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The non-executive director role

Learn how non-executive directors (NEDs) differ from executive directors and how they operate within an organisation

Introduction

There's no legal distinction between non-executive directors (NEDs) and executive directors. However, in practice, NEDs are fundamentally 'outsiders' to a company, detached from day-to-day operations and valued for their objective insight. This creates a very different dynamic within their role to that of an executive director and means they can offer a unique perspective towards corporate governance, risk management and succession planning, amongst other areas. A company must ensure that its NEDs complement the balance of skills and experience of the board.

This factsheet explains the role of a non-executive director and how NEDs operate within a company. It provides an overview of the qualities sought from prospective NEDs, and highlights why HR professionals are suited to a non-executive director role.

What is a non-executive director?

Non-executive directors (NEDs) play an important role in the corporate governance of modern companies. In the UK, the Companies Act 2006 defines a director as including any person occupying the position of director, by whatever name called, so there's no legal distinction between executive directors and non-executive directors. The legal duties, responsibilities and potential liabilities are the same for both; the distinction lies in the role that they perform.

Non-executive directorships can offer individuals lucrative recompense along with opportunities for broadening cross-sector exposure. However, the legal duties and responsibilities shouldn't be underestimated, either by those considering such

directorships or the organisations seeking to appoint them.

NEDs usually stand back from the day-to-day running of the business, drawing alongside the executive team as required to facilitate the strategic decision-making process. Exactly what this entails will vary from company to company, depending on what is required at each stage of a company's development.

How NEDs operate, and their role, will differ from business to business:

- In a new business, a NED might act as an entrepreneurial mentor whose regular presence in the office provides inspirational leadership and an experienced voice guiding the company as it grows.
- In an established business, such as a listed PLC, a NED attends board meetings and offers unique insights from their own perspective, such as on issues relating to strategy.

A company must ensure it recruits NEDs that complement the balance of skills and experience of the existing board. A NED doesn't necessarily have to know the industry in which a company is operating as this knowledge and experience should ideally be provided by the executive directors. Rather, the value of a NED lies in their ability to identify and advise upon new challenges, initiatives and market opportunities, and to develop and refocus strategic plans.

People professionals haven't traditionally been sources of talent for NED positions, but with their skills and core competences relevant to board working, they have much to offer. They are in a unique position to help boards to understand risks and opportunities as well as bringing a fresh and much-needed perspective to the decision-making process. A people professional can ensure that an organisation's key driver of value – its people – is taken seriously at board level.

The difference between directors and employees

A director is an officer of a company and not an employee. However, it's possible that a director (NED or other director) might work under a contract of service making them an employee. It's important to evaluate how the relationship is going to operate to determine if the individual will be an employee and hence if employment rights are applicable.

Since the role of a NED varies from company to company, so do remuneration levels. Some organisations in the public and voluntary sectors do not pay a remittance, though travel and some subsistence allowances are usually covered.

All listed UK companies must have an approved remuneration policy in place with which

all remuneration or termination payments to directors must be consistent.

Whilst a NED's contract may be for a fixed or an indefinite period, the [UK Corporate Governance Code](#) advises that if a NED has been advising the same company for more than nine years they should be considered for annual re-election and they may not be considered as independent. All NEDs' terms and conditions of employment should be held at a company's registered office and available for public inspection between 9:00 and 17:00 each day.

Due diligence, induction and training

Due diligence

The principal purpose of due diligence is to obtain as much information as possible about a company to enable a prospective NED to understand the company in more detail. Due diligence is like undertaking an audit allowing the prospective NED to assess the risks posed by involvement in a company. The exercise may reveal the main areas of input requiring the NED's attention.

A prospective NED should consider:

- The quality of the current the executive directors and NEDs.
- The company's governance procedures, financial position, investor relations, financial management and risk management procedures.
- The company's business plan, strategic aims and objectives.
- The company's reputation.

Due diligence should also consider the wider picture - the market a company operates in and its major competitors and the strengths, weaknesses, opportunities and threats inherent in the operating environment.

Joining a company's board of directors means assuming a role in the control and strategic decision-making processes of that company thus dictating its future profitability and value, and determining the job security of all those employed by the company. A thorough understanding of the business is vital for anyone embarking on this task to be sure they possess the capacity, capability and competence to fulfill the role.

Induction and training

The [UK Corporate Governance Code](#) advises that all major shareholders should have the opportunity of meeting a new NED. The practicalities of this will depend on how many

major shareholders a company has, but there are good reasons for complying with the Code - meeting the owners of the company puts a personal face on the company, reinforcing the significance of the role. It will assist the new recruit in establishing their place on the team.

It's crucial that every company has an induction process for its directors and it's the chair's responsibility to provide a full, formal and tailored induction for new NEDs to develop and update their existing knowledge. The induction might:

- Build upon market-specific skills.
- Contextualise the company's approach to risk.
- Impart the latest financial information.
- Examine the rules by which the board governs itself and matters reserved for its decision.
- Set out matters delegated to board committees and the terms of reference under which such committees operate.
- Review the company's corporate governance, policies and insurance.
- Scrutinise the company's business plan and performance against key indicators contained within the plan.

