

# THE VALUE OF NON-EXECUTIVE DIRECTORS TO SMALL AND MEDIUM SIZE ENTERPRISES, INCLUDING A GENDER PERSPECTIVE

Report submitted to: TLT, The Association of  
Chartered Certified Accountants, Transpire and  
Practice

February 2018

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Word cloud created from data collected during interviews

## EXECUTIVE SUMMARY

### Background to the report:

The role and value of NEDs is well defined within listed companies but little is known about NEDs in the SME market. Given the importance of SMEs to the economy and the need to support their growth and development, TLT, ACCA, Transpire and Practice commissioned this report to address the following six key factors relating to the value of NEDs in SMEs:

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

### Methodology:

The project was conducted in two stages:

1. An extensive review of the literature on the use of NEDs in SMEs covering the challenges affecting NEDs' value addition to SMEs
2. In-depth interviews with eleven NEDs and nine Executives across 14 SMEs.

### Key findings

- **What is the need for NEDs in the SME market?**  
The research established that there is a great need for NEDs in the SME market to provide required skills, experience gaps and a constructive, independent perspective that aids strategic decision-making. Interviews with Executives showed that decisions to recruit NEDs are largely driven either by investors' requirements or Executives' desire to bring about positive change (often growth) for the company. The research also showed that at present, a lack of knowledge about NEDs, lack of access to key NED networks and limited resources amongst SMEs is limiting the ways in which SMEs utilise NEDs.
- **What is the recruitment process for NEDs and who determines who is hired?**  
The research demonstrates that the recruitment of NEDs is usually an informal process where NEDs are either recommended or sought through Executives' own networks. There is some evidence of the use of formal recruitment agents but this is currently limited in the SME market. The interviews further revealed a high level of informality in contractual arrangements, hiring and evaluation processes.
- **How are NEDs integrated into the board/company, for example, through networking, mentoring and induction programmes?**  
The research found very little evidence that NEDs were supported by SMEs through formalised networking, mentoring, training or induction programmes. The expectation of Executives was largely that NEDs are bringing the expertise and looking after their own training needs. Many NEDs also felt that asking for support from SMEs may compromise their expert image and often look to their

external networks to fill their skills gap to perform their roles. Induction for new NEDs is rarely completed and when they are, these are confined to signposting NEDs to where they could get information about the company.

- **What does a NED role entail in an SME?**

The role of NEDs in the researched SMEs was usually informally defined and evolving. As such, the role was often focussed on the particular experience and expertise that a NED could bring and their ability to constructively challenge and steer strategic decision-making in the company. Many Executives expressed a desire for NEDs that can demonstrate passion, enthusiasm and business knowledge, who have been involved and instrumental in corporate strategic development in their previous roles and can therefore support SMEs' own strategic development journey. The research revealed that Executives want NEDs that can provide original alternative perspectives, a sounding board and a flexible attitude that not only accommodate formal meetings, but is also available for informal advice outside such meetings. This was considered to be adding real value to SMEs.

- **What are the challenges for NEDs and their organisations?**

The research revealed that although the interviewed NEDs thoroughly enjoying their roles, this was not without its challenges (and some of these are quite formidable). They centre on corporate fit and embeddedness of NEDs into the culture of the SMEs. Some NEDs expressed this in terms of handling conflict and others referred to it as dealing with organisational politics. These challenges are further complicated because NEDs have to recognise appropriate boundaries in terms of their roles and responsibilities and knowing when to 'let go', recognising that they are not in control and should not be making the final decision for the SME. The volume of work and the time commitment also featured in the views of NEDs as challenges of the role. On the other hand, Executives' perspective on SMEs' challenges focused on limited resources, increasing global competition and layers of regulations and how to grow the business in the context of an increasingly tough operating environment for which the NEDs seemed to be a crucial part of the solution.

- **What are the terms of engagement in relation to NEDs?**

The research has demonstrated the great informality with which SMEs engage with NEDs. This informality cuts across the various key stages in their interactions. The research revealed a number of factors that account for this level of informality, including the limited resources that SMEs have, the lack of awareness about the scope of support and areas of expertise that NEDs can bring to bear on SMEs, all reflecting the relative infancy of the use of NEDs in the SME market.

## RECOMMENDATIONS

The SMEs interviewed universally see the benefits of having a NED on the board and recognise their importance in terms of bringing an alternative perspective to the business, opening up new opportunities, acting as a sounding board and being a critical friend, eventually becoming an integral part of a more formalised governance structure/process. Based on the findings from our research, we provide the following recommendations for the various stakeholders in the interactions between NEDs and SMEs. These include SMEs, NEDs, Training Providers and Professional Advisers involved in these interactions.

