisations, particularly where there is geographic spread, boards should consider the appointment of non-executive directors to subsidiaries, divisions or regional/country boards even where there is no local requirement. These non-executive directors could be sourced from within the company, to provide the opportunity for development as well as contribution, and externally. They should also have a reporting line and access to a main board non-executive director. This could help boards to guard against being surprised by events or activities beyond their geographic location or where they have little opportunity to elicit concerns or receive feedback.

The challenge for non-executive directors will be to identify and concentrate on the really critical issues for the business. This will vary from company to company. They will need to ensure access to the core key performance indicators of the business and avoid being drowned in management information that detracts from their focus.

Whatever the changes to the role of non-executive directors there should be no doubt that the primary responsibility for the well running of the company and the meeting of legislative, regulatory and ethical standards rests with the executive directors. The non-executive directors should be there to support the endeavours of the whole board, offer an independent view and where they provide checks and balances this is seen and carried out in accordance with good business practice.

### **Attracting and appointing non-executive directors**

If the nature of the role of non-executive directors is to change or expand then this will have an impact on the skills, knowledge and attributes of candidates for these roles. If they are to have an increasing role in the oversight of corporate probity in decision making, reporting and the people aspects of the business, then boards will need to ensure they recruit individuals with relevant experience and skill. This should widen the potential talent pool even if initially it will pose a challenge to recruiters and executive directors. It will also probably reduce the likelihood of appointment through personal connection with an individual and open the selection process to reflect more closely good practice in recruitment.

The potential impact or opportunity should be recognised by those organisations that currently employ individuals with the skills and experience required for non-executive roles. If some of these individuals are to be sourced from regulators then due regard should be paid to current contracts of employment to ensure appointments do not breach ethical considerations where individuals have been closely associated in the recent regulation of the appointing company.

Recruiting non-executive directors will become more challenging. Not only will the skill set be changing but also there is increasing reluctance on the part of some experienced executives to take up non-executive posts. Anecdotally, this seems to be particularly relevant to the 'new' generation of directors who are in their forties plus. In many cases they have sufficient wealth to meet their immediate needs and do not see the risk/return premium as sufficient. Despite having a wealth of energy, ideas and experience to contribute many are restricting their activities to their own companies,

to smaller companies and start-ups where they retain a significant shareholding (whether as an individual or as part of a group of investors) or 'not for profit' organisations. This will pose a threat to the broadening of the role of non-executives and will be an untimely narrowing of the pool of highly talented executives.

In many companies the search and selection processes in the recruitment of non-executive directors already reflects the best practice operated elsewhere in the organisation. For these companies, often the challenge is to retain executive search firms that are enlightened enough to source a much wider range of candidates that goes beyond the tired list of the 'usual suspects'. They should guard against stereotyping candidates for particular roles e.g. oversight of people practices needs someone with HR experience, however, many with an HR background would not have the depth of competence to make a significant contribution and conversely many experienced business leaders have substantial practical insight. The decision making in selection needs to combine the views of both executive and non-executive directors as part of a strategy to ensure appropriate diversity of skills, knowledge and attributes. All companies should be encouraged to achieve sound recruitment practices. Special legislation should not be necessary as existing laws or directives should be sufficient as they have application to all employees, including non-executive directors.

### **Structures and accountability**

Undoubtedly there are companies who already value a proactive and wider role for their non-executive directors and ensure structures and information facilitate an effective contribution. The reverse is also true. A requirement to set out the roles and responsibilities of non-executive directors and the latter to confirm their satisfaction that the structures and processes have enabled a proper discharge of their duties could be used to encourage a more positive and proactive approach by those who lag best practice. This should not be a meaningless exercise spawning the provision of a series of statements that have little relevance or meaning. Statements need to clearly demonstrate accountability. However, the difficulties must not be underestimated as the quality of some Audit reports provides a good example how the unscrupulous can bypass the intentions for good reporting.

An increasing number of companies ensure executive board member's performance is properly evaluated and use 360 degree appraisal to good effect, with the Chairman receiving a formal appraisal from the leading non-executive director. There is no reason why similar practices should not be put in place for non-executive directors. Even where a non-executive director's role is restricted to strategy it might be enlightening to see how much the contribution is valued by colleagues on the board.

Non-executive directors who sit on Audit, Remuneration and Nomination committees should ensure they have sufficient familiarity with the subjects they are overseeing to be able to adequately question external providers of services to those committees as well as the executives involved. They need to be in a position to constructively challenge assumptions and ensure outstanding items are followed up and deadlines are met. They should be willing to call for reports and updates on important items without necessarily waiting until the next quarterly, or annual meeting.

### **Support**

Non-executive directors need access to appropriate management information. As already highlighted, it is quality rather than quantity and should be focused on the truly critical indicators. Web based technology makes this much easier, particularly where systems provide exception reporting e.g. 'traffic light' indicators, amber equals potential problem, red a problem. The best comparison is an aircraft cockpit. Modern airliners rely on a single screen and very few indicator dials, where only core information is provided and only potential or actual problems come up on the screen when they occur.

This contrasts to older airliners where 2 or 3 people were required to monitor the information. The technology exists to make it much easier for executives and non-executives to monitor performance, including away from the office. Non-executive directors should have an input into the information they require and given their expertise and experience it might well help less experienced executives to learn from their input. The value of someone standing back from the day to day and asking questions should not be underestimated.

When non-executive directors feel they should have access to further information or suggest the company collates additional information this should be discussed with executive colleagues. Only in the case of refusal without a satisfactory reason should it be discussed with the full board. The onus must be on the non-executive director to justify a request on the grounds of effective oversight to avoid executive directors being second guessed or an additional layer of bureaucracy introduced.

A new non-executive director should be treated in much the same way as any employee joining a new company. Appropriate induction should be undertaken to properly equip the person to fully discharge responsibilities. Where there is a skills or knowledge gap, this should be closed through training or coaching. Non-executive directors should be properly briefed on the company and where they have oversight of particular functions and activities they should meet with the staff involved. They should not be restricted to contact with the most senior executive.

Training and development opportunities should be offered by the company employing them and should be focused on any needs relevant to their responsibilities. Increasingly executive directors are using coaches to help maximise performance and despite a wealth of knowledge and experience, non-executive directors should also consider their use. This could be particularly useful in providing feedback on their performance. A coach could also be used where there is friction or tension between non-executive and executive directors. New non-executive directors might wish to avail themselves of generic training in the roles and responsibilities, particularly with respect to legal and regulatory requirements. The DTI have a role to play in this and could provide an e-learning solution on their website. This would ensure the quality of the training and allow informed interpretation of laws and regulation.

## **Remuneration**

The remuneration of non-executive directors needs to be carefully considered. With increased and more active responsibilities the remuneration needs to reflect this and with higher reputational risks the role will need to be rewarded sufficiently to attract quality candidates. Non-executive directors will want to share in the success of the company and there will be a need to align their reward with long term performance. However, there must be sufficient checks in place to ensure they do not get driven by short term considerations to boost apparent performance to improve their market rating. There is an inherent danger that if their remuneration is too closely linked to the executive directors, perceived or actual objectivity and independence might be lost. A unified board driven by shareholder value is a more likely incentive for business success.

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