



NON-EXECUTIVE DIRECTOR EXPERIENCE AND GOOD PRACTICE

What is the definition of a Non-Executive Director ("NED")?

Michael Grade once famously said:

"NEDs are like bidets – not sure what they are there for, but they add a bit of class!"

This is far from the truth.

NEDs are working harder than ever. The risk/reward is not what it should be. The Walker Report has made the job more onerous

Many boards are not tolerant enough of challenge and if someone asks too many questions, they are branded as part of the "awkward squad".

Lord Walker in a recent speech said:-

"The ability of NEDs to stand up to executive management is more important than the qualifications those directors hold."

While there has been a whole lot of discussion about the need for NEDs with relevant experience, that knowledge is little more than useless if it is not accompanied by a willingness to challenge the executives.

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With regard to the more practical aspects of being a NED of a SME company,

MY DEFINITION OF A GOOD NED IS ONE WHO ENSURES THAT THE BUSINESS IS WELL RUN BUT DOES NOT RUN THE BUSINESS.

Qualities which are needed:-

- ✓ Good interpersonal skills and ability to manage conflict
- ✓ Sound judgement
- ✓ The ability to influence through clear communication
- ✓ Integrity
- ✓ The conviction to say things that need saying and, as a last resort, vote with your feet
- ✓ To be commercially aware

Other key points that make an effective NED:-

- ✓ NEDs should look at the company as a whole – “take a helicopter view”.
- ✓ NEDS should not get entangled in the day-to-day operations.
- ✓ **CHALLENGE THE MD AND EXECUTIVE BOARD:**
By asking apparently simple questions about the business, the NED can greatly help an executive team to re-focus on the important rather than the urgent. Also to challenge commercial ideas such as “We have always done it that way”.
- ✓ **PROVIDE KNOWLEDGE, INSIGHT AND EXPERIENCE:**
General business wisdom and experience gained from a variety of environments has huge value as business people often learn best from the experience of others.
- ✓ **RAISING GOVERNANCE:**
A good NED should help to raise the standards of corporate governance within a company. This helps to ensure that executives understand their obligations in this respect and thus comply with the Code.
- ✓ **ADVISE ON STRATEGY:**
A business without a strategy is a business without a sense of direction or purpose. NEDs can assist the executive team in articulating the strategy. Therefore, NEDs must have good interpersonal skills and sound judgement.
- ✓ **CHALLENGE BUSINESS PLANS:**
Executives can often produce business plans where their goals are comfortable rather than stretching. NEDS can push, interrogate and raise the performance bar. They can also challenge where they believe ambitions are simply unrealistic. They provide a commercial reality check.

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- ✓ **MENTOR:**
One of the most important roles of a NED, especially for SMEs, is to act as a mentor to the executive board and coaching of directors in governance, people management etc.
- ✓ **ACTING AS A SOUNDING BOARD:**
NEDs have an invaluable role to play when a company is considering decisions such as acquisitions and disposals of businesses.

The above roles do, of course, have to be read in the context of any NED's statutory duty to promote the success of the company for the benefit of its members as a whole under the Companies Act 2006 – which he shares with his co-directors.

In addition, however, the NED can act as the impartial "honest broker", helping to make well thought out decisions where the heart wants to rule the head in some cases!

The Walker Report noted that while a complete overhaul of the contents of the Combined Code was not required, there remained parts which needed further review. Accordingly, the Market's view could be seen to be that the flexible "soft law" approach remained the most appropriate way of raising standards of corporate governance.

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The UK Corporate Governance key changes to improve effectiveness are:-

- The entire board of FTSE 350 companies should stand for annual re-election.
- There should be a balance of skills, experience and knowledge on the board.
- The chairman should hold regular development reviews with each director and there should be an external evaluation of the board of FTSE 350 companies at least every 3 years. (I am sure that this will apply to AIM and lower FTSE companies in the near future).
- The importance of the chairman and the NEDs in providing leadership and constructive debate respectively is brought to the forefront of the Code.

It is necessary to ensure that the board has a clear line of sight.

If the directors cannot see what is happening inside the business, and are thus not receiving the necessary information, they will not know what questions to ask.

Indeed, if the risk management processes are not organised in a clear and methodical way, then a small number of part-time executives do not stand much chance of over-seeing them.

These two variables – **boardroom behaviour** and **connectedness to the organisation** – are necessarily inter-dependent. Therefore, there will be no real challenge for the board room unless the company makes it possible, which means that the management needs to want it to happen.

I believe that this represents the vital points which have come out of the Walker Report in that executive management and the way they conduct themselves is central to how both the Code is applied and companies conduct themselves.

Further, discussion should be tough, testing and stretching, but conducted in an adult, grown-up way.

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Challenge needs to be focused and informed, not aggressive or hostile.

The whole board needs to come together or it risks dysfunctionality. Having prima donnas is not helpful or constructive.

In these difficult economic times and markets one reads of more fraudulent actions by companies and their executives and more hiding of price-sensitive information etc.