- It is recommended that subject to the adoption of the recommendation immediately below, those involved in recruiting and training NEDs consider an organised and targeted marketing campaign, advising SMEs about the potential value of working with a NED, supported by the evidence presented in this report.
- It is recommended that the recruiters and trainers work with a selection of SMEs and NEDs to identify and map the trigger points for the stepped changes that occur, as the SME/NED relationship moves increasingly towards a more formalised governance role. This would build upon the current research findings and require close collaboration between the critical parties to this process, to establish the transitioning stages and timing for what an SME should be looking for from its NEDs, as the business grows and becomes more complex. This should be clearly understood before the further recommendations in the report can be fully and appropriately implemented.
- It is recommended that SMEs appoint professional head-hunters and/or NED training providers, to find their NEDs, working with a formal job description. This should reflect the SMEs stage of development and the emphasis of its requirements (e.g. helping the growth of the business or improving formal control/governance).
- In the circumstances, we would recommend that the recruiters and trainers work with selected SMEs and NEDs to develop a 'low cost', standardised recruitment process, with the requisite accompanying documentation (based upon the existing on-line models currently in operation in the Executive recruitment market). This would enable SMEs to access a wider talent pool and address some of the issues associated with informality, referred to in the recommendation above.
- It is recommended that a performance appraisal process be utilised by SMEs, to validate the value added and confirm that the skills and orientation of the NED match with the position of the SME on its growth/development curve, particularly in relation to an increasing requirement for improved governance/control.

- It is recommended that training be delivered in a more targeted manner, with responsibility for acquiring/funding that training being split according to the following criteria, with a focus on two key groups:

**Aspiring/first time NEDs**, who should accept responsibility for securing/funding what the NED recruiters and trainers identify to be the base level of training required to be a NED.

**Established NEDs** should receive training funded by the SME they support, to enable them to transition their role as that business grows/develops/formalizes and ultimately enable the SME to determine whether or not a new/replacement NED is required.

- It is recommended that the NED recruiters and trainers develop and distribute material to enable SMEs to see the value of gender diversity from both business and recruitment option perspectives. To address the issue of the dearth of female NEDs, it is recommended that these recruiters and trainers pro-actively encourage female Executives (through a 'What About You' programme) to become NEDs, possibly linked to the offer of basic training at a discounted cost.

### Future Research

In relation to future research, this could address three key areas:

1. The development of a NED skill requirement indicator toolkit for potential NEDs. It would be useful to carry out broader research that seeks to identify the core skills that a potential NED should have. This is different from their duties or values, but factors that enhance the delivery of value when they get into post and something they can develop before getting into post. This should be of immense benefit to both individuals seeking NED roles and those already in existing NED roles. It may also be a useful guide for listed companies. Identifying the specific skills required for this important role will be extremely useful to the individual but also importantly to the firms taking them on. This would be a useful next step in the research process and for training providers. A toolkit would enable individuals to benchmark themselves.
2. NED value added indicator toolkits for potential SMEs. This could be used to identify NEDs value addition to organisations, including SMEs. Whilst the current study uncovered that NEDs add value and suggest that these are in the area of strategic development amongst other, this is generic and SMEs may want something specific and concrete. A study that helps to identify in what spheres of operations and the nature of the value NEDs add to firms will be useful. This will extend one of our recommendation in which SMEs are required to do a NEDs need analysis and can compare their need with NED performance post appointment. A toolkit therefore provides a structured way of doing this.

3. A further, larger, qualitative study comparing the roles of NEDs in listed companies and SMEs, including a gender analysis. Many of the initiatives borne from the Davies Report (2015)<sup>1</sup> and applied in FTSE companies could also assist in increasing the numbers of female NEDs in SMEs.

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<sup>1</sup> See Appendix 2



## INTRODUCTION

This research was commissioned by four organisations, interested in the value, role, experiences and demand for, Non-Executive Directors (NEDs) in Small and Medium Size Enterprises (SMEs). The four organisations are:

- **TLT – Lead Sponsor** (Andrew Webber, Partner) a national law firm with a strong track record of growth with a focus on supporting growing businesses.
- **The Association of Chartered Certified Accountants (ACCA)** (Jo Iwasaki, Head of Corporate Governance, Professional Insights) a global professional accounting body offering the Chartered Certified Accountant qualification.
- **Transpire** (Tony Stubbs, Chief Executive) formed to meet the needs of senior Executives and high achievers in the public, private or third sectors in a carefully tailored and coherent package of advice, training and networking to smooth the transition from a high level Executive career to a Non-Executive portfolio, and to offer on-going support.
- **Practice** (Alice Chapman, Non-Executive Director, Leadership Coach and Consultant) which provides Non-Executive Director, consultancy and training services to privately run, entrepreneurial businesses.

### Project aims and objectives

The research was based upon six research objectives:

1. What is the need for NEDs in the SME market?
2. What is the recruitment process for NEDs and who determines who is hired?
3. How are NEDs integrated into the board/company, for example, through networking, mentoring, and induction programmes?
4. What does a NED role entail in an SME?
5. What are the challenges for NEDs and their organisations?
6. What are the terms of engagement in relation to NEDs?

