

What Makes an Exceptional Independent Non Executive Director?

The role of the NED continues to evolve in line with the accelerating changes in the business environment. Boards need to be constantly looking ahead to ensure that their NEDs have the required skills and experience to drive best performance. The report investigates how the requirements of the role have changed since 2005 and provides valuable insight into the new demands being placed on NEDs, and on the evolving skill set of the very best. The research identifies in detail the factors that mark-out high performers, makes some timely recommendations on the NED recruitment and training process, and includes some thought-provoking opinions on the issues of age profile, experience and remuneration.

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Foreword

“Not another study on boards and the role of non executive directors!” was my first thought when Korn/Ferry asked to interview me for this one. Having read the finished product, I commend it to a range of potential readers.

Existing NEDs will appreciate a study built on the comments of experienced chairmen (for all but one of the chairs quoted are men) and their board members. We may squirm a bit as we read about “undesirable traits” in a NED. But we will agree wholeheartedly with the observation that NEDs must bring hard-edged skills and experience to the board table increasingly these days in areas such as risk and IT, not just finance. And most of us will applaud the increased emphasis being placed on training, for even the most experienced NEDs need to keep up with the latest developments inside and outside their company.

Aspiring NEDs will learn from this study too. It will give them the confidence to expect thorough induction programmes when appointed and request them if they’re not provided. It will also remind them that directors are appointed to add value. Candidates for NED appointments must be clear about the skills and experience they will bring to the board table. Boards, in turn, must ask themselves how to tap talent from outside their comfort zone, and nurture it where necessary.

Finally, the study will make interesting reading for shareholders and opinion formers. It leaves no doubt that the demands on NEDs have increased significantly since Korn/Ferry last asked “What makes an exceptional NED?” in 2005. Not least, remuneration committees and boards’ decisions on executive pay are in the spotlight as never before. This report also raises the question—nowhere to be seen seven years ago—whether shareholders should be more directly represented on boards.

It's also noticeable that, while boards and politicians agree that we need younger blood amongst our NEDs, many chairmen say they are doing this by recruiting more serving executives from other companies; outside observers want them to look beyond the ranks of business.

Debate on these issues is healthy. Korn/Ferry's study will certainly enrich it.

Mary Francis CBE

Senior Independent Director, Centrica

Non Executive Director of the Year

(Peel Hunt/Sunday Times Awards, 2011)

Introduction

The twenty-first century independent non executive director (NED) operates in a volatile and unpredictable world where markets are in flux and complexity only grows. At the same time, the financial crisis has put corporate governance under the microscope to an unprecedented degree. What were previously regarded as standard business practices are being questioned as never before and governments are insisting on strict regulation to ensure that companies become genuinely accountable and transparent.

More pressures emerge from every corner. Investors are demanding that boards and leadership teams demonstrate more risk awareness. Customers and employees want clearly delineated policies on climate change and sustainability. Executive pay has come under attack from government and the public. Trading and communications now operate on a continuous cycle, forcing companies to react quickly to market fluctuations, consumer trends and real-time political developments in order to remain competitive. The breakneck evolution of technology fuels this cycle and creates both new opportunities and new areas of risk. The very nature of capital markets is the subject of serious debate by political leaders and the press; even the hitherto fundamental governance principle of “comply or explain” is being questioned by Brussels.

Boards must navigate companies through these challenges. As the nature and the complexity of the issues shift, it is inevitable that the role of the NED will have to change too.

With this in mind, Korn/Ferry set out to discover more precisely what it is that boards need, and will need, from their NEDs in the twenty-first century. We hope the insights we have drawn from chairmen, CEOs and board members will help existing and potential NEDs prepare for, and fulfil, the constantly evolving responsibilities of the role.

Executive summary

In light of the vast changes impacting global businesses, Korn/Ferry International decided to revisit the question of “What makes an exceptional NED?” We last researched the topic in depth in 2005, but the changes since that time are evident to all who sit in boardrooms. Some tenets hold as true today as they did in the past, but there are noteworthy shifts in the requirements and characteristics associated with the most effective boards in today’s world.

Core characteristics remain steady. NEDs must still have a breadth and depth of executive experience. They must remain highly independent and ask challenging, often difficult questions on behalf of the shareholders. They must possess strong interpersonal and communication skills. They should be ready to listen, but also prepared to speak up when appropriate.

The expectations of today’s NED have nevertheless evolved dramatically beyond this. Driven in part by macro shifts—including increased regulation and the quickening pace of globalisation—and in part by the global financial crisis, the job today is a fundamentally bigger undertaking. It demands a considerable investment of time and skill. NED independence is still vital, but competence has become paramount. Furthermore, while NEDs must advise from a strategic vantage point of 50,000 feet, increasingly they must understand real operational detail in order to do so. They must therefore be better informed, even more committed and possess a wider array of operational knowledge.

