Beyond compliance - the role of the Non-Executive Director.

What are the real challenges in an increasingly litigious corporate environment? An exploration of current issues including performance measurement, recruitment and selection, and becoming a Non-Executive Director.
The Rise of the
Non-Executive Director

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Executive Summary

Several reports over the past few years, including those of Higgs and Tyson, have put the role of the non-executive director (NED) in the spotlight.

Our focus
The purpose of this Roffey Park/Cedar International study was to explore what makes for an effective non-executive director in the ‘post-Higgs’ era; to find out how much the role is changing; how NEDs exercise their governance responsibilities. We looked at perspectives of both executive and non-executive directors. Given the increasingly litigious context, we also wanted to find out if the talent pool for NED roles is widening, about who would like to take on such roles and about issues facing people who choose to take up such appointments.

Why we chose to look at this
Our reasons for undertaking this study are two-fold: firstly, Roffey Park’s ongoing research into workplace issues suggests that the effects of good or less effective governance are felt at all levels in an organisation and have an impact on business success. We wanted to explore how governance is currently being exercised and look at how the changes to non-executive roles recommended by Higgs and others are working in practice. Secondly, both Roffey Park and Cedar International work with senior managers and directors, many of whom are currently non-executives, or aspire to take on such roles at some stage. We wanted to discover the latest ‘state of play’ with regard to non-executive roles, both to inform our own advisory service and our other development work with clients, and to raise awareness of potential issues more broadly.

Our findings suggest that:

1. Effective governance may be at risk
   - **Boards appear to be overly risk-averse**
     The specific NED tasks identified by the Combined Code on Corporate Governance (2003) relate to the development and constructive challenge of strategy, the scrutiny and monitoring of management performance, the assurance of the integrity of financial information and risk management, and the appointment and remuneration of executives. Our findings suggest that there is an over-focus on compliance with the requirements of the Combined Code, potentially making boards risk-averse, and this may be stifling other aspects of board performance. At the same time, compliance appears to be being approached as a ‘box-ticking’ exercise.

   - **The behaviour of boards may be less than effective**
     Boards appear to be generally obedient/compliant to the will of the chairperson, and board unity appears to be the dominant shared value, potentially closing down robust debate. For many NEDs in our study, it is important to ‘fit in’ with board relationships and processes, and they are acutely conscious of the fact that allocation of committee memberships is in the gift of the chairperson. We question whether the strong desire for board unity and the shared view of the importance of the chairperson’s role is always helpful to the cause of good governance.
• **Board evaluation is being approached in ‘box-ticking’ mode**
  - Contributors to our study suggest that their boards are aware of the need to evaluate board performance, but report that evaluation is currently in its infancy, both in terms of method and the willingness of individual NEDs to submit themselves to an evaluation process.
  - In performance evaluation at least, boards appear to be in the mode of ‘box ticking’ around the mechanics by which they are measured rather than, as Cassidy (2003) suggests, focusing on convergence on ethical standards.
  - Contributors generally agree that poor performance in a non-executive role occurred as much when NEDs cross the line between executive and non-executive behaviour inappropriately, as well as when they ignore warning signs.

2. **NED roles are still unclear**
   In spite of the Combined Code guidelines, as well as the Higgs and Tyson recommendations, surveys consistently show a lack of clarity around the NED role. Our findings reinforce this. Our contributors are apparently well aware of their obligation to comply with governance requirements, including risk management, but appear more ambivalent about their role with respect to strategy. On the whole they do not appear to see their role as the ‘corporate entrepreneurs’ advocated by Taylor (2003). Given ambiguity about the role, many contributors report that boards ‘play safe’.

• **NED roles are increasingly onerous**
  Our research suggests that some of the FTSE 100 boards had already begun to try to get more value from their NEDs prior to Higgs. As a result, NEDs themselves view the role as more onerous and have become a more expensive commodity. Contributors to our study report that this greater focus on compliance post-Higgs has significantly increased their workloads, with the time required to carry out their responsibilities reported as being generally at least twice what is required in theory.

• **‘Soft’ skills are the ‘hard’ skills**
  While Higgs found that the only official requirement for selecting NEDs is previous Board or top management experience, our study suggests that for many NEDs the challenges of the role require far more emphasis to be placed on ‘soft’ skills. According to our contributors, NEDs need to be ‘emotionally intelligent’ and willing to ask challenging questions. Our list of desirable attributes for NEDs compiled from the research includes being:

Analytic, articulate, confident, decisive, emotionally intelligent, honest, independent of spirit, integrity, intuitive, good judgement, financially able, flexible, non-executive, persuasive, questioning, self-aware and well-prepared.

3. **There is a shrinking talent pool of NEDs**
   How broad then is the talent pool for such super-heroes? Has the mix of people becoming NEDs changed post-Higgs and Tyson? Our research suggests that changes are slow to occur for a number of reasons:
• **The pool is drying up**
  - ‘Eligible’ people appear to be deselecting themselves – too much work and personal risk required.
  - In the past people became NEDs while in executive positions in companies. However, given the time requirements to do the job well now, firms are apparently less willing than before to allow people to gain NED experience while in full-time employment.

• **In practice, board diversity remains limited**
  While women NEDs are in short supply and women NEDs in our study are regularly sought after to take on additional NED roles, our findings suggest that significant limits to achieving board-level diversity exist in reality. We found that:
  - Boards fear disruption, are highly protective about who they appoint and careful to maintain their culture. They tend to appoint people who fit the conventional NED mould.
  - The criteria for NED appointments have not evolved very much in recent years. Boards remain conservative in their approach to criteria for appointment, continuing to require NEDs to be able to offer similar non-executive experience.
  - While the talent pool of potential candidates could in theory be swelled by people who have gained other forms of board level experience, such as in SMEs, public sector or not-for-profit organisations (where there is likely to be a more diverse board membership), our study suggests that, in practice, boards still recruit largely on the basis of main board experience, usually in a FTSE 100 company - a factor which automatically precludes ‘non-conventional’ recruits. Consequently, NED roles continue to be offered to the ‘usual suspects’ in a shrinking talent pool.
  - While FTSE experience appears to equip NEDs for public sector board appointments, our contributors do not consider the reverse to be true. Ironically, FTSE 100 companies represented in our study appear to be actively looking for a more diverse range of candidates.
  - The process for NED appointments has not changed much. In SMEs in particular, NEDs still tend to be selected because they are known to the Chairperson. While Head-hunters are increasingly involved, they too reinforce the old stereotype in their selection of suitable candidates.
  - There are few clear lines of information about how to become a NED open to potential NEDs from ‘non-conventional’ backgrounds.
  - Rather than expanding the talent pool, such approaches serve to shrink it.

4. **Currently little help is provided to new NEDs**
  While Garratt (2003) and others suggest that more training should be made available to NEDs, in practice provision appears to be patchy. Many contributors describe NEDs’ perception of training, beyond some form of induction, as being unnecessary and even remedial.
In addition to the time requirements, NEDs in our study were grappling with less tangible aspects of the role such as:

- **Understanding the organisation**: One NED described this as: “understanding the true nature of the organisation – the stuff that is not easy to write down so that you cannot do your homework well – the stuff that is built into the walls of the place…coming to terms with that in any organisation takes time, adjustment and hard listening”.

- **Clarifying the role**: While NEDs are usually appointed because of their existing track record some still feel there is room for development. One NED suggested that, “most available development doesn’t touch on how you contribute to a company to make them even better than they are; it is just what is the minimum hurdle to get over so you don’t get sued.”

- **Board dynamics**: NEDs have to understand something of the politics and power relationships in order to see how to fit in. One NED admitted, “it is straightforward stuff but it is surprising how difficult it is and how easy it is to muck it up”.

- **Spotting the issues**: One of our interviewees raised the important question, “how do you lift a stone to find out what is going on underneath?” In some cases company difficulties may be buried or disguised in too much information, in others they may remain hidden because of too little information.

- **When to ‘cross the line’ between support and challenge**: inevitably the role varies in accordance with organisational needs. One interviewee recalled: “In my 10 years experience, there have been ‘care and maintenance’ periods, shirt sleeves rolled up; then there are the ‘better get in and help’ periods, so the line is variable all the time”.

Induction, coaching and mentoring are all considered helpful approaches to accelerating NED effectiveness in the role.

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**Recommendations**

The report concludes with a number of recommendations regarding NED selection, evaluation and development:

1. **Developing a wider talent pool of potential NEDs** should be seen as a national business priority.

2. **Boards should practise more formal and rigorous evaluation.**

3. **Board development should be taken seriously.**
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The Rise of the Non-Executive Director*

Introduction

About this study

In recent years, the role and purpose of boards has been under increasing scrutiny in the wake of various corporate scandals such as Enron, WorldCom and others. In the US, regulators and others have criticised boards for paying too little attention to corporate governance. Governance issues have therefore moved centre-stage. At the heart of such issues are concerns about unethical practice and consequent loss of public and investor trust. In the past, board meetings may sometimes have been seen as no more than rubber-stamping committees, for which board members need do little preparation.

In the UK, revisions to corporate governance have been under way since the early 1990s. The Cadbury Report (1992), for instance, set out a code of corporate governance, a key part of which separated the roles of chairperson and chief executive, and made the relationship between a part-time chairperson and a chief executive the pivotal point of the board. Remuneration and audit committees were formed and the focus and responsibilities of the NED role were spelt out:

"Non-executive directors should bring an independent judgement to bear on issues of strategy, performance and resources including key appointments and standards of conduct".

‘Independent’ means having a perspective which is not influenced by the desire for income from the company, other than directors’ fees. A non-executive director must not have any executive or management responsibility within the company. However, questions have remained about how independent boards really are, with suspicion that boards are failing to control the so-called ‘fat cat’ payouts to executive directors, and the assumption that directors can be rewarded for failure.

Board governance is increasingly being shaped by regulation. At the current time, boards must not only actively exercise their responsibilities but be seen to do so. Public companies are now required to abide by the Combined Code on Corporate Governance (2003), monitored by the Financial Reporting Council. Indeed, since 2004, under the Sarbanes-Oxley governance laws, the audit committees of all publicly listed companies are required to be completely independent and include at least one financial expert. They are also required to report on how they are carrying out their responsibilities and evaluate their own performance as a board. Individual board member and overall board performance should be reviewed annually.

The Higgs Review into the Role and Effectiveness of Non-Executives (2003) recommended that the role of the non-executive director should acquire a new and special significance. Non-executive directors are required to carry out higher scrutiny and corporate governance roles and, in the quoted sector, NEDs are increasingly becoming known as ‘independent’ directors to reflect their status on the Board. They are expected to dominate boards, leaving former executives or other interested parties out in the cold. In effect non-executives are expected to know as much about the company’s operation as other directors and are required to fulfil regulatory requirements and monitor vulnerable areas, such as accounting. In practice this is difficult because they are distanced from the detail of operations and receive much of their information from executives.
Sample and method

Participants in this study – who will be referred to in this report as our ‘contributors’- include a number of FTSE 100 and 250 Company Board Members. The sample also includes a range of perspectives from current Chief Executives, SME Non-Executive Directors including several board chairmen, members of the board of a charitable trust, a provider of training for non-executives and three specialist ‘head-hunters’. Many contributors were members of several boards, some as Chair, and several had previously been Chief Executives.

Our method was as follows:

- Study of relevant literature
- 8 repertory grid interviews, from which we elicited constructs about effectiveness in a non-executive role.
- 22 semi-structured interviews - in which we explored a variety of aspects of NED roles.
- 2 focus groups involving a further twelve people - in which we tested and validated our findings and gained further examples.

Our initial findings were also presented to a conference audience of 35 people where they were discussed and further information gathered.

*N.B. ‘Non-executive directors’ will be referred to variously as ‘non-executives’ and ‘NEDs’.*
Section 1: The Role of the Non-Executive Director

“You can’t legislate for morality and good management”.

In this section we look at:

- How NEDs and others view the role of the NED
- How governance is exercised

The Role of the Non-Executive Director – the literature

A plethora of reports have followed Higgs, not least the Tyson Report (2003), which recommends that membership of boards should be broadened to increase representation and board effectiveness. A study by Norton Rose (2003) claimed: “This is the 4th report on corporate governance and each one shifts more power in the Boardroom to the NED.”

Board roles

The role of an Executive Board is to manage a company, while the role of non-executives is to manage the Executive Board and exercise corporate governance. The role of the senior independent director is to evaluate the chairperson’s performance, taking into account executive directors’ views. All directors are equal: “The chairman, managing director (or chief executive officer), executive directors and non-executives are all responsible for the leadership of the company” (Hughes, 2004).