### Project methodology

The project duration was three months (September to December, 2017) and involved 14 businesses, where a total number of twenty, semi-structured, face-to-face or telephone interviews were conducted with eleven NEDs and nine Executives in SMEs. Interviews lasted approximately one hour and were recorded, transcribed verbatim, and then analysed by the UWE team.

We would like to thank all the NEDs and Executives who so kindly gave their time and valuable insights to this project. Without their support, the project would not have been possible.

## Demographics and career background

### Non-Executive Directors (NEDs)

Eleven NEDs were interviewed (five female and six male.) Please see Appendix 1 for further information on the NED profiles.

The majority (8/11) had a background in financial services. The next most common sector mentioned was IT/digital (5/11) in which some described as being involved in technology start-ups. Other sectoral experience included: travel, publishing, science, property, and retail. Two of the sample described a portfolio career, which had included experiences across a range of sectors. There was a broad range of functional experience, including marketing, administration, academia, HR, and coaching/mentoring. Only one described their current status as retired. All but one of the NEDs interviewed had held senior leadership positions during their careers. These were at board level either in large national or global organisations, or as CEO/MD in successful entrepreneurial businesses they started themselves and then sold. When asked how many boards they were on as a NED currently, all but two stated they were on multiple boards (between two and six). One (G/H) stated he was on seven-eight boards as a NED at the time of interview.

### Executives

The Executive sample comprised nine interviewees (four female and five male). Please refer to Appendix 1 for further information on the Executive profiles.

The SMEs represented a mix of business sectors: manufacturing, marketing and communications, catering, consultancy, and IT. One was a family-owned business with 120 employees, another had 40 employees, and the rest were micro businesses with 10 or less employees. Three of the SMEs had a single NED, two others had two NEDs. One business had four advisory board members performing the role of NEDs but without the formalised legal implications; another also described their NED's role as advisory, and one SME had two NEDs, both of whom represented the business investors.

In two cases, the role of Company Chair was performed by a NED.

## FINDINGS

The interviews with eleven NEDs (five women and six men) explored a number of themes: the role of a NED, how and why they had become a NED, the challenges associated with being a NED, any support received from SMEs; and the value NEDs add to SMEs. We also asked what advice the NED would offer to an aspiring NED and to an SME looking for a NED.

In this section, we present, in detail, the views, experiences and perceptions of NEDs and where appropriate, highlight differences in responses across male and female NEDs. This is followed by an analysis of the role and value of NEDs from the SME/Executive perspective. Finally, we explore the gender dimension of being a NED through firstly exploring why NEDs and Executives believe women are so poorly represented amongst the NED population and what can be done to help resolve this; and by asking Executives whether they perceived a difference in the value and performance of NEDs according to their gender.

### NED Perspective

#### The role of a NED: Knowledge and skills

It was important to gain an understanding of the NED role from the perspectives of the NEDs themselves, specifically because we were researching their role in the SME market, where relatively little is known about NEDs. We also wanted to know more about the knowledge and skills NEDs brought to the role. These included, experience of the type of business, operational/sectoral experience, listening skills, objectivity, the ability to challenge, preparation for meetings, diversity of thinking, a focus on long-term goals and strategy, and the use of their personal networks.

There was a general consensus amongst interviewees that the NED role was to bring an independent perspective and to introduce a different way of thinking to the boardroom. It was felt that NEDs were in a unique position to both support and challenge the company, with frequent mention of their role as a 'critical friend', acting as a sounding board and as a mentor for senior leadership. They also brought their external experience to the role and tended to be 'disentangled from the business', denoting their independent status.

There was a collective view that the NED role was strategic rather than operational; NEDs should constructively question and help management determine the company's strategy and ensure it achieves its objectives. NED A commented:

"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." [NED A, Male]

NED A also felt that in a family business, the NED needed some experience of working with this type of business because there were other influences on the business which the NED needed to try to understand and take time to learn.

For NEDs B and C, it was about a combination of supporting and challenging the board, becoming a 'critical friend' and concentrating on strategy:

"So it's not actually hands on. So it's not doing what you are doing as an exec ... roll your sleeves up and get stuck in. It's very much around advising, steering, guiding, challenging whether it be the strategy or whatever the elements are around that business to make sure the business is achieving the objective it set out to do. So it's very much for the company, to make sure the company is doing what it set out to do." [NED B, Female]

"It's less about management reporting back saying this is what we have done last month and more about these are our strategic goals and how are we progressing towards it and can we do something to make it better or correct or accelerate some of the targets we have got." [NED C, Female]

NED E explained the role was about both being a critical friend of the business but also acting as a 'sounding board' and offering reassurance to the board that they were heading in the right direction. NED K felt that he was well placed to 'ask the silly questions' that only an outsider could ask and to challenge and hold the board to task.