For this reason, NEDs should ensure more transparency with the executives, timely financial information and ensuring that internal control procedures are continually being reviewed. Today, NEDs in the board room face an increasingly tough and challenging job. New legislation under the Companies Act has ratcheted up the threat of legal action. Activist shareholders are all too ready to put NEDs under fire. This has made the role of the NED even more crucial and onerous.

Also, the NED sits around the table on an equal footing and with the same legal obligations as those who run the company on a full-time basis.

Therefore, in these difficult economic times the focus of the NEDs should be on the various risks facing the business.

There should be an emphasis on:-

- internal controls
- cash management/receivables
- gearing of balance sheet
- ensuring bank covenants are not breached
- keeping customs and protecting markets

Non-financial risks should also be reviewed, e.g:-

- retaining key personnel
- litigation
- environmental
- Health and Safety etc.

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The NEDs should ensure that the executive team fully understands the issues of the day and that they are complying with the board's decision at all times.

As they say, you cannot beat experience and grey hair - as well as having the "scars and the T-shirt". Hopefully, however, one can seek to impart one's experience of difficult times to the management teams.

You might know of Lord Digby Jones, who was once head of the CBI. He was a NED of a company called I-Soft and was criticised years ago in the Press. He said "*we cannot be seen as board room policemen. NEDs can add value in so many ways but investigative policemen they are not*".

In my opinion there should be a balance of being a policeman – ensuring that there is good corporate governance and adding commercial value to the enterprise.

In these difficult markets and economic times, I would like to share with you some of the concerns which keep me, as a NED, awake at night:-

It is impossible for a NED to know everything about a company in an average of 26.5 days per year. The issue here therefore is how does one accelerate both industry and company knowledge?

- As chairman of the audit committee, the depth and detail of the audit committee agenda and getting to grips with risk assessment is particularly challenging.
- Geographic diversity and cultural differences in many companies gives one cause for concern.
- Technology and security risks in today's world are a worry.
- Reputation risk – given that NEDs have to rely on others in the company and its control mechanisms, to keep matters under review, the fear of "what is not known" is an issue and a worry.
- Legal proceedings against directors can result in reputational damage that can, in many cases, be irreparable.

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I always try to have a legal representative at board level to advise all directors on issues as they arise. There are, therefore, many challenges in being a NED, especially in an economic downturn.

Although NEDS should not be policemen, they need to be more vigilant and clearly understand their fiduciary duties and the requirement to clearly identify major risks to the company on whose board they serve.

The guiding principles for me with regard to corporate governance and the role of the NED for companies wishing to carry out an IPO both local and international companies are therefore:-

- To ensure the ongoing implementation of corporate governance policies which have been put in place at the IPO.
- NEDs should not be removed or replaced other than in exceptional circumstances within 12 months of an IPO.
- Any changes at any time to the NEDs should be approved by the NOMAD.
- The concept of the role and the relationship between the NED and company is one which is of great importance to me, the objective being to build and open a transparent relationship with the executive directors.
- Communication, therefore, plays a major role in attempting to achieve this objective, which is made more difficult due to cultural and language differences in dealing with international companies.

It is part of the learning process for executive directors of companies to understand their obligations and to build a sound relationship with their NEDs. NEDs can also be of help with general business advice, mentoring and representing the company in the City. What I find works for me, for example, is that I speak with my companies at least weekly, get copied in on all relevant email correspondence, receive monthly management accounts, have monthly board meetings and ensure that accurate board minutes are produced when appropriate.

It is not enough to get company directors to sign that they understand their ongoing obligations.

I believe that the more one communicates, the better the chance one has to build a relationship of trust and transparency with the executive directors.

The Nomads should also play a major part in the education of the companies they are advising and bringing to the market.

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I believe, therefore, that the guiding principles regarding the relationship of the company with their NEDs are as follows:-

- NEDs must be invited to attend all board meetings well in advance of the meeting and be provided with board papers.
- the executive directors of the company must be willing to engage in full dialogue with the NEDs and respond to their requests for information fully.
- prior to an IPO the entire board should attend a meeting with the company's NOMAD and legal advisor to review the board's overall responsibilities and duties include corporate governance.
- And, finally, the best advice I can give from my experience to overseas and local companies seeking to carry out an IPO is:-
 - a. ensure that your company continues to be well-managed during the admission process as it will take up significant management resource;
 - b. meet your first year forecast – do not over-promise and under-deliver – failure to do so is likely to lead to a rapid deterioration in the company's share price and inability to raise further equity in the markets, as well as impacting on the credibility of the company's management with investors; and
 - c. appoint your NEDs as soon as possible in the IPO process in order for them to begin to build a trusting relationship with the executive directors. Please use their experience and expertise for the benefit of the company.

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Frank Lewis has over 25 years of experience in both listed and private companies. He has held a number of board positions as Chairman, Non Executive Director, CEO and Finance Director, both in the UK and abroad with growing mid-market companies.

With a background in sophisticated and developing markets, he has the commercial prospective required to assist with growth strategies, acquisitions and flotations.

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