There are a number of board sub-committees. The usual committees include Remuneration, Nomination and Audit. Some organisations (typically in the financial services) set up Financial Risk Management, or its Assets and Liabilities. Others may have committees which focus on social and environmental issues, and many companies include an environmental report to shareholders.

The diagram below depicts the organisational scenario at the top of a typical FTSE 100 company. There may be a minimum of ten individuals with seven distinct roles who are brought together in seven different groupings for varying purposes in the course of a year. By any definition this is a very complex organisational model. It should not be assumed that such a model will work effectively or be any surprise that many Boards are dysfunctional. Larger than average ambitions and egos create a powerful cocktail that places further strain on the model.
NED responsibilities
The Higgs report in January 2003 stated that there are “over a dozen” definitions of independent non-executive directors in the UK, all with different criteria. The specific NED tasks identified by the Combined Code on Corporate Governance (July 2003), relate to four key areas:

1. Strategy: the development and constructive challenge of strategy
2. Performance: the scrutiny of management’s performance in meeting objectives and the monitoring of performance reporting
3. Risk: the assessment of the integrity of financial information and robustness of controls and risk management
4. People: the remuneration of executives, a prime role in appointing or removing executives and succession planning.

However, in spite of these guidelines, surveys consistently show a lack of clarity around corporate governance and the NED role. There is no legal distinction between Executive and non-executive directors and they have equal responsibilities, liabilities and legal duties. Indeed, Garratt (2003) challenges the wisdom of distinguishing between executive and non-executive directors particularly as the distinction is not recognised by law.

McNulty, Roberts and Stiles (2002) who carried out part of the research which informed the Higgs Report, describe the NED role as not seeking to play an executive role but as creating accountability. They suggest that this is done through: challenging, questioning, testing, probing, debating, advising, informing.

McNulty, Roberts and Stiles argue that NEDs need to play both a strategic and a control role and manage the tension between the two. They identify three behavioural dynamics:

- Engaged and non-executive
- Challenge and support
- Independence and involvement

Ernst and Young (2004) also note the contribution NEDs make to the creation of corporate cultures of openness and transparency, which should enable the free flow of information and encourage responsibility and accountability. Taylor (2003) argues that effective board leadership requires directors to achieve a balance between ‘entrepreneurship’, i.e. paying attention to strategy, corporate renewal and innovation, and ‘corporate governance’, which emphasizes holding management accountable to the shareholders and imposing rigorous financial controls. Taylor suggests that the most effective board leadership style is ‘corporate entrepreneurship’ which is a combination of entrepreneurship with accountability and control. Cassidy (2003) argues however that currently boards are “in the mode of ‘box ticking’”, and that business is being dragged into convergence, not with ethical standards but with the mechanics of the Accountancy Standards Board. He suggests that the present approaches to governance are in the nature of “never mind the quality, feel the width”.

Ernst and Young suggest that the balancing act required to address each of these roles adequately, combined with increasing corporate governance and regulatory demands, means that FTSE NEDs should expect to commit at least three days a month to the role. Garratt
suggests that more training and rigorous annual appraisal of competence would be valuable for all directors and chairmen.

The more onerous nature of the NED role is reflected in the fees paid to directors. Indeed, just drawing attention to the NED role seems to have made it more expensive. Fee levels since Higgs have risen significantly. Companies typically review non-executive director fee levels every three years. A report by Watson Wyatt (2004) showed that fees rose by 38% in 2004 in FTSE 100 companies. An IDS study (2005) suggests that the average increase in fees for non-executives between January 2004 and March 2005 was 21 per cent, with the median annual fee for a FTSE 100 company being £42,000, and additional amounts being paid for extra duties such as chairing committees. The median annual fee level for a FTSE chairperson is now £250,000.

In small organisations and entrepreneurial firms, NEDs, while still relatively rare, are likely to be appointed due to the need for additional expertise and knowledge in a rapidly changing environment (Deakins et al., 2000). Deakins et al. conclude that an external director can alleviate some of the pressure placed on the entrepreneur as sole decision maker.

The role of Non-Executive Director - Our findings
In our interviews and focus groups, there was a wide range of views about how people saw the role of the NED.

Governance
All our contributors emphasised the governance aspects of the role, but opinions varied about how this should be carried out. Some placed the main role emphasis on financial scrutiny, but most took a broader view, seeing their role as to exercise governance by:

**Being engaged and non-executive:**
- High levels of engagement, building knowledge through informal contact with executives; not seeking to play an executive role, manage at a distance or ‘second guess’ executive proposals.
- Getting a feel for the people, a feel for what they’re doing, a feel for the product, a feel for the quality, a feel for the standards, a feel for the morale, a feel for the culture.

**Balancing independence and involvement:**
- Rigorously monitoring the performance of whatever it is and that is not just financial performance. Ensuring all the performance indicators are the right ones and monitoring them and managing them.
- Guard against conflict of interest. Some contributors felt ‘independence’ is interpreted too literally i.e. where too much organisation-specific knowledge is considered a disadvantage, rather than ‘independence of mind,’ –having an open dialogue.
- Being a voice of conscience: “being able to ask the owner questions his team would never dare ask.”
**Strategic role**
Far fewer participants focused more specifically on the strategic aspects of the role:

- Providing external challenge – insights into the way the world is going, what is affecting businesses on a global scale.
- NEDs can be instrumental in making changes.

Here were a number of comments which suggested that the strategic aspects of the role are considered less important than the governance aspects. In particular, a number of people commented that boards are currently going through a phase of compliance rather than skilful board performance in the broadest sense. One person likened this to the stages of skills development, with the boards with which that individual is involved being at the stage of ‘conscious incompetence’ with regard to the various new requirements.

**Being a contributor**
Most contributors placed great emphasis on the nature of board contribution, emphasising the more enabling aspects of their role:

- Supporting the Chair in what he or she is trying to achieve.
- Carving out some particular area of interest where you can get a little bit more involved.
- Offering challenge and support: Taking the risk of challenging – being informed and well-motivated.

**Has anything changed post-Higgs?**
We asked contributors to identify if, and in what ways, the focus and composition of boards was changing post-Higgs and other reports, with particular reference to NED roles.

**A greater focus on compliance**
There was a general agreement that, post-Higgs, there is a strong focus on compliance:
“In more recent years that role has obviously been enhanced into the field of compliance and monitoring and all that kind of stuff which has come out of the various reports.” *(PLC Director)*

“People have begun to take much more seriously, in small and medium size private companies, the responsibilities that they have both under the law and the Higgs recommendations. So yes, everybody is far more conscious of corporate governance in the broader sense and it has become a far more important aspect of their boardroom responsibilities.” *(Company Chairperson)*

However, for some of the FTSE 100 companies, change had begun well before Higgs:
“Everybody seems to place a mark in the sand when Higgs came along but if you were to talk to many of the FTSE 100 companies you will find that their thinking towards the role of NEDs predated that by some considerable time, in so far as balance, composition of boards, needs and so on….in the late 80s, we were beginning to rebalance boards, not because NEDs were good chaps, but because we needed to get something more from them.” *(HR Director)*
A ‘tick-box’ exercise?

On the other hand, some contributors felt that compliance with the report’s recommendations was sometimes more of a ‘tick-box’ exercise than true corporate governance. For example, according to one contributor who sits on four boards, “They can recite Higgs and define clearly the role of the executive board and the role of non-executives, but organisations are still not really clear why they want NEDs”. Indeed, for a number of contributors to the research, the role of the NED was essentially the same as it had always been: “People have always appreciated wisdom and knowledge based on experience as the NED contribution”.

There were a number of cases reported where boards were barely complying with Higgs’ recommendations. In one case, a NED found himself sorting out poor governance and lack of procedure: “There were no corporate governance rules or anything that equated to Higgs. It was completely wrong, there was no structure and they had no idea what sort of rules to adopt. For example, as a board, they had not even mentioned health and safety. They had 24 recordable incidents, including accidents with forklift trucks, things falling on people and people cutting fingers off, which the board were unaware of. As far as I am concerned health and safety goes on every board meeting. You can be found to be negligent and personally responsible for the health and safety of your employees. They had no idea of that.” (Company Chairperson)

Better preparation needed

On the whole, a key change reported was the requirement for NEDs to be better prepared than in the past for board meetings. The nature of preparation required is more or less clear-cut depending on the role. For example, requirements are perhaps clearest with audit committee membership, whereas requirements for nomination committee roles are less clear-cut. As one NED on such a committee put it, “You can only challenge if you know the people, the plan and the detail on the sector. It is easiest to contribute when it is a sector you are very familiar with. If not, it requires lots of reading”.

Increased requirement for specialist expertise

In larger companies in particular, people do see some changes happening - up to a point: “I think what one sees more now, as a result of Higgs and others, is the requirement to have people who, if not specialists, have sufficient understanding of the business dynamics and the engineering and financial issues in order to be able to fulfil their role much more professionally. The old days of getting a group of friends together, making them into directors has gone. Although, by the way, it still happens!…. However, I think the days of the glorious amateur are gone.” (PLC Non-Executive Director and former Company Vice President)

This increased focus on professional skills or other expertise appears to be reflected in board level positions across the sectors: “People have to be able to make a contribution to the depth of their experience. For example, it might be something to do with international experience and ability to advise people on how to do business in Germany and Japan, or whatever. But they have to be able to bring something to the Board rather than just being a name, someone who’s just doing a lunch plus three hours a week.” (Managing Director)

NEDs have to remain independent but free to offer their specific expertise as need be. Treading the fine line between offering contributions and steering events can be challenging at times. For example, one NED of a FTSE 100 construction company drew on her experience from another sector and suggested that the company should look at supply chain management. For the executive directors involved, this was too challenging a suggestion and was rejected.
In the case of members of the Audit, Remuneration and Nominations Committees or indeed the role of chairperson, the type of person required may be relatively clear, according to many of our contributors. Specific skills may be needed. For instance, members of the Remuneration Committee need to be able to navigate the complex pensions ‘minefield’ and may require an expert contributor. One NED of a FTSE 100 company chairs the Corporate Social Responsibility Committee and brings her special interest in the environment, health and safety etc. to her role.

SMEs

In small organisations where there is not the support of, say, a Compliance Officer or a Risk Officer, and where possibly even the Finance Officer might be from an outside company, the NED has to be even more aware of what is happening in the company as they are acting directly on behalf of the shareholders. Several of our contributors had HR backgrounds. Each of these had been drawn into providing specialist advisory service to their boards, not only with regard to executive compensation but also on major projects such as merger integration.

Indeed, the greater awareness of the NED responsibilities was thought to be in part responsible for the much reported talent pipeline blockage of people being willing to take up NED responsibilities.

Key points

- Post-Higgs there is a greater emphasis on compliance and less on the strategic aspects of the role.
- Compliance may be being approached in a ‘tick-box’ manner.
- The role of NEDs is becoming more onerous and still lacks clarity.
- Specialist skills and knowledge are in demand.
Section 2: Relationships within the Board

“It is straightforward stuff but it is surprising how difficult it is and how easy it is to muck it up”.

Jeffrey Sonnenfeld’s research (2002) suggests that structural changes in, and of themselves, do not distinguish effective from ineffective boards. What does distinguish the best from the rest is a well-functioning social system in which members trust and challenge one another and engage directly with senior managers on critical issues facing the corporation.

Importance of understanding board dynamics

Our findings echo this research. For NEDs in our study, understanding the board dynamics and something of the politics and power relationships was critical in order to see how to fit in.

Indeed, throughout the study, the importance of board relationships, especially the NEDs’ relationship with the chairperson, was emphasised: “What I would say is, just working hard doesn’t help. I think it actually goes back to the broad idea that you have to build the relationships with people around you to get support.” At its core, a board of directors is a work group, an intact social system with its own boundaries, roles and interdependences. Effective boards communicate well among members, checking for accurate understanding and agreement. They are also able to alter their behaviour as different situations dictate.

There were strong differences of view about whether or not NEDs should exercise their governance role collaboratively with executives. There has obviously got to be some form of informal and formal contact between the NEDs and executives but at the same time NEDs have to ensure that they preserve their independence and objectivity so there has got to be an ‘arm’s length’ relationship going on which, at the same time, is reasonably open. The following illustrates the more common view: “It’s about helping to create a team, not just of the non-execs but the executives”. For several contributors, on the other hand, it is vital to their governance role as NEDs to retain a critical distance from executives, even at the expense of having cordial relationships with them.