Some specifically commented that NEDs were able to draw on the wealth of their own corporate career experience and networks and could provide expert advice to fill any discipline or skills gaps:

"I mean, from my background I can also bring the financial discipline as well, as a Chartered Accountant, which some businesses have, some don't." [NED A, Male]

"I would say its part counsellor, part provider of contacts and a black book." [NED J, Female]

"I understood retail, I understood customers. So in terms of knowledge I had a lot of time at [chain of department stores] so I knew what people did when they went into the shops ... So my knowledge of retail and marketing are very high ... And in terms of skills I suppose it's my job with [CEO] to structure the company in such a way everybody was clear what they were doing, the accounts quite clearly reflected which bits worked and which bits didn't." [NED L, Male]

“For me, in this role, they seem interested in the fact that I have a finance background and an SME management role that I have as well and also combined with the HR strategic view. It’s all of that kind of hands on knowledge and the skills they are interested in is the strategic side of things. The influencing and relationship side of things that can help make things happen without having to do them yourself.” [NED N, Female]

Corporate governance was also mentioned by two interviewees. NED C felt it was about having an independent watch over the company but importantly, corporate governance aligned with culture and professionalism on the board.

Two interviewees remarked that a NED should be actively engaged with the business, making reference to ‘traditional’ NEDS, who in the past might not have shown much commitment to the role further than attending board meetings. NED E felt that that NEDs now had the same obligations and commitments as a director, which the NED should take extremely seriously.

“...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’s 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.” [NED E, Male]

The need to be objective was a key skill for NED D, alongside listening skills and handling difficult conversations. NED E pointed to focusing on the longer term goals, being a critical friend and acting as a sounding board. Being a good listener was also important for NED J, alongside a broad understanding of the SME market.

The ability to challenge was a necessary skill identified by NEDs. Interviewees were asked if they had any involvement in decision making and whether they felt comfortable doing so. Some had described their role as strategic, rather than operational and the requirement for a NED to remain neutral. However, NED C suggested there were particular instances when she might intervene, but stressed the final decision was not hers:

“The only time I would step in is when I think there is too much turnover at senior level and then there is an issue maybe, the CEO doesn’t know how to manage people, in which case we need to put in place something to help the CEO to manage people, like coaching or something like that ... So you give your feedback and you give your demands, like I would like a report on this or I would like a report on that ... Or if I feel that, for example, they drop too many plates you kind of need an audit function, internal audit so you suggest that they should hire an internal auditor. So you can influence but you don’t decide, you don’t sign off.” [NED C, Female]

In a similar vein, NED J also felt he was able to challenge, but reiterated the NED role was to advise rather than make decisions:

“Yeah. It’s not my decision, but ultimately it’s not my decision, but I do to some extent, yeah I do have a say. If I say look you don’t need to do this, you can do it like that then the chances are they will go, yeah actually you are right.” [NED J, Male]

Three NEDs (A, C and N) felt that challenging the board was part of their remit and that they felt confident their views would be noted. NED A said she felt ‘entirely comfortable’ challenging board decisions; NED C felt she had an obligation to ensure any of her concerns were addressed; and NED N felt supported to speak out and that she worked with a respectful group of people who encouraged this.

Sometimes, challenging a board decision may prove awkward for the NED, but there was no indication this would influence whether a concern would be raised, or a confrontation avoided, just that tact and diplomacy were necessary and that sometimes the NED was best placed to arbitrate. NED C had objected to the appointment of a NED through informal (networking) rather than a formal process, which she insisted went on record in the board minutes. NED D had experienced some uncomfortable moments with investors who were having financial difficulties, which meant them having to face up to some realities.

NED E explained how he dealt with the difficult conversations:

“A couple of times I have had to. I try not to get into that challenging, oh my God, face to face and all the rest of it. How I try to operate anyway is by just pointing out the sense and let’s just understand the situation we are in and often the sensible course of action is obvious. A couple of times people have just got so entrenched that they won’t back down even though it’s obviously they have done the wrong thing. But part of the NED role, you don’t need to rub people’s nose in it...” [NED E, Male]

NED G/H felt that challenging can be difficult in a family business:

“And you are just meat in the sandwich. I am sure there are some lovely family businesses, but I have never met one. I have worked for two and I just found both a painful experience.” [NED G/H, Male]

When asked how they might resolve any contentious issues in board deliberations, the preferred strategy was to sit down and have a discussion.

The role was summed up nicely by NED N:

“It’s just about providing guidance to the existing Executive team. Bringing in a broader view and a broader experience than they may have between them currently and asking those kinds of questions that might stimulate them to think differently about how they might run the organisation or the way they are running the organisation. But very supportive. A very kind of supportive, challenging way to help the organisation achieve what its aims are.” [NED N, Female]

In summary, the role of a NED in an SME is to bring some unique value to the board as independent advisor, who both complements the SME’s existing skills and brings in new skills and experience. Access to the NEDs networks is seen as important, as is constructively challenging decisions, with a specific duty to steer the business to achieve its strategic objectives. The role of a NED in an SME is not that different to that of a NED in larger companies, in that they provide an independent viewpoint on issues of strategy and corporate governance and provide skills, expertise and alternative perspectives<sup>2</sup>.