Over the last seven years, the emphasis on certain technical skill sets has risen. NEDs must now be able to tackle risk, finance and technology with greater agility. Knowledge of these specialised categories is increasingly sought after and could soon become a common

denominator for all board members. Mastering the complexities of risk is now considered elementary for boards operating in the post-crisis era. Sophisticated numeracy skills are similarly likely to become *de rigueur*. Keeping abreast of globalisation and the ramifications of technological advancements is equally critical for NEDs, who must fully understand the context in which their company operates.

Our research also probed trends surrounding the training and evaluation of NEDs. While there are no substitutes for experience, intuition and a well-rounded executive career, there are certainly procedures boards can adopt to enhance the performance of individual NEDs and hence the effectiveness of the board as a whole. Yet this currently remains an informal aspect of board management, with scope for improvement. Our findings support the case for more formal induction programmes, rigorous training and continuous support for NEDs, particularly as boards look to diversify and attract a new generation of directors.

We revisited two related topics from our 2005 report: the inclusion of less experienced NEDs and optimal board recruitment strategies. While opinions remain divided, there appears to be greater consensus that boards need more than retired executives amid their ranks. Current serving executives and those who are wrangling with international business issues in their “day job”, bring a much-needed currency to boardrooms. Further, boards with this kind of talent attract others with similar skills.

In closing, we recount what chairmen and NEDs said about some of the new challenges facing boards, including over-regulation, shareholder representation and remuneration levels. All boards today are sensitive to government and regulatory bodies seeking to exert greater control over their composition and working practices. The Bribery Act, Walker Review, EU Green Paper and The Davies Report are just some examples of the intrusions being felt by boards. This debate in particular threatens to become overly politicised and potentially damaging board effectiveness in its wake.

The central conclusion of our findings is clear: the economic stresses of recent years and the ever-growing demands for responsible governance have resulted in a fundamental shift in the requirements of the NED role.

Today's NEDs must be more engaged, more numerate and more technically competent than ever before if they are to be equipped to succeed in a role that has become much more demanding than was the case even seven years ago.

In the words of Jim Leng, former Chairman, Corus Group, "The day of the gifted amateur has long gone."

Important characteristics

The 2009 Walker Review highlighted that in the lead-up to the financial crisis the chief deficiencies in corporate governance were behavioural, not organisational. Any discussion about improving corporate governance must therefore examine the character traits underpinning individual directors and the board as a whole.

Our extensive 2005 research into the core characteristics of successful NEDs produced a framework of 10 “X Factors”, and our recent investigation largely confirmed their lasting importance. In order for NEDs to navigate the challenges and sensitivities

“We are putting together a shortlist of board values, as opposed to company values. They will be largely behavioural.”

- Sir Win Bischoff, Chairman,
Lloyds Banking Group

of the role, they must be independent minded, but also team players. They must have a breadth of experience. They must possess sophisticated communication skills; be self-confident without being dogmatic; be passionate about business and have clear, creative and visionary judgement.

We nevertheless found that this foundation was by no means static. While certain characteristics remain as vital today as they were in the past, others have dramatically grown in importance. All ingredients remain present, but the emphasis has shifted.

In order to illustrate this change, we first outline the characteristics that have remained constant over the time. These we categorise as “core”. We then highlight the aspects of the role that have grown in significance.

Core characteristics

Independence, courage and integrity. The primary purpose of a NED is to bring objective scrutiny on behalf of the shareholders. To that end, the importance of true independence of thought cannot be overstated. The best NEDs are reflective and thoughtful in their approach, ask the tough questions and offer considered advice based on sound judgement.

“Good NEDs have the ability to stand up to the executive and demonstrate their role, which is to hold the executive to account for managing the delivery of the business.”

- Sir John Armit, Chairman,
Olympic Delivery Authority

Successful NEDs must maintain integrity and have strong principles. They insist that the right thing is done for the company. As one interviewee put it, they are people who are not “followers of fashion”. They must have sufficient wisdom to perceive whether a course of action is morally dubious or financially risky. If so, they should exhibit the courage to disagree, and if the problems are systemic, to depart. As Stephen Murphy, former Chief Executive of Virgin Group, explained: “we run a number of risks in the business, therefore having NEDs who can create a spirit of integrity is important.”

“NEDs need to bring a truly independent perspective, champion their area of expertise but not hide behind it.”

- Cristina Stenbeck, Chairman, Kinnevik

Challenging, but supportive.

Outstanding NEDs balance their strong viewpoints with a supportive style in the boardroom. They are able to probe and challenge the executive team on thorny subjects without creating conflict. While asking the difficult questions is the primary task, next on the list is offering support and guidance on problematic issues. Maintaining a constructive and diplomatic style is important.

“NEDs need impeccable integrity and to focus only on what’s right for the business and stakeholders.”

