



**What does being an
Independent Director on the
board of a company involve
in today's business world?**



Gerry Brown

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“... they [IDs] have become the real custodians of companies, especially those that are publicly quoted.”

There are many reasons for the importance of non-executives (or independent directors [ID] as I believe that – echoing American business – they should more properly be called) primarily that increasingly they have the majority of seats on the boards of public companies. It's a fact of business

life that, in the final analysis, it is boards that have responsibility for the strategy as well as performance of any business. Equally significantly, independent directors represent all interested parties not just the shareholders. Many executive directors have become focused on short term results and it often falls to the independent directors to become the custodians of the longer term health of the business. It also must be noted that given the increasing mobility of executive directors and their understandable natural interest in career progression, ID's need to focus on the associated management succession needs of the business.

The consequence of all these factors is that the job of the independent director has become much more important. Interestingly, this doesn't just apply to the corporate sector but to Councils of Universities, NHS Trusts, Charities, NGOs and numerous public bodies.

ID responsibility for company strategy is the foremost supervisory requirement since this – together with ensuring the strength of the senior management team – is the factor that most affects the health of any company. IDs also have a critical role to play helping businesses deal with issues of globalisation and risk management. In addition, they should oversee merger and acquisition due diligence including approaches from predators. Finally IDs should be the eyes and ears of companies to bring best practice, experience and contacts from other different sectors and geographies.

There is no doubt that the job of the ID is much more challenging and difficult. Partly this reflects the growing complexity of the nature of the decisions that boards face on a regular basis.

Below are some examples of the issues that boards routinely face:

- ▶ Should the company do business in or with countries that have oppressive regimes whose policies are anathema to employees, shareholders and the general public?
- ▶ If operating in countries where bribery is commonplace, should the company follow local customs and pay bribes, or should it attempt to keep its hands clean?
- ▶ How should the company make sure that local subsidiaries, suppliers and so on are not behaving in unethical ways, such as exploiting child labour or failing to provide a safe working environment?
- ▶ What stance should the company take with regard to tax avoidance, conflicts of interest and insider dealing?

- ▶ What policies should the company have with regard to executive pay and stock options? How will shareholders and the public view bonus schemes that provide excessive reward, or are even seen to be apparently rewarding failure?
- ▶ What stance should the company take with regard to its customers? Will it engage in price fixing, price exploitation or dumping in order to grab market share, regardless of the long-term impact on customers?
- ▶ How safe are the company's products?
- ▶ Is the company behaving in an environmentally responsible manner?

Another key consideration of the ID remit is the impact of different types of ownership upon the needs and requirements of the role. Different kinds of owners – whether public company shareholders, private equity investors or private owners – want IDs on the board for often markedly different reasons so, consequently, require varying backgrounds, skill sets and traits. It should go without saying that the impact of globalisation on businesses means IDs need to cultivate legal, political, economic, social and cultural understanding of the various countries with whom their companies do business. Emerging countries bring with them special challenges. It is not enough to just attend Board Meetings, most IDs are also Chairmen and frequently members of the main board committees – Audit, Remuneration, Quality, Health & Safety, and Nomination – so they have to be up to date with contemporary issues and developments in a wide variety of specialist areas. Finally it is necessary to regularly visit the coal face of the business, to meet both employees and customers. If the company is international then this usually involves substantial travel.

A significant aspect of the challenge of the role and position of the independent director is that they must be truly independent in thought, action and spirit. It is for this reason that I use the term ID rather than 'Non-Executive' since frequently executive directors get too close to situations or may have personal vested interests or motivations. The ID is definitely not there to do the executive directors job but to challenge and have open minds to alternative solutions to business problems. This is particularly necessary in times of adversity (often it may be necessary to bring in specialist advisors such as strategy consultants, accountancy firms, investment bankers, remuneration consultants, tax specialists, lawyers and head hunters to assist the company). Obviously, any independent director needs to have a network of contacts to assist. Finally, it is of great importance that the ID spends enough time to really understand both the business and the sector as well as to know and understand board colleagues, the executive team and especially the CEO.

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The consequences are often dramatic if IDs are ineffective and not effectively doing their job, and a number of companies have been the subject of major losses in shareholder value which has affected the value of the pension funds, led to major job losses and, in some cases, the Government has spent billions of taxpayer's money to rescue or bail them out.

Then let us consider some of the following issues and how they have damaged companies:

- ▶ Mis-selling of payment protection insurance by UK banks, which has cost them billions of pounds and damaged their relationships with customers
- ▶ Tax avoidance which routes income through low-tax domiciles in order to avoid paying tax, and led to them being pilloried in the international press
- ▶ Anti-competitive behaviour
- ▶ Unethical behaviour, such as recent phone-hacking scandals

- ▶ Corruption and the payment of bribes in countries where the rule of law is weak in order to secure contracts

Over the years, in the UK a number of special investigations have been set up to seek to improve Corporate Governance including Cadbury, Greenbury, Higgs and Walker. In the US in the same period, two very important pieces of legislation – Sarbanes Oxley and Dodds Frank – have been passed with similar objectives in mind. Yet, no matter how many codes of conduct are developed or laws passed, it is the behaviour and actions of Directors that count. In this regard, the Independent Directors have special responsibility!

In conclusion, despite all of the above issues, the public understanding and perception of the role and importance of

the real custodians of companies – the independent directors – remains woefully inadequate.

There is a real and urgent need for Professional Bodies and Business Schools to train and educate Directors – whether current or the next generation (as well as society at large) – about the real role of Independent Directors. For those who are already independent directors they need to choose whether to be good, bad or ugly.

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The views expressed in this article are those of the author and do not necessarily represent the views of EY.

The good

- ▶ Independence
- ▶ Integrity
- ▶ Listening skills
- ▶ Cultural flexibility
- ▶ Professional
- ▶ Entrepreneurial

The bad

- ▶ Poor communicator
- ▶ Goes native
- ▶ Low attention level
- ▶ Unprepared for board meetings
- ▶ Does not visit operations
- ▶ Does not contribute to value creation
- ▶ Wrong balance regarding corporate governance
- ▶ Tries to do the executive job

The ugly

- ▶ Irresponsible
- ▶ Believes shareholders are irrelevant
- ▶ Personal interest prevails
- ▶ Low attendance at board meetings
- ▶ Corrupt, or is prepared to tolerate corruption
- ▶ Never challenges the executives
- ▶ Poor business judgement