#### NED recruitment

We then asked the NEDs how they had been recruited into the role. We were especially interested in whether this was via formal (i.e. head-hunter or recruitment agency) or informal (i.e. personal and business networks) recruitment. This is again important because we know relatively little about the SME/NED market and wanted to understand the recruitment routes for future reference.

Being directly approached or utilising connections with networks were the two most popular routes to a NED role. Three (male) interviewees described how they had been approached for their particular expertise and also through their existing networks:

“The very first [NED role] I got was actually being approached by a firm of accountants because the particular business was in financial difficulty. They needed to achieve the sale of part of the business quickly in order to survive and the bank was on their back... So I was approached and in effect almost imposed on the business at that point to achieve an outcome... The second appointment I had was again with a private company. They had just gone through a management buyout; again I have got loads of experience. I was approached. I am not quite sure where they got my name from actually...” [NED A, Male]

“It’s usually networks. They wouldn’t have heard of me but they know somebody who has worked with me. I think the network is absolutely the key to this kind of stuff.” [NED G/H, Male]

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<sup>2</sup> See Appendix 2: Cadbury (2002) and Waldron and Burman (2007)

Other interviewees had made a conscious decision to reconnect and build on their networks and one to register with head-hunters, with the express aim of becoming a NED:

“I decided to [become a NED] and then because I decided to do it I suppose I started to reach out to people I knew. So part of what I was told was actually a lot of these come through your network rather than just sending a CV in blind. So I started down that road of reconnecting with all my network and that’s how it came about, through the network and talking to people and somebody saying actually I am looking for a non-exec, let’s have a discussion and it sort of went from there.” [NED B, Female]

“So first of all I had done my credit check, did they think this was the right role for me and then having done it then networked with private equity and capitalists, banks, lawyers and all of a sudden people like X, and a head-hunter, and all of a sudden they started to come my way. So I do regard networking as a serious illness of mine. But once you get your name out there... The head-hunters were there but more as a bit of a sounding board... I would say mainly networks and I built all the networks myself.” [NED L, Male]

NED I, who at the time of interview was ‘running down his working commitments’, recalled the time he spent building his network at the start which had since resulted in unsolicited invitations to join boards. He described how he did ‘rounds of endless coffee mornings with VCs and corporate finance advisors’. NED K had also received invitations, which he would often turn down due to other NED commitments. He was asked to recommend others from his own network.

This was echoed by NED K:

“Sometimes they know my point of view and they sidle up to me and ask me questions like, do you know anybody who would be a good chair for us ... So I get those kind of approaches regularly ... They are quite often founding CEOs or a few of them have been from investors.” [NED K, Male]

The significance of head-hunters was emphasised by just one female NED, perhaps highlighting her lack of access to ‘the club’. She felt head-hunters were important especially for women whom she felt would only get onto boards that had a ‘diversity of thinking’. These were the boards where women stood more of a chance and had better corporate governance and thus would use head-hunters to open up the recruitment process.

Recruitment was mostly an informal process through networks and invitation via personal connections. This indicates the importance of building and establishing networks, both during an executive career and whilst undertaking a NED role.

Men utilised their networks, women to a lesser extent, by being approached or connecting with those networks. Informal networks should, therefore, not be under-



estimated when considering NED recruitment, although this poses a problem of diversity if those networks are mostly white, male and middle class. This informal mechanism for recruitment is echoed in the context section in Appendix 2<sup>3</sup>.

Interviewees were asked how they had prepared for their role as a NED and what had helped them most. Two female interviewees (NEDs B and N) mentioned specific workshops they had attended, one with *NEDonBoard*, the other with *Women on Boards*. These comprised talks about understanding the role of a NED and how to compile a NED CV.

NED N went on to say that she drew on the experience of her network of NEDs along with her own consultancy background, especially as her networks included a number of NEDs.

Having previous boardroom or executive experience was also evident in many other participants' accounts:

"I think from the background I had it wasn't a particularly difficult transition because I had sort of attended so many board meetings and seen so many other NEDs in action. So it was possibly easier for me than for a number of people just because of the sort of experience I had. So I pretty much knew what to expect and it's turned out pretty much the way that I had expected it to." [NED A, Male]

"So what helped me most? I guess just executive experience. So I can pull from ... because I have had a varied experience. I mean strategy is in my DNA. ...by working for [Global Management Consultant] for four years, it developed that particular way of thinking and that particular way of breaking down problems and coming up with solutions." [NED C, Female]

Others (NEDs D, E, J and N) felt preparation was through exposure to lots of different businesses in the past, enjoying success in a number of similar activities, longevity of board experience, coupled with finance experience and having credibility based on prior experience.

