Hiring an effective non-executive director

A Guest Article by Chris Spencer-Phillips
September 2012
Research on the effectiveness of NEDs

Statistics on the effectiveness of non-executive directors (NEDs) make depressing reading:

- McKinsey research in 2011 found that 44% of Boards “need to improve or improve significantly”.
- Coutts research reveals that 56% of companies do not feel confident of getting good performance from their NEDs.
- Coutts research reveals that 33% of companies have experience of poorly performing NEDs.
- Opus research: “Shockingly, only 29% of companies declared their NEDs met standards of independence.”

Reasons for poor NED performance

So the key question is: Why are NEDs not performing better? The answers would seem to lie in the following statistics:

- Opus research reveals that only 4% of NEDs are interviewed formally.
- Coutts reported that 31% of NEDs they interviewed had between 5 and 25 roles, while 10% had between 10 and 15 roles. The Walker report recommends that NEDs should not have more than 5 roles if they are to be truly effective.
- Opus research: “NEDs have an average of 5.5 roles but some have 20 and more.”
- KPMG research in 2012 found that NEDs who served on three or more boards showed a noticeable fall-off in their contribution to their third board.
- Coutts research: “Networking (89%) and business referrals (88%) are the selection routes of choice for companies.”
- Opus research: “Most NEDs are appointed through personal contacts”.

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UK NEDs – the problems and solutions

There are three fundamental problems with NEDs in the UK:

1. Many do not pass the UK Corporate Governance Code’s independence criteria.
2. Many companies do not take the interview process seriously enough when appointing their NEDs.
3. A high proportion of UK NEDs have too many roles to be effective.

If companies appoint NEDs from their own contacts, without going through a proper interview process to evaluate their suitability in terms of skills, experience and cultural fit, and with some NEDs on so many boards, it is no wonder that a high percentage of NEDs are viewed by their boards as being ineffective. The blame for this lies with their search, selection and appointment process.

In April 2012 the *Sunday Times* business section carried an interesting article by American economist Irwin Stelzer. The article stated that world discontent with capitalism was caused by two main things:

- “fat cat” executive pay being out of control
- poor corporate governance caused by NEDs not being truly independent.

Stelzer claimed that recent US legislation (the Dodd-Frank law) would resolve the first problem by linking pay to performance and giving shareholders a “say on pay”. He said the second problem would be resolved because NEDs will now have to be truly independent of the CEO and chairman, making it more difficult for the latter pair to create a board of directors from their country clubs.

We don’t have comparable legislation in the UK: we have the “comply or explain” UK Corporate Governance Code. Does this ensure that NEDs are truly effective and truly independent? Sadly, from what we see and from the research here, the answer is “no”, for the reasons given above.

However, there are a number of ways the situation could be improved:

1. The pool of NEDs should be broadened. There are a large number of very talented potential NEDs, but most search firms won’t put forward candidates who haven’t been NEDs before. They are therefore left with “generic” NEDs who are not “live”, and many of these have too many roles.
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2. Rather than appointing “generic” NEDs, boards should only appoint NEDs who really add value, taking into account the current board composition, balance and skills gaps.

3. Stakeholders should be well represented on boards. This would resolve the issue of gender diversity, since 85% of goods and services in the UK are bought by women.

4. NEDs should be “live” – in other words, employed or recently employed, rather than a long time retired. But the major search firms seem to like providing clients with experienced NEDs who have often been out of the firing line for too long to be effective.

5. NEDs should have no more than four roles, to ensure that they have the time to make a full commitment and understand all the issues so that they can be effective. As a result, NEDs should be paid more – but not so much that they can’t walk away when they are confronted with major issues that they disagree with.

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If you would like more information on any of the points covered in this Guest Article, please contact TCii on 020 7099 2621.