- Sir Peter Gershon, Chairman, National Grid
and Tate & Lyle

Effective challenge was a dominant theme in our interviews, as it has been in political and regulatory circles. As the Walker Review made clear, in the run-up to the financial crisis, the failure of the NEDs to challenge the executives on substantive issues was a serious shortcoming. The Financial Services Authority echoed this complaint, and the then-CEO

Hector Sants has said, “The structure of governance in financial companies does not need radical overhaul. The attitudes and competence of the individuals who conduct that governance does. In particular we need to create governance that fosters challenge without creating conflict.”¹

Challenging the executive team, however, requires one to build trusting relationships; they are two sides of the same coin.

It is not just different language or conversational style that is needed. Board debates and processes will have to evolve to address this need. Financial services companies may have been pushed to the forefront on this issue, but it is clear that simple nodding in agreement is not an option for NEDs on any board.

Thoughtful communication.

Exceptional NEDs have a style of communication that enables them to influence without in any way appearing dictatorial.

“Exceptional NEDs combine being brave and outspoken with being supportive.... They are both challenging and encouraging at the same time.”

- Mary Francis CBE, SID Centrica

“Your ability to challenge the executive team comes from having built up trust. Both sides have to get over any suspicion that the other is grandstanding.”

- Andy Duff, Chairman, Severn Trent

“We need NEDs who can be dispassionate, good listeners and articulate communicators. We need team players. Those who have good attention to detail as well as the big picture and not those just interested in the big deals.”

- Sir John Buchanan, Chairman, ARM and Smith & Nephew

¹ Complete text of speech available at www.fsa.gov.uk/library/communication/pr/2009

They articulate complex ideas clearly and command respect when they speak, but transfer knowledge to colleagues in a congenial manner. They are good listeners; they know when to contribute a thought and when to keep quiet. They absorb information quickly and ask the right questions.

Breadth of experience. Successful NEDs have a breadth of experience that allows them to advise on a range of commercial issues. A well-rounded career facilitates intelligent and strategic advice in the boardroom, irrespective of whether a NED has specific experience in the area under consideration. A robust commercial and political awareness—alongside skill and perspective—is necessary in order to give dispassionate and independent advice.

“They have a broad/deep reservoir of knowledge and skills accrued during a wide business career. We like directors who have had experience of things going wrong. When you’ve gone through difficult times, you have profound learnings through those experiences.”

- Steven Marshall, Chairman, Balfour Beatty and Wincanton

Among the diverse experiences that serve NEDs well is having ridden out challenging situations.

Characteristics growing in significance

However, certain characteristics have grown in importance significantly since our 2005 report. The dominant trend is one of increasing commitment, expertise and professionalism. A NED role today is more demanding and time consuming than ever before, requiring a more detailed understanding of the business. As NEDs take an increasingly professional view of their responsibilities, so there is a parallel trend of continuous improvement. NEDs are more aware of their own performance and what they need to do to improve further.

A deep understanding of the business. To be truly effective, today's NEDs require an acute understanding of the specific company they are advising. Previous industry or sector experience makes this easier for some, but even those directors must make an effort to learn about the explicit nuances of the company itself. Only by intimately understanding the business (the management team, the culture, the product/service and the customer base) can NEDs provide truly valuable strategic advice.

“NEDs need to challenge the management on operational issues. Previously, they were at 50,000 feet and felt that this was the level they should be at. That is no longer acceptable and NEDs need to be more engaged in the details.”

- Todd Stitzer, Chairman, Signet Jewelers

Furthermore, the range of issues now debated in the boardroom—reputation management, health, safety, ethics, social responsibility and technology—means that today's NED must also be able to assess the specifics of the company in context. While this was always the case, the complexities of today's commercial world require that this familiarity be far more comprehensive.

“Never believe what you are told about time commitment, for instance that it will be six to ten days a year. It's always much more, so make sure you leave yourself enough time.”

- Terry Morgan CBE, Chairman, Crossrail

Time commitment. All parties agree that the total time commitment and overall responsibility of a NED role has increased over the last seven years. Attending board meetings is now just the foundation; NEDs must be fully engaged and work between meetings in order to get to know the

business, understand the issues and build relationships with management and shareholders. Sir John Parker, Chairman of Anglo American, explained that this shift means, “You need people who will get up the learning curve quickly.”

The Walker Review in 2009 recommended a minimum expected time commitment of thirty to thirty-six days per year for financial institutions. The review outlined how this commitment needed to be clearly indicated in letters of appointment, which in some cases would therefore limit the capacity of an NED to retain or assume board responsibilities elsewhere.

Dr. Phil Nolan, Chairman of John Laing, suggests that “NEDs should anticipate spending 50 percent more time than the company says is necessary.” NEDs who sit on specialist committees must be prepared to spend even more time on the role. Committees such as audit and remuneration are increasingly technical and will require time commitments beyond that which was traditionally expected. At Standard Chartered, the Chairman John Peace explained that the NEDs on his committees now need approximately seventy days a year on board work with at least two to three country visits a year.

Feedback. The best NEDs are open to personal feedback and constantly seek to improve both their individual contribution and the overall effectiveness of the board. The introduction of the board review over the last seven years has significantly increased the emphasis on contribution and performance. Indeed, as more boards are now putting themselves through peer reviews, NEDs have come to expect advice on ways to have more impact around the board table.

