

A Submission to the Review of the Role and Effectiveness  
of Non-Executive Directors, Chaired by Derek Higgs

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# Promoting Best Practice in Corporate Governance

**ODGERS RAY AND BERNDTSON**

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# The Role and Effectiveness of Non-Executive Directors: How to Promote Best Practice in Corporate Governance

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## □ Fresh Thinking

In the light of recent failings at companies such as Enron and WorldCom, there has never been a more important time to clarify the role and responsibilities of non-executive directors who play a crucial role in corporate governance. By properly defining the challenges and opportunities which the position offers and understanding how to recruit the best people for the job, more balanced and effective boards can be formed leading to better corporate governance and the promotion of best practice. Odgers Ray and Berndtson welcomes the government's consultation on the role and effectiveness of non-executive directors (NEDs) and is delighted to present a number of reasons why experienced headhunters may be in the best position to help companies find the most suitable NED.

With a thoroughly-researched understanding of the company in question, a headhunting firm can cast the net wide in the search. This addresses those concerns expressed in Derek Higgs's consultation document about the *status quo* – that the role of NEDs is often unclear and they tend to be white males from similar backgrounds.

In part, the stereotype is borne from the historical status of the NED. In the past, they were a trusted and well-known friend of the company's Chairman. He could offer respectability in the City and provided stewardship upon request. However, he was rarely independent and was therefore hindered in his ability to hold the executive to account or to challenge a company's ideas and strategies.

As the need to find independent NEDs became ever more important, it also became essential to recruit from a wider pool in terms of professional expertise as well as gender and ethnic origin.

**Odgers Ray and Berndtson recognise that best practice involves looking beyond the traditional routes and obvious choices: promoting best practice in British business requires the most experienced minds to take forward fresh thinking.**

## □ The Role of Non-Executive Director

The non-executive director's job falls into two distinct areas: that of governance and that of bringing added value to the firm.

### > Governance

The NED's governance role comprises three central elements:

- **Integrity** of the business – NEDs have the responsibility to ask if they think that the business is being run along sound lines. The 'Enron affair' demonstrates how important this can be. Its downfall was largely due to a failure of integrity.
- **Strategy** of the business – NEDs approve but seldom set the strategy for the business. They have a responsibility to ask whether they believe that its chosen course is sensible. Marconi's failure, for example, appears to have been one of strategy rather than integrity: it was insufficiently robust and carried sizeable risks. NEDs should always be aware of the risks involved in the board's decisions. The best NED will draw upon his/her skills and experience, as well as independent thinking, to try to consider the likelihood of a successful outcome of the decision making process. However, this does throw up a seemingly intractable problem: the ability of NEDs to evaluate risk is dependent on them having sufficient information; but that data flow is controlled by the Executive. NEDs talk of being 'taken by surprise' when catastrophes occur. They must be committed and capable of procuring the information which they require without interfering in the day-to-day running of the company.
- **Management** – NEDs have a duty to consider whether the overall management of the firm adheres to the highest quality and standards. They will also be involved in decisions regarding succession planning and need to ensure an appropriate remuneration policy.

### > Added Value

Governance alone is not enough. NEDs make their own positive contribution to the future of the company by bringing their particular skills and talents into play. They can:

- Provide insight on broader questions of business and the economy, government and social responsibility
- Contribute to corporate development and strategy
- Provide useful contacts and information through a relevant personal network
- See issues facing the company from a broad, non-parochial standpoint and probe proposals in an objective, incisive but positive way
- Mentor and provide a vital steadying hand when necessary

## □ Why use Headhunters?

Good NEDs on a Board that is operating effectively can make an enormous contribution to the success of an enterprise. Poor NEDs, or those sitting on a dysfunctional Board may at best be an irrelevance, or at worst, provide a mirage of good corporate practice where in fact there is none.

**Using a headhunting firm that understands the role and responsibilities of the NED to recruit these members of the board can provide the most successful results and promote best practice.**

There is a danger, because the fees are less for a search for an NED, that some headhunters might offer a lesser service, simply scanning a database or drawing up a list of ‘the great and the good’. However, Odgers Ray and Berndtson believes that a search for an NED should be as comprehensive as a search for an executive director:

### > **Knowing the Company**

At the start of the search process, before the identification of suitable candidates for non-executive roles, there is a vital consideration of the current and immediate future challenges for the company in question:

- What are the key issues and decisions facing the Board over the next few years?
- What is the balance of people around the Board table and what qualities do they need as a whole to be able to make those crucial decisions?

The headhunter’s skill lies in considering the overall composition of the Board, including its current members and their experiences, to ensure that the appointment is complementary and leaves the board as well-equipped as possible to face its specific challenges ahead.

### > **Chemistry**

For Odgers Ray and Berndtson the key to a thorough search is **getting under the skin of the client company**, learning about their chemistry and culture, what its values are and where it is heading, and what type of person will fit most effectively. Our expertise lies in people skills: finding the right person to fill a particular position, not just in finding a candidate who looks well-qualified on paper. We seek to build a close and trusted relationship with the board, assimilating the formal criteria as well as unwritten messages to understand fully the type of person we need to recruit.

### > **Wider Talent Pool**

A good headhunting firm can draw on a wider pool of contacts and research than a Board typically could do. At Odgers Ray and Berndtson, we have immediate access to information on a very large population of relevant people and we log all the contacts that we ever make on a central database. However, more importantly, our years of experience also mean we have many well-placed sources with whom we liaise.