Few NEDs had attended any formal training prior to taking up a NED role and most cited their own past experience at board or executive level as the best preparation for the role.

The reasons NEDs felt they had been appointed were specific for each SME and included particular experience with a similar type of organisation, sectoral or functional expertise, or a requirement as an investor. One NED (A) was appointed due to having experience working with family businesses; another (NED C) because she had client experience, had worked in the 'digital' industry and had a good contact list (network). NED J summed up the reasons why she had been appointed:

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<sup>3</sup> See Appendix 2: Coulson Thomas (2007)

“I think X has had businesses for a long time that kind of trotted along but has never really fulfilled their potential... X said it’s kind of OK but it’s just not really, there is something I am not doing right or there is something that I am missing the point on or there is something, whatever it I am just, it’s just not growing like I want it to and I can’t see what it is that’s not happening. So it really was my commercial experience that X wanted.” [NED J, Female]

### Remuneration and job descriptions

We also asked interviewees whether they were remunerated for the role and/or received any other benefits. If SMEs are going to consider recruiting a NED, it is important they understand the cost implications associated with this.

Most interviewees talked about charging a daily rate or a set fee, but this was mainly seen as a nominal amount in order not to be seen as ‘working for free’. NED C was paid around £1,000 per day, which she felt was a ‘bargain for someone of my seniority’. She also appreciated having the regular income and ‘not being at risk of a gender pay gap’.

Only one NED (L) talked of taking a salary commensurate to the position. He claimed to know ‘the going rate’ for a standalone NED or NED Chair and was able to position himself appropriately. He viewed the role of a NED as a professional job and felt he should be paid properly for the role. He would not sign up for a role paying less than £30,000 per annum.

Three other NEDs (C, D and K) were ‘nominally’ paid. One said there had been no discussion about remuneration and that she charged a management fee (around £1,000 per month); another (K) said that his was a ‘token payment, partly because he concentrated on early stage companies who do not have a great deal of money. He felt he put in more time than he was paid to do so. NED N talked about a ‘nominal amount’ for the varied role she performed, which included attending board meetings and events, being an advocate for the organisation and visiting other parts of the business.

Others were remunerated through shares or equity. NED B received shares and NED I, equity. There were also some examples of negotiations for share options based on achieved improvement in profitability, to which the NED would, in part, have contributed.

The NED role itself tended not to be too formally determined, i.e. most said that they had no formal job description. NED E acknowledged that in larger organisations, the NED role would be more clearly defined but that this was not the case in an SME. NED N had never been given a job description; her selection had been based on the approval of the Chief Executive.

Some were given a generic job description on appointment (NEDs A and C) but this did not necessarily reflect the role they fulfilled, especially as the business grew and

its needs changed. NED A had a standard NED job description which had been formulated from one of the management institutes as a template.

In some cases, the NED was originally approached or invited to join the board based on their particular expertise or experience, and here it was common for the job description to be co-written. NED A was not given a specific set of objectives but after a couple of months on the board he wrote a paper with his first impressions about what he felt he could contribute. NED B said it was more a case of discussing her experience and where they wanted to take the company, which she felt made it a 'joint affair'. NED G/H got together with the board and 'worked out where the operational guy had his weaknesses', which effectively became the unwritten job description. NED I was a NED with a start-up and the majority of his role with the company was based upon what he has done before with other companies. NED J, upon starting with the SME, clarified what they wanted and what she could provide, which enabled them to set some ground rules.

Regarding contracts, again most were informal. The majority of interviewees had an expected commitment of two days per month (24 days a year) to prepare for and attend board meetings, but this was often viewed flexibly by both sides, with additional time given by the NEDs as required, for example, when problems or opportunities arose, for mentoring, for particular projects, etc. Whilst there was often no set length of appointment, five of the NEDs interviewed described having a rolling contract which lasted between three to five years. They all reported to the CEO, board and/or shareholders.

#### Why a NED and why in an SME?

We asked interviewees why they decided to become a NED and why specifically in an SME. This enabled us to understand the motivations of NEDs to work in the SME market and could help with future recruitment.

One interviewee (NED A) had sold a profitable business but felt he was too young to retire so he looked at it as an opportunity to address work/life balance issues. He felt the NED role enabled him to manage his own time, which included working from home.

Others saw it as an opportunity for a new career direction or as a natural progression from a mentorship role. NED B had met an ex-client/colleague who had a portfolio career and she felt this was what she wanted to do next. NED C had always wanted to become a NED and felt that her experience of mentoring start-ups would stand her in good stead.