“Ten years ago, it was more about ‘being in a select group—joining an exclusive club’ whereas now, the importance to the markets of corporate governance means that it’s a serious job. In that way, the NED role has moved from being an honour to being a professional responsibility.”

- Ken Olisa, Chairman,
Restoration Partners

“Training to fulfil the NED role comes out of the annual board reviews. For these to be effective you need an atmosphere where there is straight talking. NEDs have to take the process of board review and feedback very seriously.”

- Mary Francis CBE, SID, Centrica

The very best regard feedback as a continuous learning process, not just an annual exam. They constantly seek and offer advice as to how they and their colleagues can be more effective. As Baroness Patience

“It is important to give behavioural feedback, even although some may not welcome it.”

- Sir John Buchanan, Chairman, ARM and Smith & Nephew

Wheatcroft, NED of St James's Place and Fiat S.p.A, explained, “It's a useful exercise which concentrates the mind. It helps to make one more aware of what was lacking and the gaps that needed filling.”

New characteristics

The need for more specialised skill sets stood out as the major change to a NED brief today. While the role still involves testing, evaluating and probing, the complexity facing boards has increased and the required competencies have evolved accordingly.

“You cannot coast it or play at it,” said Jim Leng, former Chairman of Corus Group.

Risk. Arguably the most significant adjustment to the NED role over the past seven years is that all NEDs must now be well versed in identifying and managing all forms of risk—operational, financial or reputational. For boards, not only does this involve additional resources and a sharpening of boundaries around oversight, it necessitates a mindset that was not as present before the financial crisis and ensuing complex regulation. NEDs now must be able to “think the unthinkable” to ensure opportunities are not lost and that appropriate mitigation strategies are in place. As one Chairman described, “Risk is a massive issue now: You need to understand the risks and be clear about what the board is doing about mitigating those risks.”

“The basics of true independence and integrity are still of fundamental importance, but it is what we have layered on top that has made the job so challenging and time consuming today.”

- John Peace, Chairman, Standard Chartered

The woes of the financial services sector highlighted how few boards were adequately factoring risk into their strategic oversight. Few people truly understood the implications of a globalised economy that lacked its own safety net. Boards therefore

“Traditionally risk was something of a rote exercise. Today you need a more acute understanding of risk. Few NEDs have a risk management background, however, and it is not an easy subject to discuss at a full board level.”

- Rupert Robson, Chairman,
Charles Taylor Consulting

were not asking the right questions and failed to anticipate the now evident commercial danger. In the future, boards will have a more active role in designing and setting objectives for stress testing.

This will require NEDs to focus on risk issues separately from the executive risk committee process.

In the future, all boards could see the introduction of a board risk committee, established separately from the audit committee, to take the responsibility both for current risk exposures and future risk strategy. Good practice, as laid out by the Walker Review and Basel II, could see this risk committee drawing on external advice. It may also become best practice to see the risk report included as a separate document within the annual report.

All this will require NEDs with the knowledge, intellect and capability to master the specifics of risk analysis. More important, these governance structures will have to be complemented with a strong risk culture within an organisation.

It will be the board's job to lead the creation of any new risk culture; as is often the case, the tone has to be "set from the top".

Finance. The general lack of financial expertise on many board teams has been repeatedly cited as a contributing factor to the damage resulting from the global financial crisis. Boards today are therefore increasingly looking for NEDs with strong numeracy skills, who can decipher complex share option arrangements and who understand debt and finance issues. Financial literacy goes beyond just knowing what is going on in the markets; it is about understanding finance so that effective decisions about the business can be reached.

"Financial literacy and economic literacy are more important than ever in today's climate."

- Tim Stevenson, Chairman,
Johnson Matthey and Morgan Crucible

"Understanding financial issues is more important than five years ago; practically every medium to large company is operating in the derivatives market."

- Nigel Stapleton, Chairman of Trustees,
Mineworkers' Pension Scheme

With investors and shareholders locked into a 24/7 trading cycle, it is imperative that businesses react swiftly to market events.

During the financial crisis, many companies were slow to adjust to the unpredictable and volatile marketplace. Those whose board members had previous experience in difficult markets were undoubtedly better able to weather the storm.

Technology. NEDs today must be aware of the profound impact technology is having on all areas of commerce around the world. This is true across all sectors, not simply consumer-led industries. The confluence of existing technol-

ogies (such as mobile networks, the Internet and video) and the evolution of new ones (such as material sciences and biotechnology) are likely to have profound implications for the way business is conducted in the next decade.

The fact that information proliferates and travels at unprecedented speed alters the manner in which boards traditionally make decisions. Thanks to the entrenchment of the 24-hour news cycle and the unprecedented interconnectedness of global markets, companies cannot afford to react to events at a pace of their own choosing. Today's NEDs must be able to make tough decisions in time frames that would have been regarded as impossible only a few years ago.