The Code states that it's the responsibility of the company secretary to facilitate directors' inductions and assist with their ongoing professional development. This follows the recommendation that all directors should receive an induction on joining a company and that all directors should regularly update and refresh their skills and knowledge.

What are the responsibilities and duties of a non-executive director?

The duties of directors have evolved over the years as the courts have interpreted legislation regulating UK companies. A comparison can be drawn between the role of directors and trustees since directors are entrusted with protecting a company's assets, albeit for the benefit of the company. Consequently, directors must demonstrate due skill, care and good faith in exercising fiduciary responsibility.

The Companies Act 2006 places statutory duties on executive and non-executive directors alike to:

- Act within powers set out in the company's memorandum of association.
- Promote success of the company.
- Exercise independent judgement.

- Exercise reasonable care, skill and diligence.
- Avoid conflicts of interest.
- Not accept benefits from third parties.
- Declare interests in proposed transactions or arrangements.

What liabilities are non-executive directors likely to face?

As with executive directors, non-executive directors are liable to disqualification under the Company Directors Disqualification Act 1986. If a company's board of directors is investigated for 'wrong doing', such an investigation will include the actions or omissions of NEDs. In general, a director can be disqualified for general misconduct in connection with companies or for being unfit to act as company director.

A 2010 consultation paper issued by the then Financial Services Authority (FSA), Effective corporate governance: significant influence controlled functions and the Walker review, stated that 'NEDs have a pivotal role to play in the active governance of firms. Where it appears to us that executives have persistently made poor decisions, we will look closely at NEDs' performance if we feel they have not intervened in a timely and sufficient way. We are concerned that the existing guidance could be misinterpreted and taken to mean that we would not hold NEDs responsible for, for example, failing to intervene and challenge the executive. This is not the case, as we see such challenge and intervention as a key part of any NED's responsibilities'.

Non-executive directors and the structure of the board

As well as providing additional skills, expertise and perspective, the appointment of non-executive directors is an effective means of balancing interests in the board room. NEDs bring a level of independence to discussions. The UK Corporate Governance Code recommends that the listed public limited companies within the FTSE 350 should have at least half the board, excluding the chair, as NEDs; companies outside the FTSE 350 should have at least two NEDs.

The Code further recommends that the chair of the board should meet the NEDs separately from the other directors on a regular basis, and that they should also meet on an annual basis, without the chair, to review and appraise the chair's performance. The

nomination committees responsible for evaluating, vetting and recommending the appointment of candidates for directorship, should also comprise a majority of NEDs.

The 2009 [Walker Review](#) made recommendations to directly affect and enhance the quality and effectiveness of NEDs. It recommends they should:

- Receive sufficient training to ensure they have sufficient knowledge and understanding of the business and sector.
- Have access to support to allow them to fulfill their duties.
- Have an overall time commitment greater than in the past and that time commitment should be clearly indicated in their letters of appointment.
- Be ready, able and encouraged to challenge and test proposals.
- Chair Risk Committees.

Gender balance

In 2015, the [final annual report](#) was published reviewing the progress made on recommendations in the 2011 'Women on boards' report. The findings included:

- In FTSE 100 companies, women accounted for 31.4% of non-executive directorships compared with 15.6% in 2010/2011.
- In FTSE 250 companies, women accounted for 24.8% of non-executive directorships compared with 9.6% in 2010/2011.

The increases show that significant progress had been made since the reports began in 2010 and the fact that the numbers continue to increase year on year also indicate that the improvement is on-going.

A 2014 report [Appointments to boards and equality law](#) by the Equality and Human Rights Commission stated that the European Commission's proposal for a new directive on improving the gender balance among non-executive directors of companies listed on stock exchanges had been drafted in line with EU law on equality between men and women. The directive provides that the means to achieve the legally binding objective of ensuring that by 1 January 2020 at least 40% of non-executive board members come from the currently under-represented sex must use 'pre-established, clear, neutrally formulated and unambiguous criteria in selection processes'.

Useful contacts and further reading

Contacts

The task of finding candidates for private sector non-executive roles is often given to search firms and roles may be advertised in the national press. The following organisations offer information and services:

[FT Board Director Programme](#)

[ICSA: The Governance Institute](#)

[Institute of Directors](#)

[Non-Executive Directors' Association \(NEDA\)](#)

[Non Executive Directorship Exchange](#)

Books and reports

COYLE, B. (2019) *The non-executive directors' handbook*. 5th ed. London: ICSA Publishing.

Journal articles

CIPD members can use our [online journals](#) to find articles from over 300 journal titles relevant to HR.

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This factsheet was last updated by Ben Wilmott.