Respect and trust

Respect within the Board and between the Board and the Executive, was mentioned by most interviewees. For one person, respect was based on valuing the quality of the other NEDs and appreciating what others bring to the table. For another non-executive director, respect came more from the quality of relationships and the levels of teamwork within the board, which formed the basis of effective contribution: “You can talk about the skills and attributes of individual non-executive directors, but I think it’s less than half the story, because what is more important is how the whole lot of you work together. Whether individuals complement each other in terms of their skills and their views, whether they bring different experiences and not the same experiences. You need people who are different and bring different skills and different experiences and different mind-sets. But again, for me, you’ve got to know each other and trust each other”

(Former Executive Director FTSE 100)
For another contributor, individuals earned the right to be respected by the way they prepared for meetings and by the quality of their input: “Respect in my experience is never given: it is earned and I would have thought after three board meetings they will either have begun to ignore you or they are taking a lot of notice of what you say.” (Chairperson).

Indeed, another contributor played down the importance of relationships: “Building relationships is not essential. It should not be a cosy affair. While it is important to work together it must not get too comfy. The role is to challenge. NEDs need to be tough, to feel strongly and be willing to stand up and be counted. Equally they must not be intransigent. They need to listen to others’ viewpoint, understand where they are coming from and have respect for each other.” (Director FTSE 100)

Relationships with Executives
For several contributors, the importance of retaining an appropriate distance from Executives, so as not to be swayed to a particular cause, has to be balanced against the need for good relationships so as to be able to access the right level of information required to exercise effective governance. This meant attempting to use open and constructive approaches, so that less direct, more political approaches are less likely to be used: “What you don’t want to encourage is a situation in which people are coming around the back of the organisation and talking to the NEDs as a means of influencing the board.” (Deputy Chairperson, Charitable Trust)

One NED was quite specific about the key relationships which needed to be established in order to ensure timely flows of the right information: “I have always made it my business to develop the strongest relationship with the Finance Directors because at the end of the day, when things either have gone wrong or are about to, it is the finance matters that are going to be the most serious. So first the relationship should be with the CEO, secondly with the Finance Director and then- it depends if you are a Marketing or Sales guy and if you have had a lot of experience- you will no doubt be friendly and set up a relationship with the sales and marketing group. If you are a manufacturing man you will wish to establish a relationship with the production people.” (Company Chairperson)

The role of the Chairperson
The importance of the role of Chairperson to board effectiveness was emphasised by nearly all contributors; in particular, the Chair’s ability to manage board meetings: “I think the way the board meetings are conducted is very much in the control of the Chairman and the way in which you can challenge comes down in large measure to personal relationships. I think all of us expect, and in my case enjoy, a challenge. The board is a team and you are not knocking holes out of people, you are challenging them in a sensible way. They need to respect you to do that”. (Company Chairman)

Given the importance of the role of chairperson, the particular style of the individual can have a major influence on board effectiveness. One NED described how one chairperson whom she considered to be too strong generally prefaced his remarks with ‘my view is…’ before inviting other comments. She noted that the chairperson’s style did not invite contradiction and generally influenced the outcome of any debate.
Other contributors agreed: “The Chairman, of course, has a strong role to play in how to run meetings, how to ensure members participate and when to shut up.” (Director FTSE 100) Several interviewees believed it was the Chair’s responsibility, in the interest of the Board, to ensure that formal and informal relationships developed effectively: “A good Chairman will ensure for example that there are some informal times when Executives and NEDs get to know each other, or they will arrange that two or more will meet between Board meetings or talk on the phone. A Chairman will put particular NEDs together with the appropriate Executive counterpart in between Board meetings. A good NED will, through the Chairman and the CEO, ensure that there are some informal consultations or discussions of that sort.” (Non-Executive Director)

Chair and Chief Executive

Most of our respondents cited the key relationship between the Chair and the Chief Executive in setting the tone for relationships more generally within the Board: “Firstly the way the Chairman and Chief Executive interact is hugely defining in terms of style in the Board room and secondly how the Chairman and the Chief Executive react with the other Board members.” (Chairperson Voluntary Sector)

For the chairmen in the sample group, being able to trust the Chief Executive was seen as crucial: “You have to rely very strongly on the relationship that you have with the Chief Executive and you have to support him. The day you decide he is unsupportable is the day either you resign or you fire him and get a new one.” (Company Chairperson)

Dissent vs unity?

We asked both the more experienced and relatively new NEDs to recall how they had settled in to their roles when new to the board. For most, the primary concern was finding out how to work well with the chairperson (who is probably responsible for your appointment and opportunities for ‘progression’ to committee roles), and then with the rest of the board, for example: “I think you have to have that capability as a NED of fitting in with, and adapting to, the particular style of Chairmanship.”

Given the importance most people attached to effective working relationships at Board level, a number of NEDs suggested that sorting out any dysfunctional board relationships should be a key priority. One Director gave advice as to how to go about this: “Talk to the Chairman, talk to the CEO, highlighting that there are not such good general relationships and suggesting how they might help. If that doesn’t work speak to the senior independent director. Then if that doesn’t work the NED has to ask themselves if it is fundamentally detrimental to the working of the Board and therefore what is he or she going to do about it.” (Non-Executive Director)

The senior independent director is sometimes in an invidious position. They represent the shareholders as well as having to represent the chief executive and chairperson. According to several contributors, they can find themselves in an ambiguous role and need to be clear what they want.

Other NEDs considered that relationships should be sorted out by the individuals directly involved. One female director on a large Utilities board actively challenged people who caused her problems: “I took aside the one or two trouble makers on the Board and went to see them. I had a discussion with them about where they thought I could fit in and that seemed to work quite well after that.” (Non-Executive Director)
Key points

- Many NEDs grapple with the 'softer' side of their role, such as knowing where they can fit in, how to manage board relationships, The chairperson appears to be pivotal to board performance; NEDs are expected to fit in to the chairperson’s way of doing things, which may lead to a loss of board independence.

- Boards appear to prefer unity rather than welcoming diversity.
Section 3: The challenges of exercising good governance

“And anyway, you’ve only got to open the newspapers any day of the week and you see where calamities have occurred, scandals have occurred, people have behaved disgracefully and it hasn’t been picked up, or it has been condoned or whatever.”

Given the greater responsibilities placed on NEDs following the recommendations of Higgs and the application of the Combined Code, it is understandable that NEDs in our study take their governance responsibilities seriously and are concerned to get things right.

When things go wrong...

For many of our interviewees, experience alone may not be enough to equip people to know what’s really going wrong within a company. Instead, many contributors consider that learning to exercise good governance is an ongoing process: “I have seen so many examples where people didn’t spot that things were going terribly wrong - including the non-executives with fantastic reputations and titles and all the rest of it…” In one typical example, a NED describes how wisdom came only with hindsight, and that success can lull boards into a false sense of security/complacency: “I’ve been involved in something recently where everything looked absolutely tickety-boo. It was a small business. We were doing brilliantly and it all fell apart in six weeks. I had no clue at all. None of us had any clue. In fact the execs didn’t really have a clue, which was one of the problems as it turned out in retrospect. I think it is very difficult.”

According to our contributors, effective governance is most likely to be compromised as a result of:

- The way the board functions
- The relationships between individuals and between the executives and non-executives.

Tell-tale aspects of ineffective board behaviour and ways of operating include:

1. Lack of awareness

As discussed earlier, boards should be the ultimate backstop with regard to ensuring ethical and appropriate business and organisational practice. Effective governance seems most likely when boards have the right (level of) information they need to assess the way the business is operating. Lack of that awareness seems to be caused by any combination of the following:

- Inexperienced NEDs
- Failure to ask the right questions and unwillingness to ask ‘awkward’ questions
- Executives withholding or ‘massaging’ information
- Too much, or too little, or the wrong sort of information being presented to the board, often too late for NEDs to prepare
- Poor board dynamics
- Over-controlling or laissez-faire chairperson
• Tendency to ascribe ‘horns’ or ‘halo’ effect to certain people and issues
• Boards which become dysfunctional – complacent, lazy, over-executive etc

2. Political behaviour and lack of trust
Trust is a key feature of board effectiveness. One person suggested that functional Boards trust each other, dysfunctional Boards don’t. Politics of the destructive kind can become an end in itself, rather than the practice of good governance: “It’s the little groups; the chief executive manipulating the chairman, and the chairman manipulating the chief executive and all the rest of it. That’s the real world, that’s politics and I wouldn’t go on a FTSE 100 Board again because I couldn’t stand it any more, having had the experience that I had for five years as an executive director on a Board which behaved like this. It’s really so unpleasant… Lots of people are still hugely turned on by that, lots of women are also quite excited by that. I’m just saying that, having done it for five years as an executive director, I’m not interested in it either as an executive or as a non-executive.” (Chairperson, Charitable Trust)

3. Tolerance of dysfunction
A number of examples were cited of boards whose overall performance was poor. In such circumstances politics is likely to be rife, the level of scrutiny likely to be light and potentially biased, and some potentially damaging things are allowed through the net as a result: “It’s about dysfunction. You get a very strong sense of the tremendous politicking and plotting that went on. Some people were in on the plots and some people weren’t and some people were told this and some people were told that. This may be inevitable when you’ve got people fighting for the top job. But it partly came about because the board had been dysfunctional for years and it would be easy to blame the chairman and the non-executive directors at the time but it’s not quite as simple as that because they had all condoned this really very dysfunctional Board.” (Former Executive Director, FTSE 100)

Size of board
The size of the Board is also seen to be a factor in how well or otherwise a board functions: “If the Board is too big, it is very difficult to know all the other members and it’s very difficult to trust them and it’s very difficult to have any real discussion and real debate”. It is also relatively easy for the Chair in such circumstances to take a strongly directive role which may stifle dissent and challenge: “When I first went on the board, it was over twenty people. It was ludicrous! If you were sitting down one end, it was very difficult to catch the chairman’s eye. Anyway, half the time he wouldn’t catch your eye because he had no intention of letting you speak. So look at the size of the Board, look at the balance of the execs and non-execs.” (Chairperson, Charitable Trust)

Exercising good governance
The key challenge is to find out what you need to know in an appropriate way; to know when greater scrutiny is required, when to challenge and when to support.

A balancing act
For most new NEDs, finding the appropriate way of operating at board level can be a challenge, especially for newly retired executives who have not yet scaled back their level of involvement in decision-making. NEDs have to tread the fine line between maintaining
independence and getting inappropriately involved in decision-making at the wrong level. Many find themselves walking a fine line between being engaged/non-executive and being too deeply involved/demanding too much detail/expecting to be consulted on operational detail.

This dividing line between executive and non-executive behaviour is something one has to sense, or become more aware of with experience: “I think it’s something every non-executive has to grapple with: where your input stops and starts…. I don’t think there is a line that is visible and everyone can see it, I think it is a line you have to find”.

The challenge of course is to know when it is appropriate to ‘cross the line’ between support and challenge, for instance when something is worthy of further investigation. As one person pointed out: “It is different for every individual depending on their style and experience and their character and how much sense they talk and how much help the organisation needs… I certainly felt that in my 10 years on the board there have been ‘care and maintenance’ periods, and there have been ‘shirt sleeves rolled up, you’d better get in and help’ period; so I think the line is variable all the time as well.”

Sensing at any one time where that fine line is between intervention and non-intervention is an art, and opinions vary as to whether training would be helpful in developing that judgement. A common view about how to develop the ability to sense where greater scrutiny might be required is as follows: “If we had a job description for NED positions I am not sure that would be very helpful. So where I have discovered it, (and I think it is possibly different for every person and different for every organisation), is through feedback – feedback from the operational people and feedback from fellow directors. If there is active listening going on you will discover over a period of time where your help is valued and where it isn’t. Indeed also where your help works and where it doesn’t”.

Another NED suggested that another form of learning, albeit after the event, is where a NED’s advice has been ignored but his or her instincts are subsequently proved to have been correct: “You have got the temptation to say ‘I told you so’, but then there are occasions your advice wasn’t heeded and actually the contrary advice worked very well and you think ‘ah well, OK, then I have something to learn out of that’”.

Several NEDs considered that, when things are going wrong within a company, it is the chairperson’s or senior non-executive director’s responsibility to intervene, rather than any other individual NED’s.

**How do you find out what you need to know?**

Of course, one way of finding out what is going on is to talk with the organisation’s management. The NED is in a position to ask for information and it is important that he/she asks the right questions. Most contributors felt that this came with experience: “You can’t know what the executives know about a company so the financial aspects are very important. It is important to know and understand the financials and ask the right questions and ensure a system, particularly that the audit systems are adequate. It comes back to having some understanding of the market-place or type of company so you know what questions to ask.”

