

# The Role of a Non-Executive Director

## What is a NED?

A non-executive director (NED, also NXD) is a member of the board of directors who does not form part of the executive management. NEDs usually stand back from the day-to-day running of the business. The NED must however be careful as there is no legal distinction between executive directors and non-executive directors under company law. As a result NEDs have the same legal duties, responsibilities and potential liabilities as the executive management.

The role of the NED has changed in the last 25 years when Tiny Rowland notoriously compared non-executives to trinkets on Christmas trees. Board meetings were amiable in nature and were often followed by a good lunch. The role today is much more professional. NEDs must challenge; to do so they must gain a detailed understanding of the company.

The input from NEDs will vary according to the ownership structure of the business. For example, in a new business, they might act as mentors. At the other end of the spectrum, an NED of a listed PLC may just attend board meetings a few times a year. Being an NED in a public sector organisation, such as an NHS Trust, may require further skills: often meetings of the board are held in public, in which case the ability to deal with unscheduled questions and communicate well are essential.

Within a private or private equity backed business, the NED can provide additional confidence to the shareholders that their investment is being used effectively. NEDs also bring some broader commercial experience to what may be an enthusiastic and entrepreneurial, but commercially naïve, management.

However some businesses see NEDs as cheap consultants. They want them to open doors and undertake business development. This is not in itself a bad thing; there are many businesses where the NED should be able to assist with business development and use their many years of experience to help grow a business. However, it is not advisable to appoint NEDs to the board solely for their little black book. There needs to be wider commercial input.

## Roles & responsibilities

NEDs are the custodian of corporate governance. The governance structure determines the responsibilities and authority levels among within the company and specifies the rules and procedures for making decisions. However, most NEDs do not look for appointments to focus on corporate governance; that is a by-product of their role. Even those privately owned and PE backed businesses that do not need

to comply with UK Corporate Governance Code are obliged to ensure their businesses are run with the same rigour as those that do need to comply.

The key responsibilities of non-executive directors are:

- **Strategy:** constructively challenging and contributing to the development of strategy.
- **Performance:** monitor and scrutinise the performance of management in meeting agreed goals and objectives.
- **Risk:** satisfying themselves that financial information is accurate and that financial controls and systems of risk management are robust and defensible.
- **People:** determining appropriate levels of remuneration of executive directors; having a prime role in appointing; where necessary removing senior management; and planning for succession.

## **Appointment**

The UK Corporate Governance Code requires a full, formal and tailored induction for new directors on joining the board. As with any senior appointment, it is essential that there is an induction process for new NEDs. This can vary from organisation to organisation, but should include meeting all the senior staff and visiting the majority of its operating units. The induction should include an understanding of the business environment, market sector and strategic issues.

NEDs must fully understand their time commitment, role and responsibility. Often they are not given a specific guide as to the amount of time required. The NED should allocate enough time for the job and get to know key people at board level and below. They must also leave adequate time to read and assimilate board papers. The time requirement is often more than expected, especially if the company becomes stressed or is involved in some form of corporate finance process.

Whilst appointments are made under contracts for services and not employment, taxation is another area that needs to be considered. The Finance Act 2013 has recently introduced changes to IR35, which will impact NED fees paid from 6 April 2013 onwards. It should be noted that HMRC does not accept that it is possible for NEDs to carry out their office holder duties in a self-employed capacity. HMRC's starting point is, almost invariably, that NEDs should be treated in the same way as executive directors for PAYE purposes. This is because both executive and non-executive directors are regarded as 'office holders'. There is no statutory definition of the word 'office' but it would certainly include the majority of NEDs. Payments falling under these provisions are subject to PAYE (including NICs) via the payroll.

For the first appointment the NED should at least have their own mentor who understands the role of a non-executive and is able to provide help and guidance.

This may be one of the others NEDs, or someone from another organisation. There are firms that specialise in providing such mentoring services. There are also good courses run by the Institute of Directors and the Institute of Chartered Accountants that will provide guidance on the role of the NED.

## **Pitfalls**

Can the NED influence outcomes and add value without undermining the executive management? Certainly they should not be passive but must ensure robustness in the board and both challenge and contribute to the decision making process. Initially this may be difficult; a good NED does not join the board and immediately criticise the business even if they have a valuable contribution to make. The best NEDs invest time in gaining the confidence and respect of the management team so that robust challenge is seen as constructive and not combative.

Moreover NEDs must understand the difference between executive and non-executive. It is the executives' job to run the business. If the management team are not capable, it is not for the NEDs to take over. Instead it is their job to ensure the correct management team is in place. People from similar backgrounds may think their approach is the only (right) one and this can create conflict when both parties think they know best. There is a risk where the CEO and the Chairman come from similar backgrounds that, rather than provide challenge, there is conflict.

Appointing the wrong person as an NED can have a terrible impact on both the individual and the company. The appointment of an NED should be seen by the board as a valuable, strategic appointment, not a box ticking exercise. The NED needs to have some empathy for the business but need not necessarily be steeped in the industry. However they should have excellent communication skills. Unlike an executive role, the NED is not a decision maker; they are a strong influencer and these softer skills are vital to ensuring a non-executive appointment works.

## **What makes a good NED?**

It helps if a newly appointed NED has seen other good NEDs in action. A person who has not seen what 'good' is may struggle with their first position. The dynamics of the board are also important: it is essential the board works as a team. The NEDs should be involved in strategy sessions with the senior executives. The Chairman must ensure the board does not just come together for board meetings. A good NED will be committed and confident but not egotistical, and should ensure the board makes the right decisions. They must have strong principles and act as a conscience for the shareholders, while providing their contribution in a constructive way.

A breadth of experience helps the NED assess commercial and governance issues and, if they have seen the situation before, this will help with the decision making process. Being able to grasp concepts quickly and analyse the issues without getting lost in the detail is vital.

A key role is being able to challenge as well as support. The NED must be prepared to ask difficult questions and be persistent and stimulate debate. The NED must spend the time to understand the business and be well prepared for meetings. That is not just reading the board papers but possibly asking questions in advance of meetings. In fact they can often assist by ensuring the board pack is fit for purpose and thereby guide the board to focus on the issues that are important and require input from the directors.

## **Conclusion**

Being a NED is a proper role with responsibilities; it is not a collection of part time jobs with a guaranteed income. Therefore anyone taking on this role must be committed to it and understand the legal obligations.

If you are appointing a non-executive director, you need to articulate why, and assess what skills and experience you need on the Board to help you grow the business. Make sure you take the appointment process seriously and understand the value the right NED can bring to you as a management team (this includes personal development) as well as the business as a whole.

As a non-executive director, do not forget to pay heed to the taxation issues. Ensure there is a good induction programme and that you understand what your role as an NED in this business is. And do not forget to check there is sufficient D&O insurance in place.

Most NEDs are taking on the role to keep busy and give something back not for the salary which may be risible. This should mean that as an NED you choose carefully the roles you take on. If you do, you will be contributing to something you enjoy.

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