The NEDs had made a particular decision to join an SME board. Their reasons varied, but overall, it was the ability to see that their involvement was making ‘a real difference’:

“Well for me it’s the ownership structure I find it interesting. You know, an SME is often very similar to private equity and so the decisions are a bit different, the problems are less hairy, they don’t have any regulation yet, you know, you can get quite close to the executive teams, it’s quite fun. You can actually, the smaller the company the bigger the impact you can have so that’s also quite fulfilling.”  
[NED C, Female]

“...because with SMEs you can see things happen and change quite quickly and you can effect change. Now maybe that means I am not effectual at a high level, I don’t know, but SMEs you can actually get things done quicker.” [NED E, Male]

Three interviewees, who had worked for global corporations or large FTSE 100 companies during their careers, disclosed their preference to take up a NED role in an SME was influenced by the frustrations of that experience. NED G/H specifically felt he could not make a ‘real difference’ in a large corporate company but that he could in an SME.

Others (i.e. NEDs E and K) had ‘a pet hate of office politics’ which they felt could be ‘cut through quickly in an SME’; and that bigger companies tended to be too bureaucratic. They felt it was more fun to work with an SME, where they could help the company to grow and develop.

The need for NEDs in SMEs was very clear amongst interviewees. Unlike larger organisations in the UK, it is not currently a legal requirement for SMEs to recruit NEDs onto the board. However, there was general agreement that there was a definite need for such appointments for various reasons, for example, the independent viewpoint which was raised as a key role of the NED:

“I think a lot of business whether they are family businesses or non-family businesses could benefit from an independent viewpoint, somebody who asks the questions that maybe others won’t because maybe they think they are stupid, or just don’t have the experience of other businesses to ask. So I think a lot of smaller businesses would benefit from having a Non-Executive or an independent director, call them what you like.” [NED A, Male]

SMEs have limited resources to access knowledge and experience outside of their individual speciality, and some of these gaps can be filled through the appointment of a NED, particularly during the early development of a business.

Most NEDs felt SMEs would benefit (relatively cheaply) from the knowledge, experience and strategic advice that they could provide as a NED. NED B said that in her experience, small businesses may not have everything established, such as governance, processes, procedures or a strategy. There would be a lot involved in

getting the business going, and ‘some of the basics may not be in place’. She felt that part of the NED role was to ensure the governance was there, at least at a base level, and to act as a mentor with experience of the SME market. The ‘extra bit of support’ and looking more strategically at the business, was why NED D felt SMEs needed NEDs.

Looking after the shareholder was important for NED I, through good governance and working ethically and within the law. Most SMEs may not have been on this journey before and may not have a complete management team. This was where the NED could add their experience and expertise, to help the SME along that journey.

NED J felt there was a ‘huge need’ for NEDs in the SME market in order to fill the skills and expertise gap in the company. NED L felt that CEOs and MDs of SMEs in particular needed to talk to somebody who had relevant experience in the sector:

“The point is, a lot of the people in SMEs haven’t necessarily had either the proper education, proper training or exposure to bigger companies that do it properly and you can’t read a book on that.” [NED L, Male]

This was echoed by NED N, who felt that SMEs do not have the breadth of experience of other organisations, nor the specialist functions that they need to make the right business decisions. NED K also felt there was a real need:

“Well there is real need, so look at what’s really needed. Have people around these early stage companies that can help them grow and build good companies. That’s the key thing. You need to have the team around the team that helps companies sail. Quite a lot of the entrepreneurs are quite technically, they don’t really know much about the rest of it and you can build around them and build good companies. That’s the thing, whether they are NEDs or Chairs or Executives it doesn’t really matter it’s about building and scaling companies, that’s the fun bit for me.” [NED K, Male]

The NEDs interviewed evidently enjoyed working with SMEs for a number of reasons and we wanted to understand further what they most and least enjoyed about the NED role, the latter in relation to what they perceived to be the challenges of the role.

#### What NEDs most enjoy about the role

NEDs K and A particularly enjoyed seeing the people and business develop. NED K described why this was the case:

“Over many years you see people who at the beginning were really out of their depth and are now excelling. Excelling in the business but also as people, they have learnt so much. For me you help the people grow, you help the company grow. That’s the biggest attraction, to look back and see. You see them develop, see them grow, see them being better leaders and better business people, that’s

the best for me.” [NED K, Male]

Seeing the business succeed and grow was also most enjoyable for NED J, who also enjoyed coaching Executives and watching them go on to succeed. Being part of an organisation doing ‘amazing work’ and having an impact on the business was most enjoyable for NED N. She felt that as a NED she could focus on specifics, rather than the day to day aspects of the business.