One NED warned against becoming too involved with the organisation’s management: “You have to be very careful of this because as a NED you have a particular role. What you can’t do is undermine your executive members. Good companies will ensure that you have access. It comes in different ways; either you visit manager or/and they will bring them into board meetings, that is a
common way of doing it. Even so you cannot be sure that you will know. You should not be getting too involved because you are there as an NED.” (Non-Executive Director, Head-hunter)

One NED on a Risk Management sub-group described getting to know the organisation by collecting ‘bottom up’ data: “One of the key questions is ‘how do you lift a stone to find out what is going on underneath?’ We joke about the volume of response we got which was incredible – when we got to chip fryers and weeds in the garden it was not really the kind of significance we were after – but it was a good reality check for us. When you sit around a table every three months and you look at paper reports and you meet just a couple of the staff you get a certain incomplete picture of the organisation. It isn’t because people are hiding things from you it is just inevitable”. (Functional Executive, major PLC) There was also the temptation, having lifted the stone, to continue to probe, which wasn’t ultimately their job and involved ‘crossing the line’ several times.

The danger is that NEDs can be kept in the dark by having too much information provided, too late: “The Executive in some companies I have come across will want to bury the NEDs in information and the debate on most boards takes place from time to time regarding what is an appropriate amount of information. The outcome of that debate should always be the NEDs telling the Executive what they want to see and asking the NEDs to make sure they see what they can reasonably expect to see.”

NEDs can and should challenge the amount of information they receive, whether it is too little or too much. “It is no good going to the board every month and saying, ‘we have achieved that budget and that budget’ because that is not necessarily what the board is interested in. They are interested in a much wider range of issues to do with strategy and people.” (PLC Director and former Vice President)

One CEO saw it as an important duty to be open with the NEDs: “I think it’s totally unfair on non-execs to come into a meeting, to be faced with a very, very complex question and to be asked to make a decision. It’s down to all of us to make sure the non-execs have the right level of appreciation and I encourage them if they have questions. I have always tried to run things in an open way. I think the chief executive who begins to hide things from the Board or be economical with the truth is finally going to end up in trouble. Where you have an open relationship with the Board, with the non-execs the better it is.” (PLC Director)

Early dissemination of relevant information provides an early warning system which escalates urgent issues to the Board in time to discuss remedial action so that the Board does not receive shock reports.

What NEDs can contribute when things go wrong

Most of the NEDs in our study saw it as their responsibility to intervene directly when things go wrong. However, there were a number of caveats:

I. You need to have the time to get involved when things go wrong

One NED warned that prospective NEDs should ensure they have the time and capacity to deal with problems when things go wrong. In such circumstances, hopefully exceptional, NEDs need to be sufficiently flexible that they can take more direct responsibility if need be, as in this example: “The company ran into troubled times and it was at a time when I was very busy and would rather have given it up because I was having trouble coping with everything I was doing, but I couldn’t really do that. I always advise people taking on NED positions to think very carefully about the type of company, ensure that they are not going to be taking on too much.
We were bid for twice and the second time all the executives stood down leaving the NEDs running the company, that was a tricky one. So yes, they all have their moments. This example happens quite regularly to companies and people often don’t think what they are taking on. Once you are in you are in, you have the same responsibilities as executives. You have to have the capacity of hard work.” (Non-Executive Director and Head-hunter)

2. You need to have specific expertise which is relevant to the situation

One non-executive director appointed to a Limited Partnership as representative of the Principal Directors was able, by his professional approach, to uncover unacceptable dealings. The finance director realised that it would not go unnoticed: “The finance director said to me, ‘look I know from the way you address the accounts, and from the way you have marked up your copy of the reports and so on that you are going to find this out so I would rather tell you myself. We awarded the non-executive chairman, as a gift, a quarter of a million pounds.’ As far as I am concerned I find it is completely and totally unacceptable. It is clearly not illegal but it is an unacceptable process and procedure. I asked whether it had been properly approved by the Board, were there board minutes, were the management buyout people aware of it and so on? I asked all the right questions and I didn’t get all the right answers. I felt that it was going to be very difficult to deal with that company and particularly with that chairman knowing that he had given himself that money. There are some really awkward situations you can get yourself into.” (Company Chairperson)

Summary

- NEDs need to be able to dedicate both time and relevant expertise when things go wrong.
- Many struggle with knowing how to spot the issues and when (not) to take a more interventionist approach.
- Poor communications with the board can keep NEDs in the dark.
- The style of the chairperson is a strong influence on the way the board exercises governance and many boards may still be rather more relationship-driven than the various reports recommend.
- Board unity is still seen as being valued above diversity, particularly in the private sector. According to many of our contributors, the degree of independence a Board adopts can be jeopardised if debate and challenge within the board is limited.
Section 4: What is effectiveness in a NED role?

In this section we look at the findings from repertory grid and semi-structured interviews, and from focus groups, relating to:

- The characteristics of effective NEDs
- The characteristics of less effective NEDs

Characteristics and qualities of effective NEDs

The characteristics and qualities described in this section have been identified through repertory grid interviews carried out with 8 people in non-executive director roles and also through semi-structured interviews and focus group sessions with a further 34 people. Participants in this part of the study included current chief executives, NEDs, members of the board of a charitable trust, and several board chairmen. Most of these were members of several boards, some as chair, and several had previously been chief executives.

People were asked to identify people whom they consider effective NEDs and compare how their behaviour and approach differed from with those of other people whom they consider to be relatively less effective NEDs. From these interviews we elicited a number of constructs and from discussion with people taking part in semi-structured interviews and the focus groups we gained examples of how NEDs demonstrate these characteristics/qualities.

In our study contributors agreed, on the whole, that what made NEDs effective was not a special set of skills but the kinds of qualities that make people successful in life generally – “the qualities of behaviour like being polite, respectful, charming all those kinds of things are important. Ability to be articulate, clear and precise; and intellect and knowledge which is of a high quality, together with a sense of being a good listener - the ability to keep quiet and listen.”

(Non-Executive Director, FTSE 250)

In particular, the following characteristics were what distinguished effective from less effective NEDs:

- **Analytical** – They are analytical and able to think quickly: “The board process is a dynamic one and what they are very good at is thinking on their feet.” They will typically demonstrate an understanding/ concern about the market view.

- **Articulate** – They must be good communicators, have good listening skills and be able to express and describe concerns: “There is an element of theatre about a board meeting in that you have to be able to put over what you are saying. I am not saying you need any actors on the board but you do need someone who is able to communicate on a strong level.”

- **Confident** – Their confidence is evident to others in the way they go about things: “It is a sound grip on what they are there for, and what the organisation’s best interests are about, so all the while they are working off a very solid platform and it shows. They stand out in meetings when the chips are down”. They are also able to respond to challenges themselves: “There are some things that you can rehearse and some things that you cannot and it boils down to having confident people”.

• **Decisive** – about whether to raise a concern or not; about when a matter needs to be more fully investigated.

• **Dedicated** – They are willing to give substantial time to carrying out the role of NED. They are usually prepared to make a long-term commitment and face up to hard challenges.

• **Financially able:** – “I don’t think you can be a non-executive director of any company without a strong financial ability…there is quite a bit of political ability as well”

• **Flexible** – “The successful NED amends his behaviour accordingly to reach into the zone of comfort of the other person, and therefore the person who has the largest degree of flexibility in terms of their style and behaviour will have the greatest degree of emotional intelligence and that is world class.”

• **Honest** – They must have high levels of integrity and probity. As Pehr Gyllenhammar says, ‘no crooks, no cronies, no cowards’.

• **Independent of spirit** – They are proactive and must be “able to rock the boat if necessary”.

• **Interpersonally skilled** – They must be able to offer high challenge in a non-threatening way.

• **Intuitive** – They see the implications of changing circumstances; they demonstrate “a sense of anticipation, a whole raft of unquantifiable things”. As one chairperson described how an effective NED typically operates: “When he sees a pattern developing, when he sees an issue unfolding, he needs to bring into play the instinct of what has happened at the party. There are indications immediately, it is a personal warning system perhaps.”

• **Judgement** – For most contributors, good judgement comes from having good business sense, being able to see the bigger picture and being a strategic thinker. For some contributors, good judgement is acquired through specific experience, while for others relevant experience is not always essential to good judgement: “They have got to have a good grasp of how the company is running. It is nice to have if they have got some sector experience and I am sure there are some industries where you do require to have a lot of sector experience, but again I think sometimes it is an advantage not to have so you can bring fresh ideas in to the conversations.” (Executive Vice President, Human Resources)

• **Knowledgeable** – Most contributors agreed that breadth of understanding is helpful, based on broad business experience. Effective NEDs might also be specialists but they need to be able to take the wider view and contribute beyond their sphere of expertise. In particular all NEDs need to be knowledgeable about the organisation and have a good understanding of corporate governance.

• **Non-executive** – Effective NEDs understand the requirements of the role and are able to adjust their behaviour accordingly. It was easier to find counter-examples than examples of effective behaviour with regard to this quality, for instance: “we have just hired a new NED who has come out of an executive role. He is finding it incredibly difficult to not interfere in the daily running of the business. It is quite an important skill requirement.” (Director)
• **Persuasive** – “They are able to convince fellow board members to address an issue or push it up the list of priorities, or sometimes to drop something – organisations sometimes try to do too much.”

• **Questioning** – They typically act as a critical friend: “Where I worked before we had some particularly difficult NEDs, only because they always asked challenging questions for the big investments that had to be made”.

• **Self-aware and self-possessed** – “They have to have self-awareness; there is a thing called ‘emotional intelligence’ - the more of that the better; it is a very important characteristic”. In addition they are described as ‘well-balanced’ (as opposed to arrogant), ‘modest’ and ‘prepared to admit weaknesses/mistakes’.

• **Team player** – Effective NEDS are generally described as collaborative, democratic and supportive. They are also able to connect well with all generations and tend to act as good coach/mentor to other NEDs.

• **Well-prepared** – They are always diligent in preparing for board and committee meetings and following through. Some are willing to plough through heavy board documents, investing a great deal of time in so doing, while others have helped reshape the nature of board papers so that they are more informative and take less time to ‘see the wood for the trees’.

**Do you need to be in the public eye to be effective?**

Some of the NEDs considered to be most effective were high profile public figures: “you get exceptionally good NEDs who are real prima donnas but have been hugely successful in their field. They are very talented and have an enormous amount to bring”. Equally, some of the other NEDs considered very effective were not well-known beyond their field but were willing and able to use their contacts where these might be helpful to the company.

**Characteristics of less effective NEDs**

In contrast, NEDs who were considered to be less effective were described as follows:

• **Poor attitude** - The most common failings of less effective NEDs appear to be arrogance and rigidity. Many were described to us as ‘conceited’, ‘lacking vision’, ‘rigid in sticking to his guns’ etc.

• **Executive behaviour** - A common characteristic of less effective NEDs is the ‘control freak’ tendency, most commonly demonstrated by new NEDs or by NEDs who have recently retired from executive positions.

• **Interpersonal skills** - They tend to have less well-developed ‘soft skills’ than more effective NEDs and tend to take an undermining approach which is characterised by regular negative criticism of others, particularly executives. Their approach creates tension and defensiveness in those around them.
• **Lack of knowledge** - They typically have low or outdated sector knowledge. They are uninformed and may be unaware that this is the case. They have a poor understanding of corporate governance, especially of changes in requirements of NEDs and often know even less about the particular organisation.

• **Lacking commitment** - They show a very short-term commitment to their role as NED and give the bare minimum. In a number of cases mentioned, the NEDs in question have a portfolio of NED appointments as well as other business interests. One particular individual boasts of being able to walk away from each board table at the end of each meeting, leaving the organisation’s issues and concerns where they are when he leaves. While some NEDs suggested that a portfolio of nine or ten appointments was feasible, others considered the optimum number of appointments should be no more than five. Less effective NEDs are also typically uninterested in the company and/or board meetings. They don’t bring contacts and remain detached, aloof, taking the stance of an ‘outsider,’ rather than showing interest and commitment to the board and the company.

• **Lack of preparedness** - They are typically not well-prepared for board meetings, may arrive late and may not even have glanced at board papers at all. One individual was described as expecting to be briefed by others when he arrives, rather than reading board papers himself. Less effective NEDs are often not detail conscious, so often fail to ‘read between the lines’ of issues, especially financial matters. Their lack of preparation and generalist tendencies mean that their contributions tend to be superficial and reactive. They are also often described as dependent on other NEDs for a steer.

