



NEDs - are SMEs missing a trick? | July 2018

Non-executive directors in SMEs

The role and value of the non-executive director is well defined for listed companies. However, the picture is far less clear for small and medium-sized enterprises (SMEs), which represent the bulk of the UK economy.

As a law firm that works regularly with SMEs looking to unlock opportunities, secure finance and grow, we wanted to consider the role that a non-executive director (NED) can play in their success. Specifically, how NEDs are currently used in SMEs, what value they do and could bring, how more SMEs might benefit by involving a NED and how a company and NED can formalise the role.

The study's unique focus draws on the perspectives of SMEs and NEDs. Observations and recommendations are based on a detailed analysis by UWE of existing research, together with original interviews involving 11 NEDs and nine executives connected with 14 SMEs.

Partnering with UWE's Business and Law School, The Association of Chartered Certified Accountants, Transpire and Practice, we undertook a study to shed fresh light on the role and importance of NEDs to SMEs.

The research was based on six key objectives:

- What is the need for NEDs in the SME market?
- What does a NED role entail in an SME?
- What is the recruitment process for NEDs and who determines who is hired?
- What are the challenges for NEDs and their organisations?
- How are NEDs integrated into the board/company?
- What are the terms of engagement in relation to NEDs?

This TLT report draws out the key findings and recommendations from that study for our clients and the broader SME market and discusses how TLT can help SMEs to navigate the appointment of a NED.

Please do get in touch if you have any questions, would like a copy of the full report or would like to discuss the findings in more detail.



Andrew Webber
Corporate Partner, TLT



Nina Searle
Corporate Associate, TLT

Click on a section to find out more

To NED, or not to NED?
An SME and NED's perspective

Welcome to the club
Recruiting and managing a NED

Looking forwards...
Bringing a NED on-board

To NED, or not to NED? | An SME and NED's perspective

An SME perspective

Unlike listed public companies in the UK, it is not a legal requirement for SMEs to appoint NEDs to the board. However, the research shows a real appetite for NEDs in the SME market and a clear understanding of the potential benefits they can bring.

This includes recognition of the role's importance in bringing an alternative, experienced perspective to the business. Also, in opening up new opportunities, acting as a sounding board to the senior team and eventually

becoming an integral part of a more formalised governance structure/process.

SMEs want NEDs to demonstrate passion, enthusiasm and business knowledge; critically, to bring to the table their experience of corporate strategy and business growth in a previous role. But, they need to be certain of obtaining the value-add given the SME's limited resources and time.

A NED perspective

The NED perspective from the research was similarly positive, with a clear view that SMEs benefit from the additional outside knowledge, experience and strategic advice. Executives supported this, referencing a NED's ability to fill skills gaps – particularly when looking to grow the business, tackle regulation or compete in an increasingly tough operating environment.

The key triggers for an SME deciding to appoint a NED back this up, with those triggers largely driven by investor

requirements or an executive's desire to bring about positive change (often growth) for the company.

However, despite the positivity, the study does indicate limited knowledge about NEDs within the SME community, a lack of access to key NED networks and limited resources amongst SMEs to manage their recruitment and contribution when in role. This could limit the potential value and impact the NED role can bring – something that the SME community clearly recognises.

What should a NED contribute to an SME?



An independent viewpoint on strategy



Advice on corporate governance and wider legal and statutory regulations and obligations



New skills, expertise and alternative perspectives



A willingness to provide formal and informal advice



Access to useful networks



A sounding board for ideas, a coach and a critical friend



Filling experience and knowledge gaps



Experience of the 'growth journey'



Passion for the organisation's growth and culture



Support tackling the competition locally, nationally and internationally



View from the frontline

.....

“My view of being a non-executive is to bring an independent view and discussion to the table around the boardroom, to constructively question strategy, to help management determine strategy, to bring experience which they themselves may not have had depending on circumstances and to provide a sounding board and sort of mentoring for the Chief Executive as well.

“I would say it's part counsellor, part provider of contacts and a black book.”

.....

Welcome to the club | Recruiting and managing a NED

Recruitment

The recruitment process for NEDs in the SME market is currently an informal one, where potential candidates are either recommended or sought through an executive's own network. The study does suggest some evidence of the use of formal recruitment agents, but this is currently limited.

The role requirements themselves tend not to be formally determined; indeed, most NEDs said they did not have a formal job description. Some were given a generic job description on appointment but this did not necessarily reflect the role they then fulfilled.

Contracts & pay

Contracts were generally informal as well, with the research indicating a typical expected commitment of two days per month to prepare for and attend board meetings. This was

often viewed flexibly by both sides, with additional time given as required.

While there was often no set length of appointment, there were examples of rolling contracts of between three to five years. Pay was typically based on an agreed daily rate or set fee for the role, with some share or equity based remuneration based on achieved improvements in profitability. All NEDs reported to the CEO, board and/or shareholders.

In role

Informality continues to be the watchword for SME NEDs when in role, with the research indicating very little formality or governance around the position. Roles were generally informally defined and evolving.

Ongoing assessment was also limited, bringing some risk – particularly in an increasingly competitive and regulated business environment. There was similarly limited evidence

of support in terms of formalised networking, mentoring, training or induction programmes. From the NED's perspective, although they reported enjoying their roles, the informal approach to both the recruitment process and when in role generated some challenges including:

- Challenges with corporate fit and integration into the culture of the business (expressed by some in terms of managing conflict and organisational politics).
- Concerns about recognising appropriate boundaries for their roles.
- Lack of clarity around any final decision making.
- Work volumes and time commitment.
- No ongoing training from the SME to fill knowledge gaps.
- Lack of management of objectives and expectations.
- Lack of NED training, but NEDs expected to be knowledgeable and require little training.

