

The Role of Non Executive Directors in SME's



3 good reasons why you shouldn't hire one and a few why you should!

By Jonathan Wright

Jonathan is an experienced non executive Chairman and Director with over 30 years experience in the recruitment and human capital services industry. He was Chief Executive of the Alexander Mann Group for over 10 years and then the founder and Chief Executive of the AIM listed business Hexagon Human Capital. His non executive career includes periods at the FDM Group where he lead their listing on AiM and with the FTSE 350 Company Spring Group up to their sale to Addecco.

As well as 2 IPO's Jonathan has lead 12 projects raising Private Equity as well 15 mergers and acquisitions in total raising in excess of £350m for shareholders.

There is an old joke that goes something like this; "why are Non Executive directors like supermarket trolleys" : "because you fill them both with booze and they still go in their own direction"

I have been on a few boards in my time where I have seen similar behaviours, no names mentioned! Better to turn to the IOD to get some insight on what an NED should really do;

The Institute of Directors (IOD) defines the role of a Non Executive Director as;

"Essentially the non-executive directors (NED) role is to provide a creative contribution to the board by providing independent oversight and constructive challenge to the executive directors"

The IOD comments further;

"The 1992 Cadbury Report initiated a debate about the main functions and responsibilities of non-executive directors. Today, it is widely accepted that non-executive directors have an important contribution to make to the proper running of companies and, therefore, more widely to the economy at large. As the Cadbury Report said, they "should bring an independent judgement to bear on issues of strategy, performance and resources including key appointments and standards of conduct".

All of that is well said but it raises two important issues for me;

- For Public Companies (plc's) it sort of says you must have some so getting them on board can be seen to be more important than what they do or the value they bring
- For SME's where money is undoubtedly tighter it doesn't really say anything specific that the board can measure

Having sat on more than 12 boards over the past 17 years as an NED ranging from a dot com start up to a FTSE 350 company I have learnt that to add real value there is no single definition of the role. Importantly understanding what you need from an NED and where the value is coming from is often more difficult and more critical for an SME than it is for a larger business. So why would you need one and how can you get value from one (or more)

Firstly let's look at three typical scenarios where an SME shouldn't hire an NED. At the heart of these "mistakes" is a confusion between the value an NED can bring and the need to augment what, in an SME is usually a fairly slim management team. Board's and owner managers of SME's often look to bring in an NED to manage functions or departments as it is a way of bringing in experience at a low cost. Don't do it, you are better off solving this problem by hiring a specialist full or part time employee or outsourcing the function if you can. The crisis will always happen at a time when the NED is not available and in any case by handing over an operational area to an NED you are missing the point about where they should be adding value:

The three most common mistakes that I see in hiring an NED:

- Bringing in an NED as a substitute for a financial controller or FD
- Being attracted to an accomplished and experienced business man that has no experience of the sector
- Using an NED to head up a sales or another functional area

So what is the point of hiring an NED and how can you best get value from them. Firstly it is very difficult to define what skills you need in an NED if you are not clear about your own objectives. These do not have to be financial but they usually are or they have a financial component to them. To help you I would suggest that you put your objectives down in 3 simple bullet points:

- Rather than answer that awful question from your bank manager "tell me what your business plan is for the next 3 years" imagine you have achieved everything you want to achieve from your business, it may be in 3 years time it may be in 10-20 years but describe what that looks and feels like. One sentence
- Now express the answer to the first question in financial terms.
- Now explain how you will want customers and staff to describe what your brand will stand for when you get their

Big high level stuff I know, but that is the point.

Let's go back to Cadbury's comments about the role of an NED; they "should bring an independent judgement to bear on issues of strategy, performance and resources including key appointments and standards of conduct". They can only do that if they understand where you want to take the business and they will only be allowed to do it if you remain focussed

and committed to your end goal. Of course over time the end goal may take on a different shape but that is OK as long as you recognise it and make the relevant changes.

So to put this in context let's be more specific about the role of the NED. Your overall objectives will throw up challenges in the following areas, not all of which a single NED will be able to cover and they may not all be relevant to your company;

- Organisation development and senior team performance
 - Business owners/CEO's/MD's often get too close to their senior colleagues and don't measure their capability in terms of the long term goals of the company. Experienced NEDs will give an independent view on senior team structure and performance based on experience with organisations on similar journey's to your own
- Analysing performance and financial management
 - NED's with direct sector experience will offer a different view on performance, often focussing on a series of key performance indicators that are more strategic and in turn improving reporting in the eyes of potential investors or financiers
- Building market share and competitive advantage
 - An NED drawn from a target market or with high level experience of the type of service offerings you are working towards can bring credibility in front of clients and potential new employees
- Governance and compliance
 - In this ever more regulated World keeping your company compliant is increasingly important. Having an NED that can provide the oversight on these issues and keep the board in check can be invaluable
- Raising investment or executing a sale or partial sale of the business
 - This is a specialist area and a once in a lifetime event for most business owners. It requires careful planning, the correct presentation of the company's financial performance and real clarity around future strategy.

At the end of the day and in my experience the success of an NED will probably be measured in terms of how much share holder value has grown during their appointment. That is why I am suggesting the high level thinking prior to the appointment.

That said one of the most common questions I am asked is "how do you pay an NED and should they receive shares in my company". The most common mistake for businesses and first time NED's is trying to gear remuneration precisely to time spent. That misses the point of building value over the medium term and inevitably leads to disputes. Let me tell how one of our industry's most successful entrepreneurs once presented remuneration for an NED to me;

"If your business is currently worth £2m but after working with me for three years it becomes worth £20m would you give me 10% of the upside". The intelligent answer is "Yes". It then follows that the day rate of the NED becomes irrelevant so my message is focus on the big picture, do not take your eyes off the prize, or allow the NED to take his or her eyes off the prize, set monthly remuneration at a sensible level that typically covers between 2-4 days per month – usually £2,500 - £5,000 – and then a meaningful "bonus" on

achieving medium term goals. This bonus can be expressed as a fee or stock or stock options, it depends on your company's circumstances and your medium term goals.

Appointing an NED is an important matter and managing one to achieve your goals is complex so you should take your time, be clear on your objectives get references and examine case studies from your prospective NED. It is also important to recognise that an NED "is not for life". Business circumstances change and what was the right profile at one point in time might not be right for a new phase of development, it is improbable that one individual can provide the independent support for a business through out its lifecycle. NED tenure is usually from 3-5 years, don't be afraid to make changes when they are needed, good NED's will also recognise this and should help with their succession.

Happy to answer your questions

Jonathan Wright