**Characteristics shared by both high and low performing NEDs**

In some cases, effective and less effective NEDs shared common characteristics. For example, both might:

- Offer public profile
- Bring contacts
- Be autocratic
- Be aggressive.

What made the difference was the combination of those characteristics, how these were used and the context/situation the company was in. For example, in some cases, the ability of a NED, especially the chairperson, to take charge and aggressively drive through an investigation of a risk issue was considered to be in the company’s interests. Conversely, in other cases, autocratic behaviour was described as effectively stifling opposition, leading to greater compliance and reduced independence within the board. In a couple of examples, the high public profile and good reputation of NEDs was considered a positive asset for the board and the company, since it brought useful contacts. In another case, the reputation of a high profile NED had been tarnished by the failure of a company of which he was CEO and brought discredit by association to the company of which he was a board member.
Summary

- What makes NEDs effective is not a special set of skills but the kinds of qualities which help people succeed more generally.

- In particular, they need ‘emotional intelligence’, good judgement and the willingness to offer support and challenge.

- Given the demands of the role, the borderline between effective and ineffective behaviour appears linked to the degree of preparation and commitment a NED demonstrates.

- A common perceived failing is when a NED inappropriately adopts an executive approach to their role.
Section 5: How is performance measured?

In this section we look at how some boards are attempting to measure NED performance.

The Combined Code on Corporate Governance (2003) states that the board of a publicly listed company should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. Performance evaluation is increasingly taking place at three levels:

- The chairperson
- Individual board members
- The board as a whole.

Board evaluation in the UK appears to be something of a secret art. In continental Europe, board evaluation is carried out more systematically than in the UK through supervisory boards; however, these processes are often seen as ‘rubber-stamping’.

In 2004 Highland Partners investigated board evaluation using qualitative interviews, following the Combined Code’s (2003) directive that boards of publicly listed companies should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. They concluded that “very few boards are able at this stage to make the link between evaluation, performance of the board and performance of the business over the longer term” although they acknowledge that there are a few signs of progress. With regard to non-executive directors they found that a key problem is that there is little clarity around role definition, accountability and expected contribution. Unless these are established at the outset there is little to evaluate.

In our study, long-standing board members have indeed noticed some changes taking place in recent times:

**Board evaluation is being taken seriously**

Shareholders of course need to be aware if directors are being effective and boards are expected to report on their evaluation process in company accounts. This is reflected in comments from most of our contributors; for example, one company secretary told us that: “board evaluation was top of the agenda for most company secretaries last year”. Another suggested: “My experience, as part of the new combined code, is that all boards are beginning to have formal assessments. In practice I think this is happening”. In the Listed sector, companies are expected to review their performance according to the new Operating Mandatory Review (2005).

More generally, our interviewees situated performance management and evaluation in the context of the board as a whole rather than at individual level: “I think you should think about the board as a whole and how the board is performing and whether the board continues to meet the needs of the company and is aligned with those needs. That is the process that sometimes doesn’t happen and within that you can then look at the individuals, but I think you must keep that overall board evaluation in focus.”

Boards should assess themselves on how well the board is performing versus the objectives it set for itself. Some of the board assessment factors which were mentioned by a few directors in our study included how the board responds to crises, how it carries out its
environmental responsibilities, how the board interacts with staff, how well board committees work, the nature of relationships and communications within the board, whether board papers are the right length and quality. Boards should also consider if training is required. On the whole, though, most NEDs reported evaluation to be treated as a ‘tick in the box’ rather than something more thorough-going.

**The evaluation of NED performance is in its infancy**

NEDs are now expected to make an active contribution to the work of the board: “Certainly people are less willing to put up with people who are not making any valuable contribution. If you go back to the old days, our history was such that all invitations to the board were to people half way to the House of Lords. A tenth of the directors were not regular, contributions were infrequent; all that has now changed.” *(Company Secretary, FTSE 250)*

However, in many cases, evaluation of NED performance remains in its infancy. In practice, NEDs often only seem to know they are not performing when their appointment is not renewed. Otherwise, the most common approach is self-assessment— it is an individual’s belief that they have made a difference and other external evidence: “Well if they ask me back! If they renew your term, that’s usually quite a good sign. You’re valued, the contribution you’re making is valued.”

Our findings reflect the mixed picture in a large MORI survey involving 605 telephone interviews with directors (75 chairs, 250 EDs, 275 NEDs) of UK listed companies in August/September 2002, which informed the Higgs report. Their key findings with regard to NEDs are as follows:

- 81% received some sort of briefing (only 24% a formal induction)
- 62% never received training for their role (4 out of 5 who did found it useful)
- Only 38% had been given objectives for their roles
- 76% had never had a formal performance review (34% of companies don’t review their board performance)
- 52% have never discussed company business with investors
- 92% are satisfied with their role (NEDs in FTSE 100 companies (72%) are more satisfied than those in 250 (60%) followed by other companies (48%)
- Lack of time or commitment is seen as greatest barrier to effectiveness by 25% of NEDs (Mori).

**Evaluation processes**

A variety of evaluation approaches were described by interviewees: “Sometimes it is very formal using a third party, but no more than 10% are doing that. Often it is the company secretary who devises a questionnaire and that is supported by the chairman at each individual’s discussions.” *(Non-Executive Director)* A few NEDs reported that their boards had either considered using or actually used an external consultant to carry out the evaluation process, but on the whole boards represented by people in our survey were carrying out their own assessments.

In our study, performance management practices reported ranged from informal encouragement to more formal output from an evaluation. A number of companies in the
focus group were doing dummy runs of operating and financial reviews. Measures typically include financial, governance and corporate responsibility topics: “I can think of one particular board who have actually written together a Board Improvement Plan that identifies areas of weakness on the board, including individual performances - issues about where particular people could give greater input. This plan was set out to define who should do what and by when. This is issue-driven rather than personality-driven, but giving the board members each specific tasks to do by a certain time is intended to improve the overall performance of the board. I haven’t seen that in many cases, but I think that approach is rather interesting and it is certainly different from the much softer approach to a chat over dinner with the NEDs concerned with the chairman saying, ‘it would be helpful if you did this or that.” (Chairperson, Voluntary Sector)

In reviewing NED performance, there was general agreement that the conversation does need to take place with the Chair as the person most likely to give feedback. In some boards, NEDs and the chairperson have regular one-to-one meetings, especially in the ‘induction’ period, where the chairperson can find out how things are going for the individual. Often during these meetings training needs are identified and objectives set. Indeed, the most common method was a series of one-to-one meetings with the chairperson. One NED reported how she had attempted to apply some good performance appraisal practice imported from her experience elsewhere by preparing studiously for her appraisal conversation with the chairperson. Her chairperson responded with shock.

In addition to skillset and general competence, the factors most commonly considered in reviewing NED performance were reported to be:

- How individuals contribute to board discussions: in particular whether people contribute only on issues they know something about or whether they are able to make a broader contribution also.
- The nature of interactions- do NEDs manage relationships effectively?
- Attendance levels.

There were, nevertheless, a few examples of more searching assessments, such as using 360 degree feedback and facilitated away-days, more so in the Voluntary Sector than in PLCs: “These days progressively you find the review of the NEDs more akin to that of the executive directors. In other words there are predefined objectives. We talked a moment or two ago about the process of bringing them in for specific reasons. Therefore you have a benchmark against those aspects of performance which can be measured. To what extent are they supporting the executive directors? To what extent are they contributing their particular skills? To what extent are they managing to communicate properly? To what extent are they managing to keep harmony between executives and non-executives? That process is a bit more formal these days in many companies” (Director, Human Resources)

There were mixed views about whether assessment needs to be formal and recorded. Most people agreed that boards are generally reluctant to go through a process of examination of any sort, and as one said, “Senior people don’t like to be individually assessed.” There was a feeling, however, that if it could be done well, in a positive and constructive way, feedback would be more welcome.
Assessing the chairperson’s performance

As far as our contributors are aware, the assessment of the chair’s performance appears to be somewhat of a cursory affair. On the whole the senior independent director carries this out and the chair’s performance evaluation is generally based on:

- His/her manner of chairing board meetings- for instance, does s/he allow particular individuals to dominate?
- The nature of the relationships within the board- whether or not they are constructive.

Similarly, the chair is evaluated on how appropriate the board and committee composition are considered to be in the light of corporate strategy. Board processes, including the length and quality of papers and any training requirements are also reviewed.

Whole board development

Very few of our contributors reported having taken part in a whole board development process. One or two had attended formal courses where they role-played business scenarios. Some boards used 360 degree feedback. However, there was a considerable degree of scepticism about the new industry of board evaluation and development provided by various consultancies. Concerning the development of the board as a whole, there are two general views: one is that the board should minimise expenditure and tackle issues internally; the other is to invest in getting outside consultants to help with evaluation, identifying any issues and developing a programme to tackle them. On the whole, the boards represented by individuals in our study preferred to manage their own evaluation and development processes, even though these were relatively primitive by current executive development standards.

Summary

- Board evaluation is being taken seriously as an idea but its practice is in its infancy.
- NEDs appear not to take kindly to individual assessment of their contribution, though many would welcome constructive feedback.
Section 6: Recruitment and selection of NEDs

The somewhat ‘closed shop’ nature of board composition and the process by which NEDs are appointed have been considered as the source of some of the poor board performance which has made the headlines in recent years and a system in need of overhaul.

In this section we look at:

- Whether greater diversity among NEDs is actually happening
- The selection criteria and recruitment processes for NED roles.

What the literature says...

The overwhelming majority of NEDs are men, though increasing numbers of women exercise governance roles particularly with regard to public sector and not-for-profit organisations. According to data supplied by Hemscott in 2002, the British director population is a highly homogeneous group. At that time only 6% of non-executive and 5% of executive posts were held by women with less than 1% of chairmen being female.

Once in the NED ‘club’, other appointments follow - NEDs of publicly listed companies tend to be invited to take up further NED positions. The relatively ‘closed shop’ nature of many boards has been criticised on the basis that when board membership is drawn from a small privileged group of people who know the ‘rules’ of board behaviour, it may be difficult for effective scrutiny and governance to take place. In the past there has been little restriction on the number of appointments a NED could hold or on the length of those appointments. Indeed, some ‘professional’ NEDs have developed a portfolio of appointments which have offered a viable financial alternative to being employed as an executive. Under the Combined Code (2003) it is recommended that NEDs serve no more than two three-year terms on any one board. There are also recommendations that chief executives should not become chairperson of their own organisation.

In theory, since the publication of the Cadbury, Higgs and Tyson reports and the Combined Code, there should be greater mobility in board composition. The Combined Code (2003), for instance, recommended that NEDs should serve no more than two three-year terms with the same company. Our contributors generally welcomed this recommendation as it encourages new blood and ideas to circulate in the board. In theory too, board membership should be broadened to include a more diverse pool of NEDs to reflect the globalisation of business and recommended new talent pools from non-commercial sectors and using executive search firms to identify potential candidates.

This should be good news for would-be NEDs. The characteristics of effective NEDs identified by Tyson (see Section 3), with a view to broadening the range of candidates capable of assuming NED roles, are in contrast with what Higgs found, namely that previous board or top management experience is the only official requirement for board membership. Tyson recommends rigorous and transparent non-executive director selection processes as well as research and measurement to encourage greater board diversity.
Broadening the talent pool

Given the changing nature of the role, the question of who gets to become a non-executive director has therefore been under the spotlight. One of the key recommendations of Tyson and other studies is that the talent pool of people capable of exercising NED responsibilities should be broadened and become more diverse.

The appointments process is central to the issue of enabling greater diversity at board level. Public sector board level appointments are relatively transparent, with open advertising of available roles, and subject to scrutiny through various government screening processes. On the other hand, private appointment processes have generally not been required to be transparent. Conventionally, people are invited to become NEDs on the basis of their reputation, connections and experience. Consequently, people outside the mainstream of non-executive director experience can have difficulty finding out how to prepare for, and position themselves for such positions. On the other hand, Head-hunters have warned that the pool of high-quality non-executives has shrunk as many become choosier about the posts they are prepared to take (Tucker, 2005).

Diversity still a distant prospect

A survey by Russell Reynolds Associates in 2002 suggested that quality and relevant experience is valued more than diversity, although they found that international experience was highly sought after. The head of the Association of Chief Executives of Voluntary Organisations (ACEVO), Stephen Bubb, said that government and UK businesses had ignored calls to promote boardroom diversity when appointing non-executive directors (Thomas, 2004). Having written to the company secretaries of all the FTSE 250 companies to ask whether any had taken steps to widen recruitment, only one replied and asked not to be contacted again.