“The impact of regulation has strengthened. The compensation and audit requirements have become more technical and there is more interaction with advisers.”

- Sir Paul Judge, Chairman,
Schroder Income Growth Fund and NED,
ENRC and Standard Bank Group

“The world is quicker because of technology and volatility is far greater, so there are shorter decision-making cycles. NEDs must be able to absorb and synthesise information more quickly.”

- Gareth Davis, Chairman, DS Smith,
William Hill and Wolseley

“News travels much faster, with dire consequences for businesses. For example, after the Japanese tsunami and the catastrophic results on Japan's nuclear plants, Siemens decided to close its nuclear business, and France reorganised its power business subsuming the strong solo nuclear player within the rest of its power business. These major decisions were taken within weeks, not years.”

- Mike Parton, CEO and Chairman,
Damovo Group, and Chairman, Tele2

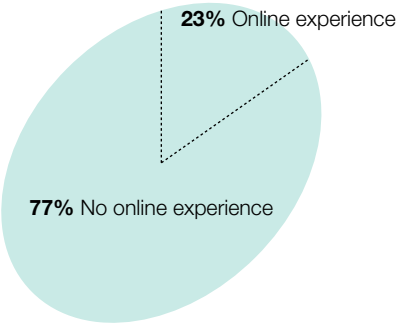
NEDs also need to understand the commercial impact of social networks, digital media, e-commerce, mobile and other technologies. Online platforms are changing the way customers interact with brands and are therefore driving new business models. Understanding how they work is becoming essential to any boardroom discussion about corporate strategy. As new technological platforms and trends inevitably emerge, NEDs will also have to stay continually up to date and informed.

One of the crucial effects of new technology, particularly social media, is that it shifts power into the hands of the consumer. If boards are to stay abreast of the nuances of digital communication platforms, they will need NEDs with specific knowledge and experience to help frame strategic discussion around these areas. Such candidates will likely come from the younger generations, the so-called “digital natives” who grew up in the era of online everything. Not every board member needs to be an expert, but this knowledge needs to be represented.

The strategic importance of technological knowledge is undoubtedly front-of-mind for chairmen. As you might expect this trend is particularly pronounced in consumer facing sectors. For instance, in the last year twenty-three percent of NEDs appointed to the boards of FTSE 350 retail companies had some form of online experience. This represents a marked increase from just five years ago when only seven percent of NEDs taking up board positions had such experience².

Table 1
FTSE 350 Retail NED
Appointments

2011



2006



2 Elliott, Sally and Twynam, Ben. 2011. “Building for breakthroughs. The leadership of innovation in UK retail”. The Korn/Ferry Institute.

Undesirable traits

During the course of our research we also asked executives and board members what they thought made a NED ineffective. As in 2005, we found that identifying negative attributes provided a useful way of highlighting positive ones. Among the behaviours that can harm, or even derail, a NED are:

Big egos. Boards have no need for NEDs who join to further a personal agenda, enhance their political currency or who are motivated by status. That includes pushing political correctness on issues such as the environment, diversity and corporate social responsibility. All NEDs should remember they are there to represent shareholder interests.

Confrontational personalities. Individuals who are challenging for the sake of it—or who believe this is what is expected of them—make poor NEDs. Dogmatic, inflexible opinions have no place in the boardroom and those who must win every argument will find the boardroom an unsatisfying place to be.

Lack of preparedness. NEDs who do not fully commit to the role—which includes reading all materials in advance of the meetings and attending all meetings—will make little positive impact. Board members also express irritation with those who display a lack of enthusiasm for the goings-on, such as by constantly checking messages or e-mails during meetings.

Shallow comprehension. NEDs who do not make the effort to fully understand the business—often indicated by a lack of participation or asking the wrong questions during meetings—will be ineffective. Peers quickly divine who is not clear on the big picture.

Disrespect for boundaries. Failing to understand the distinctions between the role of the NEDs and that of the executive team will cause conflict. Drifting into the realms of operational decision making, especially during crisis situations, will damage relationships with the CEO and others in senior management.

Continuous improvement

However deep their skill set, exceptional NEDs are always seeking insight and support to be even better.

What the individual can do

“The strongest NED is the one who is joining the board for the right reasons,” explained Olympic Delivery Authority’s Chairman Sir John Armitt. This has little to do with status; NEDs should select businesses that genuinely excite them and where they believe they can offer real value as a board member. Having target areas of contribution—though not a personal agenda—can also make the experience more rewarding.

Prior to joining a new board, NEDs must take “due diligence” seriously. This includes researching not only the company, but also individuals on the management team and the board itself. Brushing up on the industry sector, attending conferences, reading

analyst comments and networking with other board members can facilitate this process. Extensive reading—to ensure financial and political literacy—is essential for keeping abreast of corporate priorities.

“When considering a board opportunity, test yourself on what you think that you can offer. If you join a board where you are able to really contribute, you will be valued and enjoy your time.”