With an extensive team of desktop researchers and consultants who work in partnership with people in both the public and private sectors, a headhunting firm like Odgers prides itself on its ability to bring together a diverse long-list of candidates from the widest possible pool of talent. We understand where the particular experience of management in not-for-profit organisations may be relevant as well as previous experience in the corporate sector, and we have the ability to judge potential as well as past achievements. We recognize the transferability between sectors, the skills which can be common to disparate types of businesses and the types of personalities which succeed at the top.

**That means a headhunting firm can offer a nominations committee a real choice: interesting alternatives in the light of a thorough understanding of the business in question and how best practice is evolving.**

### > Feedback

An additional benefit for companies is that through their research, headhunters learn much about the company in question and can convey back to the Chairman what the external perception of the business is.

## □ The Modern Agenda

The implications of the broader search has a close connection with the government's concern that there are disproportionately few NEDs who are women or from an ethnic minority background. Just as a headhunter is aware of the need to stride cultures and size/types of organization when performing a search, so it is equally important to consider people from a **full cross-section** of modern society. Patricia Hewitt MP has shown particular worry about the current demographic whereby only 2% of FTSE directors are female. She is adamant that her concern is 'not about some silly political correctness'. Rather, she wishes to acknowledge that 'if we're only recruiting from half the human talent pool, it's not surprising we've got skills shortages'.

**As headhunters, it is our duty to help our clients understand why a woman's CV may show a different career path to a man's.** In our not-for-profit practice, where female consultants outnumber male ones, we are well-placed to interpret women's CVs in the light of their often different professional routes and evaluate them in the most appropriate and accurate way. If you judge excellence by the same criteria as one might have twenty-five years ago, then it will make it difficult to hire women NEDs as they may not have had equivalent opportunities. The same is true of ethnic minority candidates: if a client judges a CV on dated criteria, excellent candidates who may have different educational opportunities to British nationals, may be overlooked. Headhunters add value to the search by factoring in those considerations so that people's current achievements are given their true recognition.

International appointments can be of major value, bringing different experiences and understandings to bear on issues. This is especially true in more internationally-spread businesses. There are however real logistical problems with recruiting board members from abroad. It is a major time-demand which may not be balanced adequately by the remuneration available. Reporting requirements are different in other countries and it is absolutely vital that a foreign candidate shows him/herself to have a proper affinity with British business. However, once again, a candidate's

understanding of the global and local nature of business is something that a headhunter would test rigorously through carefully planned interviews and referencing.

Academics can also offer an alternative source of NEDs, always provided they can make the mental jump from the world of theory to the practical world of business. They tend to be outside the ordinary networks of the headhunter, but the flourishing education and public sector practice which we have at Odgers can yield rich rewards on this front.

## □ Looking Forward

The challenge for the future is to ensure that non-executive directors are recruited because the qualities which they can offer are well-matched to their companies' needs. They are there to offer the Board cooperation, positive input and guidance. A headhunting firm can offer the following advantages in recruiting NEDs:

- Searching the widest possible pool of potential candidates based on our knowledge and **experience of the company** and our understanding of the precise demands of the position
- An ability to find out-of-the-ordinary candidates as well as predictable ones to offer companies **a real choice**
- A determination to find candidates who are chosen for their talent and experience but are also **representative of a modern Britain** to take their companies forward
- **A constant and updated awareness of best practice and a strong desire to promote it through the appointments made.**

A vigorous code of practice that is short and clear would be of great benefit and would be taken very seriously by professional recruiters.

**Virginia Bottomley**  
**Partner**

**Ian Odgers**  
**Partner**

## The Role of Chairman

The role of the Chairman can vary widely, and each company determines for itself the range of activities the Chairman will undertake. These depend on the nature of the company, its circumstances, what attributes the Chairman brings with him or her, how these complement those of other members of the Board and the Chief Executive, and how duties are best shared.

However, there are certain duties which the Chairman, and only the Chairman, can perform.

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### **1. With ultimate responsibility for the governance of the company, through the Board, he/she must ensure that:**

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- the integrity of the business is solid, that the company is being run on a sound financial and commercial basis
- the strategy of the group is robust and sensible
- the top management are of the right quality and performing within the defined strategy to the highest standards, prudently, ethically and in the interests of the stakeholders
- management remuneration is appropriate
- succession is planned and properly executed, so that the quality of the management in the immediate, medium and long term is guaranteed

### **2. The Chairman is the leader of the Board. He/she**

- directs the Board, stimulates discussion, and makes sure it concentrates on issues that are relevant to the Board, without interfering with detailed internal management
- makes sure Board meetings are properly run, and board members have relevant, up-to-date information
- ensures the Board is properly balanced with directors who can add real value to the company; he/she must also review the performance of the Board
- is the official link with the shareholders, setting a tone and value for the company
- provides liaison between the executive and non-executive directors between board meetings and nominates the Committees

### **3. He/she must establish that a strong relationship with the CEO. He/she must**

- be the sounding board and counsellor to the CEO, provide advice and support but maintain a critical objectivity, never letting his/her support cloud his/her evaluation of the CEO's performance and his continued suitability to the role
- share duties as appropriate with him to maximise the impact of the top leadership

There are several other roles in which the Chairman can get involved, particularly in the areas of external representation. This includes significant involvement in investor presentations and financial road shows, customer relations, and an ambassadorial role in corporate affairs, but these depend on each company's particular circumstances.

Prepared by;-

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