In March 2005, Richard Donkin reported in the FT that none of the recent reports has found any significant rise in the number of directors from anywhere other than senior executive roles or from those who have recently retired from senior roles. He reports one source as believing this to be due to the increasing complexity of committee roles requiring people with specialist knowledge.

What we found...

We asked contributors if they had noticed any changes in board composition and NED mobility since these various recommendations were made. Our findings reinforce the view that things are not changing fast. Our contributors report that unity is indeed still seen as being valued above diversity, particularly in the private sector. The more diverse talent pool from which NED roles can be sourced, advocated by Tyson and others, appears to be coming into being very slowly. The general picture was that not a lot had changed in the last three years.

The case for diversity is recognised but...

Many of our contributors, including several chairmen, supported the case for greater diversity in board membership: “You have got to have that mix of diversity to bring something new and challenging to the board; diversity of background and commercial diversity helps to be able to just stretch the organisation in terms of thinking. The other sort of diversity I think is to have more
I think there is more of a sense of enquiry today, there is more collaboration - all the feminine characteristics. But I would rather take away all the superficial stuff about the numbers looking good.”

While the proportion of women NEDs in our study is unusually large, very few of the women NEDs in our study have been newly appointed to these boards in the past three years.

**Boards fear disruption**

Our contributors describe good boards as being highly selective and protective about who they appoint, as conservative and careful to maintain their culture. Above all they fear disruption. Consequently, head-hunters are cast in the role of change agents when, and if, they challenge a chairperson’s view of what the board needs in a NED appointment. One woman Director believed that Chairmen tended to choose men that are known to them: “One can only talk from one’s experience. The people I meet are white Anglo-Saxon males and that hasn’t changed.” (Director) Women directors suggest that clients looking for NEDs put pressure on head-hunters to select candidates for consideration who ‘fit the bill’.

Equally, many CEOs still prefer to have executives rather than NEDs on the Board. On the other hand, there was some recognition that change is afoot: “The old boy/girl network I think is fading away fast and rightly so as well.” Another NED commented that such moves are not before time: “You only have to look at the ‘great and the good’ having all appointed each other to various boards and everything becomes very stale and you end up with group think.” (Executive Vice President)

**Is there a shortage of talent?**

Many of our contributors commented that not enough ‘non-conventional’ candidates for NED positions were coming through the system, especially not coming to the attention of head-hunters. Indeed, experienced women and ethnic minority NEDs find themselves much in demand. One of the women NEDs in our study reported that she finds herself being approached to consider new NED positions on average four times a month.

**Why are more people not putting themselves forward for NED roles?**

We discussed this issue with one of the focus groups, who mainly comprised individuals who were in NED roles or would ideally like to become a NED but had not done much to further their ambition. The main reported reasons therefore why there appears to be a dearth of ‘non-conventional’ candidates for NED roles are as follows:

- The more significant responsibilities and related personal risks
- The time required to carry out such roles – usually at least twice as much as specified in the role description
- Lack of information about how to navigate the NED recruitment circuit
- Not being ‘networked’ with the ‘right people’
- Unwillingness of recruiters to consider non-conventional backgrounds for NED as relevant (see above)
- Lack of experience and confidence to take up such roles
- Increasing unwillingness of employers to release potential NEDs for such roles, given the time requirements, unless these are clearly linked with their main job e.g. as lawyer, investment analyst etc.

Given these perceptions, it is reasonable to assume that many potential NEDs screen themselves out at an early stage, thus reinforcing the perception that being a NED is a closed shop which is open only to a few.

What experience counts as relevant?

One of the main barriers to the creation of a broader talent pool is the ‘catch 22’ situation in which candidates are unlikely to be considered unless they already have relevant NED experience. In all cases reported, feedback given by head-hunters to unsuccessful candidates was that they lacked relevant board experience, especially with FTSE 100 companies.

Other would-be NEDs who took part in a wide-ranging discussion on the subject suggested that they had frequently failed to get past the first stage of screening for NED positions on the basis that other forms of board level experience, especially public sector work such as chairing an NHS Trust, were not considered relevant. As one person put it: “I was told that the skills and mindset needed to chair a board responsible for governing an organisation which spends public money, are not the same as those required to chair a company which creates wealth”. Other people described public sector boards as being much more bureaucratic and slow-moving, given the range of stakeholders involved, than typical commercial company boards.

In the focus groups, public sector board members hotly refuted this point of view, though amongst the focus groups, it was recognised that the transferability of experience tended to work mainly one-way, with NEDs moving from private to public sector appointments but not the other way round.

Whether or not other forms of governance role would equip people for a NED role was an issue which produced sharply different viewpoints. Several of the NEDs interviewed were able to contrast their experience of NED roles with other governance roles, such as school governors or Voluntary Sector board roles. On the whole, NEDs agreed that the responsibilities and experience of public sector board members are very different from a company NED role. Some felt that the skills required were similar, and the requirement for legal and financial skills in particular were the same in different sectors. However, the focus of PLC boards is sufficiently different as to make the board level skills similarities between sectors almost irrelevant.

A public sector board role is considered to be more structured, has clearer boundaries and a lesser degree of freedom. In contrast, major PLC boards are more complex: “I think there is a misconception that just because somebody is a good operator of a National Health Service Trust they can be a good NED of a private company, but that is not necessarily true. I have to say I am unconvinced that, just because a person may be a good committee member or a good operator in a meeting, it would make that person a good NED. I think the heart of excellence in the non-executive game is first of all to have had a successful business career and to be able to bring knowledge and wisdom to the table that can guide management in strategy. You don’t get that by running an office or a school. You are either public or private. The difference is ‘what does it take to make money’.”
If you have spent your entire life working for the government you have no concept of how to make money. You have a hell of a lot of experience in how to spend money but not how to make it. We need people to run companies in this country who are experts at making money.” (Non-executive Director, FTSE 250)

So for the great majority of our respondents, the flow between board experience in different sectors could be only one-way - from private sector to public/not-for-profit sector, rather than the other way round: “It is difficult to see an easy path from School Governor, Not-for-profit, Public Trustee Board/Non Exec role to that of being a prime candidate for a NED on a major PLC. They are different worlds.” (Director, FTSE 100)

Another woman former FTSE100 Executive Director disagreed with Higgs’ suggestion that lots of women in the ‘non-for-profit’ and public sector could be candidates for FTSE boards. She believes that the skills and experience required of a FTSE 100 director are not particularly common in the ‘non-for-profit’ or public sectors. She described, however, how one NED appointment had led to a string of voluntary board appointments for her: “To some extent you make your own luck. You’ve got to forge your CV and you’ve just got to look at taking opportunities to widen your experience and your exposure. I think the difficulty for most women is that you get kind of channelled into a rather narrow career path”.

Knowing how to apply
Another barrier to broadening the talent pool was highlighted by some would-be NEDs in our study. While public sector board appointments tend to be advertised, even finding out how to apply for board positions in the private sector can be difficult if a would-be NED is not ‘networked’ with other NEDs. Getting onto the books of the right ‘head-hunter’ was considered the most effective way of maximising one’s chances of obtaining a NED position.

Recruitment processes
“We put more effort to selecting our graduates than our Board” (FTSE 100 Director)

Tyson recommended more rigorous and transparent appointment processes to create more meritocratic and diverse boards. Research by Highland Partners (2004) suggests that, while the need for more transparent recruitment processes for non-executive directors is recognised, this is undermined in practice because both chairmen and their search advisors tend to rely on the ‘usual suspects’. They underline a clear debate about ‘who they are’ as opposed to ‘what they bring to the boardroom’.

Networking and word-of-mouth still appear to be the most important sources for identifying non-executive positions (Ernst & Young, 2004). They argue that: “the practical reality is that the selection process only appears to come into question when a board is failing”. Some people reported that head-hunter firms are generally quite specific about what is required: “The market is changing. Most of the head-hunters now are well practised with NEDs and treat them like any other recruit. So they are being much tougher on the characteristics for what is required and what isn’t. You do need to upgrade the NEDs because of the new requirements.” (Executive Vice President, Human Resources)
One FTSE 100 director recognised that some changes have taken place over the past ten years from a time when it was ‘really pretty cosy’ and the chairperson would offer NED posts to people he knew personally. In 2003 his board reviewed their Nominations Committee’s terms of reference and now have a more transparent and professional process whereby job specifications are drawn up, external consultants used and there are no personal contacts. However, he still admitted to relying on ‘gut feeling’: “If you ask me to provide evidence of carrying out a detailed survey of the existing skills etc. etc. then we haven’t done that, but we have a gut feel as to what is missing and what we need.” (Company Secretary, FTSE 250)

In another FTSE 100 company, NED recruitment is taken extremely seriously and a professional recruitment process is used: “We spent about the last six months of last year in hiring two new NEDs. It took a whole six months from defining the role, talking with the head hunters, going out to search, the interview process, making sure we got the balance right. It’s no shorter a process than actually hiring senior executive directors.” (Director, Human Resources)

**Head-hunter perspectives**

Head-hunters in our study suggest that there is a greater willingness than in the past amongst some of his clients to broaden the recruiting pool: “Two years on there is much more willingness to think creatively about how to populate a board, what to do about bringing a good balance of skills and experience to a board and there is a willingness to think outside the existing pool”. (Head-hunter)

However, while a number of women would-be NEDs suggested that head-hunters had dismissed their applications at the first stage, head-hunters complain that there aren’t enough experienced and qualified women to put forward as candidates. As one head-hunter put it: “Where on earth are all the women? There are the same issues across most sectors although probably FTSE100 boards are the worst.”

Some head-hunters report that they are actively seeking to broaden the search for talent for NED appointments to include ‘non-conventional’ candidates. For example, one head-hunter reports that he actively looks for relatively young candidates for NED roles, on the basis that they are likely to have the energy and tenacity needed in today’s NED roles. Moreover, they are likely to have other forms of employment and therefore be less likely to conform and comply with board procedures just to fit in: “I don’t believe that non-executive directors should be the older statesman and I mean that in the sense of age. There is no reason at all and, in fact, I have put a non-executive director into one company who is only in his late 30’s. I think one of the fundamental misconceptions about non-executive directors is that they are old and have been in an executive position at a senior level. There are specific skills that you often need and if that happens to be somebody who is in his 30’s that fine.” (Company Chairperson)

**Selection criteria**

Following the Higgs report, Tyson (2003) was tasked to identify the profile of relevant skills and experience that make for an effective NED. She identifies potentially attractive non-commercial skills as:

- Professional skills (legal or accountancy)
- People skills
- Strategic leadership
- Sensitivity to political, environmental, social issues
- Regulatory skills
- Technical or scientific knowledge
- Global experience.

Our contributors suggest that, in reality, the choice of a NED inevitably depends on the composition of the board. As one NED suggested, however, the tendency is to fill gaps by bringing in a new director rather than provide development to existing board members:

“Looking at the individual is probably going to be misleading in terms of understanding the quality of the board. What you need to look at is the sum total of the experience of the board - how it works together and if, when you have done that, you conclude that there are actually skill sets missing or there are gaps. Then the first thing you need to do is to say ’can we bring on another director who is going to supplement that?’ Having said that, there is room for something that goes beyond induction training which is where most companies stop.”

One head-hunter agreed there was no single profile of an ideal NED: “There are different kinds of people for different purposes: - different board, different personality, different chemistry, and it is therefore about the individual match in the context of the board. First they have to get on with the CEO and chairman - there has to be that trust there.”

Even ‘prima donnas’ have their place: “Ideally they are self-aware, but in practice you get exceptionally good NED’s who are real prima donnas, who have been hugely successful in their chosen field, have an enormous amount to bring, are very talented. They can be just frightful but, in the right place, work really well and do a great job.”

On the other hand, a number of general selection criteria surfaced from interviews. What was commonly reported as being desirable/sought in filling a NED position were:

**Maturity/experience of life**

While specific skills and knowledge can be hired in, a ‘wise counsellor’ is more difficult to identify. PLCs tend to look for experience and maturity and it is seen as difficult for a young person to have the experience in life. One head-hunter remarked: “Historically the chairperson seems to have considered that, in order to be effective on his board or her board, you need to have done it before. So there is a sort of self-perpetuating part which says, well unless you have done this before, you are not going to be much good at it”.