- Stephen Murphy, former CEO, Virgin Group

“NEDs need to continually update themselves and put a lot into getting to know the company especially during the first three months of their appointment. They should also get around the business on their own initiative and be self-motivated in this regard.”

- Jim Leng, former Chairman, Corus Group

Much of the advice given by our interviewees focused on the critical need to carry on developing knowledge of the business and building relationships with key individuals throughout one's tenure.

"I'm a great walker-around. The more time a NED spends with the business—not just with senior management but also with the layer below that—the better they can help make decisions."

- Nigel Keen, Chairman, Laird

Time should be spent on site visits to factories, shops, offices, banks and other places of work. NEDs should talk to all layers of management, get under the skin of the company and take part in as many induction meetings or outside courses as they can.

What boards can do

It is dangerous to assume that by the time people are recruited to boards they are so experienced that training will be redundant. Methodical induction and proper training programmes, particularly for new NEDs, will improve the performance of individuals and the board as a whole. Most of the chairmen we interviewed recommended an induction of several days to ensure new NEDs have a thorough understanding of specific company affairs and the varied aspects of their role.

Inductions should involve site visits and training on the specific legal responsibilities and ethics codes. They should also cover shareholder expectations

and the company's governance priorities. More technical aspects—like financial details of audit and remuneration committees—require formal training by specialists.

"Because a more diverse group of people are becoming NEDs, some arrive to the role without an understanding of how the boardroom functions. It is therefore important that they are given a good grounding of what is/is not expected."

- John McAdam, Chairman, Rentokil Initial and United Utilities

"Onboarding should include key site visits so that NEDs can see the company's operations. At BP, for instance, they visit research and technology centres, oil rigs, and pipelines and spend time getting to know management."

- Douglas Flint, Chairman, HSBC

Though not necessarily common, one-on-one mentoring stood out as a particularly valuable training method for new NEDs. Several we interviewed said they had found the practice extremely beneficial, allowing them to build relationships while at the same time learning from more experienced members of the board. For our interviewees, interestingly effective mentoring included both operational and strategic aspects of the company and a “warts and all” introduction to the dynamics of the board and expected boardroom behaviours.

“A new board member would get up to speed more quickly and therefore add value sooner as a result of another board member acting as a mentor for the first few months.”

- Rupert Robson, Chairman,
Charles Taylor Consulting

Boards can also enhance NED performance by providing the necessary administrative support. Phil Nolan, Chairman of John Laing, was adamant that “no one should expect to become an effective NED if they have insufficient administrative support.” The quality and timeliness of board documents—a function of executive and secretarial support—can greatly affect the quality of board discussions and therefore the success of directors.

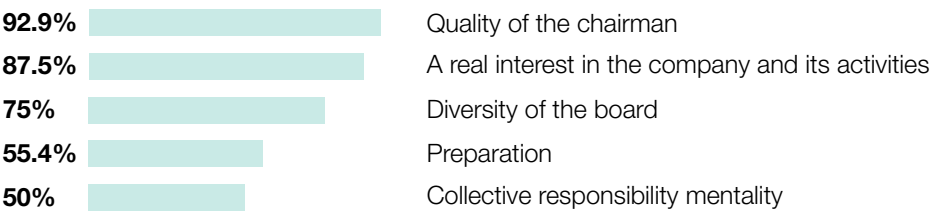
Following the FRC Guideline that all FTSE 350 boards should review their performance annually and use an independent external facilitator every three years, board reviews are becoming more common. When first introduced, external board reviews were regarded by many as unnecessary and largely unwanted regulatory intervention. Today, however, it is clear that the broad consensus is that a board review can be a valuable tool in enhancing effectiveness.

Several interviewees commented on personal feedback they had received from peers gathered through an independently facilitated review, and regarded it as helpful in supporting their own personal improvement.

Finally, as John McAdam put it, “The onus is on the Chairman to make it work.” In research conducted by Korn/Ferry, Tomorrow’s Company and KPMG in 2011, 93 percent of board member respondents agreed: the quality of the chairman is critical to boardroom effectiveness. A good chairman was already often the *sine qua non* that differentiates a high-performing board from an average one, but the added nuances and

Table 2
What are the most important characteristics of boards that have effective conversations?

Based on the percentage of respondents who ticked each characteristic.



demands facing boards today have increased the centrality of the role. The growing complexity of the boardroom agenda, coupled with the changing mix of skills needed on the board requires chairmen to create a culture and dynamic that extracts maximum value from each board member. This requires a sophistication of team leadership and facilitation of a higher order than seven years ago. Much care and attention should go into the selection of a chairman, as this individual will shape the experience and effectiveness of the board and set the tone with management.

“I sit on two FTSE 100 boards, both chaired by recognised heavyweight chairmen, both of whom believe they do a first-class job. In fact, one does a great job of bringing the best out of the board; the other is too focused on process and agenda management.”