The predominantly informal approach to the role could suggest a lack of awareness or know-how around the process of appointing a NED and the scope of support needed when in role. It also likely indicates both the infancy of the use of NEDs in the SME market and the lack of time and resource within the SME to manage the process that would come with a more considered and structured best practice approach.

While this informality may be expected given the pressures and resource constraints in the market, there are likely to be some negative consequences that will need to be addressed. The lack of any formal contractual arrangement or job description, for example, undermines accountability. It may also expose the relationship to uncertainty and conflict further down the line. Importantly, reliance on existing networks for recruits could impact the role's independence and objectivity while limiting access to the full spectrum of talent and thus the diversity of the board.

Key findings

- There is a great need for NEDs in the SME market – to provide required skills, fill experience gaps and add a constructive, independent perspective that assists strategic decision making.
- NEDs require and should expect support from SMEs – in terms of training and performance appraisal to ensure best performance and value-add.
- The main challenges NEDs face in working with SMEs are around corporate fit and the establishment of NEDs within the SME culture.
- NED recruiters should encourage diversity at all levels within the NED community.
- The NED recruitment process needs to be formalised and more accessible.

Appointing a NED - key recommendations

- Appoint a professional head-hunter to support recruitment.
- Have a rigorous recruitment process and advertise and hire from a balanced and diverse list of candidates.
- Search beyond known networks when looking for a suitable candidate.
- Have a clear job description for the role. Make sure it reflects the organisation's stage of development e.g. helping the growth of the business or improving governance.
- Have clear contracts in place to ensure clarity and transparency on both sides.
- Consider remuneration carefully and how this will link to and drive performance but allow sufficient independence.
- Work with recruiters and trainers to map the role and how it might develop towards a more formal governance role as the business grows; the organisation will need different skills at different stages in its development.
- Look at a more formal approach to training. What should be funded independently and what support will come from the SME?
- Document formally the NED's appointment, scope of role, objectives and approach to training.
- Have a clear performance appraisal process that documents the skills and orientation for the role and ensure this is used to validate and assess the value added during the term.
- Make sure there is regular two-way feedback.



"I don't see how you can do the job unless you [complete an induction]... I know what my skill set is and they may not. I know what I don't know: What's the culture like? What's the motivation like? So I drive my own induction."



Looking forwards... | Bringing a NED on-board

Both executives and NEDs evidently derive value and enjoyment from the relationship. Although the role of the NED in the SME context is in its relative infancy, there is recognition of the important external perspective the role can bring and its potential impact during key transition points in the organisation's growth.

What is clear from this study and our experience at TLT is that the majority of SMEs do not have a NED in place, even when they would benefit greatly from engaging one at an early stage of their business growth cycle. There is a lack of awareness of the benefits a NED can bring, how to recruit a NED and how to use them to their full potential.

The appointment of a NED is not just a governance issue, but should be looked at as a strategic decision to help move the business forward. As an SME scales up, there will be key points where a NED can bring real benefit and experience. As the study demonstrates, it is important to have clear parameters around the NED role, strategic objectives and length of tenure. There can often be a diminishing benefit if a NED is with a business for too long.

The current informality of approach across all areas of engagement must also be addressed if the role of the NED in the SME market is to evolve and have a greater impact on organisational success. In particular, a focus on

mapped and defined role requirements and the evaluation of those alongside a more rigorous recruitment process is needed. The discussion around remuneration is often an issue of debate and the pros and cons of consultancy versus employment and equity versus cash need to be weighed up.

At TLT, we would advise formalising the appointment of a NED with clear documentation around the NED's role – specifically, clarity around objectives and remuneration. A formal training programme should also be put in place. This approach will ensure that the SME and NED understand what each expects from the appointment. Also, what return on investment in that appointment they are likely to see.

While it is not a legal requirement for SMEs to have a NED in place, many external equity investors make it a mandatory requirement before investing in a fast growth company or SME. The investment community also echoes the study's findings around the need for greater gender diversity within the NED community and is encouraging this change.

Ambitious companies can become investment ready more quickly by bringing in their own NED at an earlier stage.



“...there is a harder edge to it than the traditional image that somebody may have, oh it's a fluffy NED role, you just turn up once a month for a board meeting and nod. Well maybe that was the case a few years ago. Now I think you have the same obligations and commitments as a director so you have got to take it seriously.”

Be investment ready - get a NED on-board at an early stage

Our study demonstrates that SMEs recognise how limited resources and a lack of sufficient internal expertise can act as a brake on growth and how a NED can help to address that. Investing some time at the start of any recruitment process to scope what the organisation needs and then finding the right person to deliver that will increase the chance that the investment made will deliver great pay back to the SME in the future.

How can TLT help?

Our team of corporate specialists has an extensive and detailed knowledge of SMEs, fast growth businesses and directors and their duties, as well as the markets and sectors in which they operate. We can help in many ways including with securing a NED, developing the necessary corporate governance materials and advising on remit, remuneration and documentation around the appointment.

Please get in touch to discuss how a NED could help scale up your business and take it to the next level of development.

For a copy of the full report, please contact Clara Snow: clara.snow@tltsolicitors.com

TLT team



Andrew Webber
T 0333 006 0085
E andrew.webber@TLTsolicitors.com



Nina Searle
T 0333 006 1804
E nina.searle@TLTsolicitors.com



Clara Snow
T 0333 006 1227
E clara.snow@TLTsolicitors.com