**Previous experience of PLC board membership**

The same person commented on the lack of risk-taking in board selection: “The chairman historically has thought ‘well if this person hasn’t sat on a PLC board as an executive or NED, he or she probably wont be able to make a contribution very early on. So why should I take the risk of bringing someone on board who cannot hit the ground running?’” (Head-hunter, and Board Chairperson)

Indeed all the PLC board directors believed that the skill set required at board level is beyond that of a divisional MD, and that previous board experience is therefore highly desirable, if not essential.
Being prepared to express a view

“The two chairs that I have worked with have both chosen people because they have a view and are prepared to express it, not because they will nod when they are asked to. So in that sense I have found it to be a very healthy experience in that there is a certain amount of contradiction and a range of views is expected, rather than tolerated.” (Board of Governors, Charity)

Energy and urgency

In smaller companies a different type of person may be needed. One director described the (much needed) challenge a younger member had brought to the board: “He has brought a sense of urgency, energy, dynamic to the board that wasn’t there before.”

Knowledge and skills

In another small private company, the NED would be required to act in an almost executive capacity: “What I am also looking for is knowledge and skills rather than contacts. I can appreciate that in a number of senior non-executive positions in large public companies it is very good to have that level of contacts with other people in similar positions and so on, but in small private companies it is experience and knowledge one is after, and input to a board meeting which stimulates the team.” (Company Chairperson).

Summary

- Selection criteria for NEDs appear to have not changed much in recent years and to be more in line with Higgs’ recommendations than with the Tyson recommendations for a broader non-commercial skillset.
- Diversity is still a distant prospect and there is still a perceived lack of a broader talent pool from which board appointments can be made.
- Lack of information about how to apply for NED roles, the more onerous nature of the role, lack of time to do a NED role and lack of previous experience at board level are amongst the reasons why people do not apply.
- Similarly, while the recruitment processes of NEDs are becoming more professionalized, many appointments still appear to be made as a result of being personally known to the chairperson or recommendation from other board members.
- PLC board experience appears to equip NEDs for public and not-for-profit board roles, but not the other way round.
Section 7: Becoming a NED

While some head-hunters report a lack of people with the relevant skills and experience willing to put themselves forward for NED roles, many senior managers attending Roffey Park programmes express interest in becoming NEDs.

Why do people want to take on NED roles?

The time seems to have gone when it was just a formality for a company to have a NED. Given the challenges of the role, it is curious that there appears to be a growing interest in finding out how to break into the world of NED roles by (mainly middle aged) professionals. In some cases, contributors to the report who were already in NED roles stated that they were keen to develop a portfolio career, and that they were hoping to find a means of both ‘putting something back’ and being paid for the work involved. Several people openly admitted that they had been flattered to be invited to join a board in the first place, and rather enjoyed the relative ‘closed shop’ aspect of their experience as board members.

Other reasons for wanting to be a NED were:

- Opportunity to ‘rub shoulders’ with more experienced people
- Believing in the organisation and its thinking
- ‘Putting something back’ and recycling experience
- Filling gaps in career that aren’t met in own organisation
- Gain insights into other companies
- An opportunity to contribute more broadly than in one’s own area and organisation.

Advice offered from experienced non-executives to would-be NEDs was as follows:

Know what you bring and what you want from the role

Many NEDs suggested that it is important to think about the level of personal responsibility in a NED role before taking it on: “Given that the demands are now so great on a NED, from shareholders, legally and externally, you have to be very clear about what you are bringing to the NED role, and be focused.” (Director, FTSE 100) Another NED said: “A golden rule I have is, that if I cannot make a contribution, I don’t want to be there. You have to be able to make a contribution to make it worthwhile.” (Company Chairperson)

Similarly, it is important to be clear what an individual can gain from taking on a NED role: “As a NED the role needs to be important to you. You need to ask why you are sitting round the table, and be sure you are not wasting your time. You must do what is the right thing… have the guts of your conviction, otherwise you are letting yourself down. As a NED, the role must excite you. You need to be keen on learning yourself; to be good at your job. The role must add something for you - breadth of interest and transferability of experience, skills, knowledge. A NED role takes up a significant amount of time, so you need to be clear about the reasons for taking it on”. (Director, FTSE 100)
Similarly, the role can be anything but glamorous. Some NEDs reported that the satisfaction they gained from managing risk as a NED was not equivalent at all to the gain to be had from executive activity, and to some extent they found the NED role a chore, even if they enjoyed other (mainly social) aspects of the role.

Recognise the amount of time required

Indeed, due to the heavy time commitments they felt under, some NEDs advise others not to go for a NED role. A number of NEDs suggested that they had seriously under-estimated the time that would be required of them in the role: “If I was asked to take up a non-executive director position now, I would expect that the time allocation would be at least double what they say.” (Former Vice President)

This was especially true of people who still had full-time jobs, or equivalent. In some cases, people were spending weekends and holiday time keeping up with the (paperwork) demands of the NED role, in addition to the time required in meetings: “One major company on whose board I sit has 12 board meetings, 9 remuneration committee meetings, 5 audit meetings, 3 nomination committee meetings and that doesn’t include strategy away-days, meetings of analysts and major investors. It doesn’t include their business and social events. That is before you’ve opened a report to read it at night at home. The demands are really quite big these days if the job is done properly.” (Director, Human Resources)

Another NED agreed: “You have to sit on all these committees and you know, the remuneration committee can take weeks of your life. If you’re trying to get a new option scheme through you have to sit on the audit committee… it’s all about managing risk rather than you actually contributing to the business.”

One Director described encountering increasing numbers of ‘plural’ non-executives. These were people who had quit full-time employment and are making a career of non-executive directorships. He believed that, given the amount of work that any single board membership can generate, four or five appointments was the maximum that anyone could handle and commit sufficient time to preparation, even when all is straightforward. When things go wrong and more effort is needed, people can find themselves over-extended: “The problem with NEDs or with any board is that you don’t know what is going to happen and if something goes seriously wrong then what he may have regarded as a small time employment, can take up a much greater time.” (Company Secretary, FTSE 250)

How do you prepare for a NED role?

Many contributors saw becoming a NED as a quantum leap: “I think that the move from being a line manager, to being an executive, to being a NED – it all sounds like a continuum, but in fact there is a lot of change and it is not just minor changes, which means that people do things that are qualitatively different.” (Director, PLC)

So how then can one prepare for a NED role?

Develop your interpersonal skills

“The key to being a good NED is undoubtedly interpersonal skills and the way in which you operate within the board”. One person suggested that at board level interpersonal skills are even more important than when working one’s way to the top of the hierarchy: “In a company they tend
to be in some form of high position and they are constrained by this and when you get onto a board you are judged on your performance as an individual and you are working on a peer basis with people from difference backgrounds. I think it is that piece that should go into executive development.”

**Broaden your experience**

One PLC Director felt that one of the problems for people ‘climbing the greasy pole’ in large organisations is that they become ‘parochial’ in some respects. He described the need for broadening experience and working with people from different backgrounds. He suggested that this broader perspective allows your ‘antennae’ to operate effectively when in a NED role.

**Routes to the Board**

A large MORI survey involving 605 telephone interviews with directors (75 chairs, 250 Executive Directors, 275 NEDs) of UK listed companies in August/September 2002 informed the Higgs report. Nearly half were appointed through personal contact with a board member (only 1% answered an advertisement).

**Through networking and sponsors**

One woman director of a FTSE 100 board in our study described her routes to the board as being through networking, finding sponsors and taking jobs that other people didn’t want in order to gain valuable experience and contacts; for example Group Accounting was less ‘sexy’ than Mergers and Acquisitions. She then became an executive committee member in a subsidiary business without the legal implications of the main board but providing excellent opportunity to learn. As the only female, she had to learn tools and techniques to ensure she was seen as an equal and credible. She developed self-awareness, seeking feedback and questioning why her ideas were not registering. She became more precise about how she spoke, clearly stating what she was thinking and built up the courage to challenge and make sure her ideas made the agenda.

**Gain NED experience while still a senior manager/director**

One of the traditional pipelines to NED positions has been through gaining experience while employed in a full-time job in a major PLC, investment bank or legal firm for instance. A number of experienced NEDs’ careers had followed this route: “I think the way in which my career developed was not unusual. I was allowed to have one non-executive job while I was still employed and I would recommend that whole-heartedly to anybody. If you are sitting on a board of directors of a big company, having the experience of another one is very helpful. It helps you put things in context. It introduces you to different ways of thinking and doing things and that is very important but I wouldn’t advocate to anybody who is trying to hold down an important job to take on any more than one. So then when you come to retire you can expand as I did and take on a portfolio and then I think the thing which boards of directors are looking for is your executive experience” *(Non-Executive Director, FTSE 250)*

Another NED described how she obtained her first board appointment before leaving her FTSE 100 employer. She talked with her boss and gained his permission and support before approaching a relevant head-hunter. The head-hunter explored the candidate’s preferences
regarding the nature of organisation and its culture and was careful to propose appointments that fitted. The first appointment then opened up other avenues for the NED in question, with other companies tending to approach the NED directly.

As stated earlier, one of the key challenges for people in full-time roles is the being able to devote enough time to the NED duties and it was recognised that they would need a lot of in-house support to do this. While some felt that more could be done to prepare high potential managers to take on NED positions, there appear to be increasing difficulties for organisations in supporting senior managers to take on NED roles: “At this level the managers are heavily loaded in their substantive role and it’s not easy to create the space or time to take on a NED role. In my organisation they would have to seek permission and it would entail spending their own time on the NED responsibilities. They therefore have to have a passion to want to do this. It’s not an easy option.” (Director, FTSE 100)

Chris Johnson, a partner at Cedar International who contributed to the research, suggests the following pointers for people considering applying for NED roles:

- Consider why are you interested in a NED role, be honest with yourself
- Take stock of your career, consider
  - Where are you now?
  - Where do you want to be?
  - How do you get there?
- Build your knowledge and understanding of the “NED market”
- Develop a plan to focus on the type of NED role you are looking for
- Get out and network, go and seek inputs, advice, feedback from those who might help e.g. current NED, advisors, head hunters etc
- Be realistic, if you haven’t got listed company experience then your less attractive to some roles
- Start the process whilst you are in your current role don’t leave it until you leave/retire
- Start small and build your experience, one role often leads on to another
- Make sure the role offers good financial return to you in terms of time and effort; NED roles are increasingly time consuming and demanding.
- Large corporations often have links with NED Head Hunters, advisors for the development of their most senior managers, make sure you check out what’s already available
- Be clear on what you can bring to the role and have your marketing skills
- Set yourself realistic objectives and timeframes, it takes time and effort.

Finding your feet

Once in a NED role, how does one quickly become effective? Research carried out by Highland Partners in 2004 suggests that there is little clarity around the role definition, accountability and expected contribution of non-executive directors, particularly of the senior independent director.
**Be clear**

This puts the onus squarely on the shoulders of the NED to help shape the specific nature of their contribution: “I think if it is a large board you need to have a conversation with your chairman before you join. Be clear about what is expected of you and what contributions so that you can prepare accordingly. It is worthwhile getting some external training... Be clear to start with where you can make your contribution and clarify that with the chairman, what he is expecting from you, he may be expecting more or less and chairman’s vary hugely on what their expectations are.” (Non-Executive Director, Head-hunter)

**Observe and learn**

Most interviewees reported that it was important to take time to really understand the nature of the role and of the organisation before attempting to make a major contribution. For many, there was no substitute to an ‘apprenticeship’ based on listening and observation: “I think the way I really learnt most was watching the people I admired on the boards I joined. Because at the beginning I thought ‘What the hell am I supposed to do?’ So you keep quiet at the beginning and you listen hard and you watch, and there were some good people on various boards and I watched how they handled themselves and how they presented issues. And you could also usually tell the sort of thinking that they’d done beforehand.” (Former Executive Director, FTSE 100)

**Get to understand the business**

An urgent priority for new NEDs is to get to understand the organisation’s business model: “Firstly there is understanding the true nature of the organisation – the stuff that it is not easy to write down so that you cannot do your homework well, the stuff that is built into the walls of the place, the history, the context, the culture. Coming to terms with that in any organisation takes time, adjustment and hard listening.” (Functional Executive, major PLC)

Most contributors agree that getting to really understand the business takes time: “There is no short cut to getting an understanding of the business in my view other than walking the floor and getting a feel for it. That applies in my advertising agency and model agency and equally well to an office structure and a factory outlet. One has to begin to try and understand the business.” (Company Chairperson)

One NED considers that board papers alone will not give you what you need to know. In her experience, some companies supply reams of board papers while others supply sparse information. She finds the most effective way to understand the business is to work for the company for a couple of weeks at the start of her NED role. She has experienced this in a couple of cases where she has worked alongside people in a ‘non-intimidating way’. She found that by insisting on this aspect of induction, she has been able to develop her intuition about what is really going on.