- Anonymous

Related boardroom issues

Our 2005 report broached several topics which, at the time, were developing as boardroom issues. We revisited these topics to inquire whether the same issues continue to pose a challenge to corporate governance and, as importantly, to find out whether any new issues have emerged since 2005.

Less experienced NEDs

In our previous report, we weighed up the arguments both for and against the case for younger, and therefore less experienced, NEDs. At the time, opinion was divided but

leaned towards reservation about their inclusion. Those in favour argued that younger board members brought freshness, relevance, enthusiasm, and sharpness. The opposition suggested they lacked the experience, independence and time to be able to truly fulfil the role of the NED.

Seven years later the discussion remains polarised. Most recognise the value that younger, serving executives bring, especially in light of the increased emphasis on financial and technological expertise needed on boards. Many also appreciate the dangers of having board teams that are “long in the tooth” or board members who are too long

“out of the flow” of the current commercial environment.

“It’s always nice to have at least one person as a NED who still holds an executive/operational role.”

- Michael Harper, Chairman,
BBA Aviation, Ricardo and Vitec Group

“I personally don’t think there are enough industrialist/operational NEDs — people with experience of the coal face and not just the balance sheet.”

- Ian Grice, NED, Diploma

In this respect, it is generally agreed that boards need at least a few younger directors with currency and sharpness alongside experienced NEDs with broad wisdom and insight. The best balance is still being debated.

At the same time, this acknowledgement does not necessarily correlate with tangible changes. Most boards continue to be the province of retired executives. Baroness Patience Wheatcroft said, “When you look at boards they are still mainly a combination of sixty-somethings and too few younger people.” The statistics back up her sentiment. In 2001 the average age of FTSE 100 NEDs was fifty-nine, and in 2011 that figure rose to sixty. For FTSE 250 boards, the average age increased over the same time period from fifty-eight to fifty-nine³.

“I like to see some ‘grizzlies’ who have been around but who are up to date, as well as younger NEDs who still have a day job and are current on international business. In a globalised economy, a board with the right mix is even more important.”

- Alan Thomson, Chairman,
Bodycote and Hays

The stagnation of average board member age largely comes down to necessary experience, capacity and avoiding conflicts of interest. Current executives often do not have the time to invest in a NED role, especially given the increased commitment required.

“As the board evolves, there are always gaps that need to be filled and it’s part of the life of a board and the chairman to manage board development.”

- Anthony Habgood, Chairman,
Reed Elsevier and Whitbread

Herein lies a dilemma. On the one hand, the increasing complexity and specialisation of boards recommends the inclusion of younger directors at the ‘sharp end’ of their careers. On the other, this talent pool either lacks the necessary experience or time to fully engage.

This could lead to the emergence of career NEDs: executives in their late forties and early fifties who step off the executive treadmill to build up a portfolio of NED roles. The increased accountability and responsibility

³ Data sourced from Boardex.

associated with being a NED might make this a meatier and more attractive career option. However, this will also increase the risk that such executives will quickly lose the currency that made them attractive to boards in the first place.

Recruitment process

The prevalence of the “old-boys’ network” in board recruiting remained strong at the time of our last report, although a move to greater professionalism was underway. Leading boards understood that appropriately strategic governance requires taking as a whole the perspective of a board, identifying gaps in the aggregate set of skills needed to provide the appropriate level of challenge and support to management and then embarking on a targeted process to recruit those missing skills. This process undoubtedly helps build a more balanced team aligned to the company’s long-term strategic goals.

“It is hard to go outside the ‘tried and tested’, but often the best NEDs will be executives of large divisions/ subsidiaries of international groups. Therefore it is important to open up the candidate pool.”

- Andy Duff, Chairman, Severn Trent

This trend towards a more professional recruitment process has expanded in recent years. All respondents who mentioned the subject spoke of the utility of using consultants and rigorous assessment methods. Recruiting to meet the new demands of the NED role is essential and will be hard to do through personal contacts alone. It is critical to identify the issues facing the board in the coming years and the skills needed to master them—and then properly brief the search firm. Having a coherent definition of requirements smoothes the process and prevents ambiguity. The time and effort boards put into the candidate search and selection process will pay dividends for years in the boardroom.

“Never take second best. If you are not happy with the shortlist, then go back in and keep looking. Find people leaving their executive career who are perhaps worrying a bit about what comes next. That requires knowing who, coming out of companies, will be strong on boards.”

- Phil White, Chairman,
Kier Group, Lookers and Unite Group

It is the chairman's role, supported by the nominations committee and with appropriate advice, to define which new skills, knowledge, experience, personal contacts and other attributes future board directors will need. This process not only encourages better recruitment, but also allows boards to communicate clearly with new candidates as to what is expected of them.

The problem is that as boards become more targeted and specific in identifying their talent needs, so the identification of suitable candidates becomes harder. The ideal NED today is the corporate equivalent of superman: they possess wisdom but remain plugged into current developments; they need a breadth of experience alongside a depth of knowledge; they need a variety of complicated and niche skill sets but also sophisticated communication skills. They also need to have the time and passion for business to commit to the increasing range of responsibilities.

This broadening of overall business and awareness, combined with the increasing focus on specialised skills raises a new recruitment challenge: the talent pool will shrink if boards hire only candidates who can tick this growing number of boxes. Broadening the search, marrying different skill sets and encouraging a diversity of knowledge/background are therefore essential if boards are to truly meet the talent challenges that lie ahead.

"I think boards need greater clarity about the attributes they want. Once you understand the varied skills needed, you recognise that everyone need not be the same. Boards should think more broadly and imaginatively about recruitment because the real issue is that boards are too similar. There is not enough divergence in the experiences and backgrounds of directors. It's all too comfortable."

- Baroness Margaret McDonagh, NED, TBI

Regulation

The introduction of widespread business code reforms has substantially altered the corporate governance landscape. However, there is broad recognition that a cultural shift is required to spur change; regulation alone will be unsuccessful.

Heavy-handed regulation could in fact hamper healthy board dynamics and constrict the ability of boards to act decisively and of chairmen to fashion boards that best meet the specific needs of each company. Many chairmen are concerned that the recent flurry of regulation could cause long-term damage to effective governance.

Shareholder representation

In light of recent large-scale corporate governance failures, some directors are asking whether shareholder representation on boards should increase. Traditionally, shareholders influence corporate decisions only by formally electing board members. It has been suggested that this “one-step-removed” relationship should change in order to improve communication between shareholders and boards.

The argument is that more robust engagement with shareholders would help directors better manage company affairs. Greater engagement would go a long way in solving what the Walker Review

“Stakeholder representation on boards is really valuable. Too often, in the private sector, this is dismissed on grounds of conflict of interest.”

- Sir John Armit, Chairman,
Olympic Delivery Authority

termed the “agency problem” at publicly traded companies, the potential misalignment of the shareholders’ and board members’ interests.

At the crux of the problem is accountability, particularly in companies with dispersed ownership. Addressing this issue is critical, especially in light of the mounting legal ramifications of corporate failure. Granting shareholders more or new forms of representation might be one way forward.

At the time of publishing, in its submission to Vince Cable’s Department for Business, the Association of British Insurers, whose members control about 12 percent of the stock market, backed a proposal that would give investors the right to block a corporation’s future policy on pay. Interestingly, two days after this announcement, the board of a top five global insurer apologised to shareholders for failing to act on one of the biggest investor revolts over pay at a FTSE 100 company in recent years, with almost six in ten of their shareholders opposing its

remuneration report. In the spring of 2012, the FTSE 100 had three CEO resignations as a result of pressure from shareholders. Is this perhaps the beginning of a “Shareholder Spring” and a renewed focus on active stewardship?

Remuneration and recognition

As the risks and responsibilities for NEDs have risen so has their remuneration. This has taken a number of different forms, including “salaries”, daily rates and incentive schemes in the form of shares. However, many suggest that pay structures are still not optimal. While financial reward is not the primary motivation for many of the best NEDs, is it realistic to expect any NED to shoulder the added responsibility of the job without added compensation? In some quarters, the potential reputational risks have become so pronounced that many individuals are reluctant to consider a NED role.

“The time/fee ratio is way out of kilter. At the same time, reward does not necessarily correlate with performance.”

- Martin Flower, Chairman,
Croda International and Low & Bonar

“I pay for the time they commit in the normal course of events and I am paying for an option on more of their time if I need it at specific times.”

- Anthony Habgood, Chairman,
Reed Elsevier and Whitbread

Compensation levels are still generally “reasonable”, said one NED, but a lack of movement on pay for several years is giving rise to concern among directors. At the same time, pressure and criticism from the media and regulators on corporate pay have companies feeling that their hands are tied.

Some question whether increased pay will lead to better performance. With tough budget restraints in place and with many executive salaries frozen in recent years, shareholders could start

“In the US it is normal and accepted for independent directors to get options. Here, it is banned. The easiest way to bring NED remuneration into alignment with shareholders would be to provide options. I would suggest a consultation on this by the FRC.”

- Sir Paul Judge, Chairman,
Schroder Income Growth Fund and NED,
ENRC and Standard Bank Group

asking whether higher NED pay will really deliver better governance or higher returns. The best boards are likely to continue to attract coveted candidates regardless, making the issue even harder to resolve definitively.

... and finally

The additional skills and time commitment demanded of the role also raises the question of correct job title. Even in 2005, many NEDs questioned the title “non executive director”, arguing that to be described as a “non” something is inappropriate. Today more than ever, the case to change the term is becoming stronger. With NEDs now expected to possess expertise around an array of complex topics, and as boards become more accountable, “independent director” would seem perhaps to better reflect the greater responsibility and professionalism of the role.

“The ‘NED’ title is a misnomer; it describes what they don’t do! Their title should instead reflect what they are there for, as an ‘independent director’.”

- Jim Leng, former Chairman, Corus Group

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