**Find a way to contribute**

After gaining sufficient understanding of the business model, NEDs then have to find an appropriate way to contribute. Some respondents stated that the pressure/desire to contribute effectively caused them to sometimes behave inappropriately in the early days. Part of the issue appears to be linked with the need to win the respect of fellow board members and to be seen as credible by executives: “I have observed in myself and others a bit of the ego trip – they have asked me to be on this thing and they must want to listen to me. But that doesn’t mean I should open my mouth at every possible occasion. It’s gauging what you are there for
and what you have to offer. It takes time to find your level and I probably went from saying too little to saying too much and I may be somewhere in between now”. *(Board of Governors, Charity)*

Another Chief Executive believed that it was easy for a NED to destroy credibility early on by asking inappropriate questions: “The key challenge is to get up to speed and understand our businesses pretty quickly and I think we have significantly improved our induction programme to that extent. The key challenge is to enable them to have the confidence to ask the appropriate questions and to know enough about the business not to ask a question which quite frankly is just dumb, therefore damages them in the eyes of the co-directors.” *(Company Secretary, FTSE 250)*

**Get to understand the relationships**

As stated earlier, finding a way to manage board relationships is one of the key challenges for a new NED: “I think the challenge in the first few months is to get to understand how the individuals on the board interrelate together, because that is very important… You quickly get to understand whether or not they have adequate board reporting procedures, both financial and descriptive”. *(Company Chairperson)*

NEDs need to be intuitive and alert to the power and political nuances within the board: “You have to understand the organisation from the perspective of the stakeholders, who won’t always be equal. The success of any organisation is always dependent on the stakeholders so you have to understand what the weighting is between the various stakeholders at any particular time and it will change so you have to be sensitive at times to how that weighting shifts.” *(Deputy Chairperson, Charitable Trust)*

**Make time to ‘tune in’**

Some boards are reported to have processes in place to allow NEDs to prepare to contribute effectively to a board meeting: “We will have our pre-meeting which will run for about an hour that is just to get us all tuned in. I think it is very useful to do that because of the diverse backgrounds we all come from, you do need to be able to come together so to be able to have that space before you start the formal meeting allows us to tune in to each other and the topics, so we know how to behave”.

On the whole, NEDs agreed that it can take up to a year for an inexperienced person to begin to make a really effective contribution: “I would say you really will not mature until you have been with a company for six months to a year.”

**What support is needed or offered?**

**Induction**

Formal induction and mentoring would be welcomed by most NEDs in our study, though very few contributors had received any. As one NED says, “‘We would do that if we were bringing someone into an organisation as an employee, but we don’t do that with boards – it is a common failing. You could get there quicker if there was some form of shadowing, mentoring or buddying”. *(Functional Executive, major PLC)*

Given that boards are expected to bring in new blood from time to time, contributors suggest that boards would be well advised to introduce such processes as a good induction process which would shorten a NED’s time to effectiveness: “I think if you go onto a board for the first time it is actually quite difficult to align your thinking precisely as to what you should be doing
and what you should not and there is a great tendency to try and bring to the board the skill set you have got, rather than operate as a genuine NED and look across the whole thing. So I think people do need some help in aligning their perspective of their new role.”

In one FTSE 100 company induction was considered essential: “We now give a fairly fulsome induction programme, whereby we will arrange for a new NED to visit and go out with the management of each of our principal divisions and businesses, probably have a presentation from that management outlining the key issues facing them and they will also have been taken through, as part of their induction, key procedure issues by the chief executives and the finance director who will run through and detail the financial structure and the challenges there.” (Company Secretary, FTSE 250)

One chairperson proposed harnessing the skills of retiring board members to coach new NEDs in “how they can make a contribution, when they should talk, when they should be quiet, when they should challenge, when they should support”.

Development
Tyson recommends more and better evaluation and training for board members. In our study, there was a general view that courses and development that are available focus on the legal and governance requirements as well as the responsibilities and liabilities of being a NED. These were regarded as helpful, even if they simply raised awareness. However, many NEDs recognise such training as limited: “Most available development doesn’t touch on how you contribute to a company to make them even better than they are, it is just what is the minimum hurdle to get over so you don’t get sued.”

Many contributors also recognised the need to update existing non-executives periodically and try to have at least one board meeting with presentations at a business location throughout the year, to get them closer to the businesses. One NED described the proactive stance taken by the HR team of one company to provide board members with vital information: “At board level for example you may not see what is happening on a day by day basis in the area of, let’s say, trading. So the HR Department lay on a series of seminars, sandwich lunches and things like that, so that people can come along and hear what is happening.” (Director)

There were mixed views on the value of other forms of development, with some NEDs seeing a need for greater emphasis on the ‘softer’ issues, such as when and how to make a contribution. On the whole, there were more reservations expressed about the value of training and development for NEDs than enthusiasts for it. One Director described the sensitivities involved: “It is true that around many board room tables there are some pretty large egos and that has historically got in the way of any sort of discussion even of development and help, because a lot of these people do think they know it all. So going back to the classroom or having a coach or whatever, is not going to happen to them. There is, nevertheless, a great recognition that it would be helpful in many cases to bring to the party support in developing certain areas, support and thinking. I think there is some awareness of the benefit of these things even amongst the hard core of people who would say they have been there, done it and know it all.” (Chairperson, Voluntary Sector)

Coaching
One development approach which seemed to be regarded as more useful than most was coaching: “I think coaching does take place but to be honest we don’t come across it a great deal. Maybe it is just where we are sitting. I see a lot of executives who have coaching generally, but...”
haven’t come across it specifically at work. I myself did not have any mentoring or coaching” (Non-Executive Director)

Another NED felt that coaching was unnecessary and doubted what was to be gained. This person was sceptical of the growth of board-level coaching and evaluation services now being offered by a number of consultancies: “To be honest with you it is like who judges the judges? At some point there is always someone out there who knows more than you do, but I think once you get to the board table you have got to be there on your own. I know there is a huge industry out there which is geared to personal development for NEDs. I am not sure if that is a very good idea for NEDs.” (Non-Executive Director, FTSE 250)

While the assumption behind many of the reports looking at boards is that the chairman/woman acts as coach to NEDs, in practice this was rarely mentioned in our study, as the following typical comment suggests: “In some cases the chairman of the company will act as the coach for that NED, but that’s unusual because the chairman is probably quite busy.” (Headhunter)

Mentoring

Similarly, many contributors to our study had benefited from mentoring by other NEDs and role models. One FTSE 100 director, however, described the cumulative benefits of mentoring throughout his career: “The way my mentors approached their own roles and responsibilities was extremely helpful to me. They were challenging but always very helpful. Their ability to be open and to ask questions without you feeling foolish…you were able to ring them up and ask for their advice. They wouldn’t see it as a point of weakness but as a way to help. It was very good to have that relationship. It was a long time ago now but I deal in the same way with people who work for me”. (Company Chairperson)

Summary

- Good interpersonal skills, and the ability to use networks and make one’s own opportunities, appear key to becoming a NED.

- Ideally, the best route to a NED appointment is while still employed in a relevant role, though networking appears the most helpful means of finding out about possibilities and building relevant relationships.

- Once in the role, NEDs need to be able to learn fast, both about the company and about how the board’s political processes work.

- They need to be willing and able to make an active contribution from the outset though most agree that this can take time to achieve.

- Active support and development by more experienced NEDs can cut down the length of time needed to complete the learning curve. A good induction process was considered very important but provision appears piecemeal.

- Coaching and mentoring were considered the most effective development approaches.
Conclusion

While it is still early days since Higgs, Tyson and other relevant reports were published, the findings of this small study seem to suggest that, in some respects at least, board practices may be changing less quickly than recommended by Higgs et al. Ironically, while there is a reported greater focus on compliance with the requirements of good governance, including the examination of various forms of risk, compliance seems to be generating 'tick-box' approaches to governance.

Similarly other reported aspects of the way boards operate may mitigate against effective governance in the fullest sense. The style of the chairperson has a strong influence on the way the board operates and all our contributors have emphasized the importance of board relationships, which may mean that many boards are rather more relationship-driven and even 'cosy' than might be pre-supposed. There is a strong reported emphasis on 'fitting in' at board level and NEDs are aware that their 'advancement' to interesting areas of responsibility on different committees depends on the chairperson. The style of the Chair is therefore a critical factor in stifling or encouraging debate and challenge and enabling an appropriate amount of scrutiny.

Board unity is reported as being valued above diversity, particularly in the private sector. With regard to board composition, it would seem that not much has changed since Higgs and Tyson et al. There is still a perceived lack of a broader talent pool from which board appointments can be made and the criteria relating to 'relevant experience' remains much as it was before. Indeed the Tyson report’s recommendations on diversity may take a considerable time before they are fully embraced.

The role of NED is time-consuming and requires good preparation. NEDs are expected to contribute professional knowledge and even apply their expertise directly from time to time. There are few job descriptions and many NEDs suggest that it is important to forge your own role from the outset by being clear what you want and can contribute. The broader talent pool from which NEDs can be drawn appears to be not much in evidence. Many would-be NEDs deselect themselves before embarking on the appointments process. Lack of time to do a NED role and lack of knowledge of how to obtain such a role are two of the perceived barriers. Similarly, while the recruitment processes of NEDs are becoming more professionalized, many appointments still appear to be made as a result of being personally known to the chairperson or recommendation from other board members.

What makes NEDs effective is not a special set of skills but the kinds of qualities which help people succeed more generally. In particular, they need 'emotional intelligence', good judgement and the willingness to offer support and challenge. Good interpersonal skills, and the ability to use networks and make one's own opportunities, appear key to becoming a NED. Once in the role, NEDs need to be able to learn fast, both about the company and about how the board’s political processes work. They need to be willing and able to make an active contribution though most agree that this can take time to achieve. Active support and development by more experienced NEDs can cut down the length of time needed to complete the learning curve.

Given the demands of the role, the borderline between effective and ineffective behaviour appears linked to the degree of preparation and commitment a NED demonstrates. A common perceived failing is when a NED adopts an inappropriately executive approach to
their role. Knowing if, when and how to cross the fine line between non-executive and more interventionist approaches is an art which requires ongoing refinement through learning borne of experience.

Board evaluation is being taken seriously as an idea, but its practice is in its infancy. There was a general view that NEDs do not take kindly to individual assessment of their contribution, though many would welcome constructive feedback.

**Recommendations**

From these findings we conclude that:

1. **Developing a wider talent pool of potential NEDs should be seen as a national business priority**
   - We believe that a pipeline/formal means of progression into NED roles should be clarified for people who have other forms of board-level experience. Would-be NEDs should be required to have formal training, and be assessed in how they exercise both scrutiny and other aspects of a non-executive role.
   - If the talent pool for NED positions is to be broadened, organisations should be encouraged to enable high potential managers to take on such roles as part of their overall development.
   - A central Agency should be formed to act as a ‘clearing house’ for NED appointments and screening, NED development and training.
   - All NED appointments, in common with public sector appointments, should be openly advertised.
   - Boards should ensure that their interpersonal dynamics enable appropriate levels of support, challenge and debate.
   - Cross-sectoral insights can be increased by ‘swaps’ or secondments. PLC Boards, for instance, could invite junior board members of public sector/not-for-profit boards with relevant expertise to be ‘attached’ for a period of time as a form of development.

2. **Boards should practise more formal and rigorous evaluation**
   - Boards may benefit from more professional approaches to evaluation such as those practised today in leading-edge organisations. Beyond compliance with reporting requirements, boards should approach the evaluation of their practice in the spirit of learning and improvement.
   - Chairmen in particular need to be skilled in how they approach and role model the process of evaluation and development. Board dynamics and the level of support and challenge should be a key area of evaluation.

(…….continued)
3. **Board development should be taken seriously**

- Development should be firmly put on the board agenda, in part as a 'governance quality improvement measure'. We recommend that boards should commit to an annual development activity in which they can more obviously focus on how board dynamics operate rather than on the usual business of the day.

- In addition to the ‘hard’ aspects of the NED role, ‘soft’ skills development should be made available, concentrating on how to manage board dynamics in a constructive way.
References


Donkin, R. (2005) Are boards noticeably better after the Higgs reforms? FT March 10