For NED I, enjoyment was gained through his ability to work with the board to set up the business strategy:

“I like the strategising part of it as well particular things that are just there and haven’t really done that before or their planning and so on, it’s really been a bit detached from what they actually do... I like to really work at getting the strategy down into its fundamentals and then really, to use the phrase, holding it to account or taking the agreed actions... So I like that continuum of working to set up what the strategy is. Part of my job is to see that they are doing whatever it is to deal with the underlying issue as well as the symptom and to be moving things forward in the way that they have said they want to. Not me imposing that on them, it’s what they said they wanted to do.” [NED I, Male]

NED B and C also enjoyed the strategic aspect of their NED roles. NED C particularly liked the opportunity to be strategic on a regular basis, without having to be ‘bogged down in all the detail of the business’. She also liked the flexibility of a NED role, learning about a new business, not being embroiled in politics and the regular income she received from the role. NED B commented on how she liked the opportunity to be strategic by taking the ‘helicopter view’:

“I think it’s really, I would say, this is my personality, I am a very strategic in my approach on things. So being a sort of helicopter I suppose, it’s quite easy to start to see and I guess it’s part of my consulting bit, but you start to see things over the horizon or maybe challenges before they have seen the challenges, that sort of thing. You know, in this scenario this could happen, have you thought about that.” [NED B, Female]

Connected to this, others talked about how they enjoyed seeing the ‘end result’; NED L described the importance of being clear in his own mind why he was there and when it was time for him to move on. He felt that NEDs ‘should not hang around past their sell by date when they no longer add value’. This point was also picked up by NED E who talked about the problems of ‘career NEDs’ whom he felt were not really there to make the business succeed. He most enjoyed seeing the company work and its ultimate success.

The variety of the NED role, interacting with people and being part of a team were the most enjoyable aspect of the NED role for NED D, who also felt she had a ‘proper insight’ into what was happening in the business at each stage.

In summary, male and female interviewees most enjoyed having a hand in the growth and success of the business and its people. The opportunity to be strategic was also important for some, especially the ability to take the 'helicopter view' and not to get drawn into the detail of the business. The end result of the business was important to all interviewees.

#### What NEDs least enjoy about the role

In terms of what interviewees least enjoyed about their NED role and found to be challenging, two male NED interviewees pointed to the potential for and their experiences of conflict as the least enjoyable elements. NED A commented that while he believed that some people thrived on conflict, this was not his style and that he had 'learnt to deal with it'. NED L least enjoyed the 'politics', dysfunctional boards and 'back biting/defamatory remarks', which he felt could potentially 'destroy boards'. While he had not experienced these kinds of behaviours personally, he had observed it amongst Executives in a number of NED Chair/NED roles he had held.

The responsibility of the role was a challenge for NED K:

"...You have a lot of responsibility on your hands. Not just those you are chair of, but even as a non-exec director, you have the responsibility to do the right thing and unless you are really thinking about it and taking it seriously you are not really doing your duty. Sometimes I may be anxious about the decisions I push forward and making the company do, am I doing the right thing. There is a big responsibility there." [NED K, Male]

A lack of control was in issue for several NEDs (E, B and J). NED E missed the opportunity to be 'hands-on'; for another (NED J) there were certain things she would do differently but she had to accept that it was not her business; for NED B, it was more about being in a temporary role and not having control over the final outcomes.

Volume of work and the time commitment were the least enjoyable aspects for NEDs D and C. NED C also commented on the time commitment involved, lack of social contact with staff, the amount of liability associated with the role and the small amount of money awarded for the role.

In summary, while the potential for and actual conflict amongst Executives, was identified by two male NEDs, this was not raised by any of the female NEDs, who were more concerned about a lack of control over key decisions and the responsibilities associated with the role (the latter also being raised by one of the male NEDs). Challenges identified in the context section (Appendix 2) included issues of trust between the board and the NED<sup>4</sup>, but this was not a concern for the NEDs interviewed for this study.

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<sup>4</sup> See Appendix 2: Coulson-Thomas (2007)

In the next section, we move on to explore sources of support that were available to NEDs via the SMEs, both during their initial appointment and their on-going NED role. The above quite clearly demonstrates that these are a group of experienced, qualified and competent people who, due to the experience they already have, plainly did not require a great deal of support.

#### Sources of support: Induction

The first area we explored was induction - when the NED initially joined the board of an SME. This can be an important way to introduce and culturally integrate individuals onto boards and for the NED to get to know more about the business itself. Half of the NEDs interviewed had been informally inducted, while the other half had not.

For those who had undergone informal induction, this was mainly in relation to understanding the business and getting to know employees. NED A spent a week visiting different parts of the business talking to people, seeing how they worked, what they did and trying to understand the business. Alongside being shown around the business, NED E was also given background information, accounts and some industry data to analyse. He was also introduced to key members of the team at director level and below. He was conscious that he needed to know enough about the sector in order to operate efficiently but was also careful not to become overwhelmed by the information he was given. NED B received an update about the business and also spoke to people individually. NED C described her induction very succinctly:

“So I met all the directors and then I met their reports and the various areas of the business. So it was very much driven by them. You know it continues because they put on particular events they invite us to go and see those so that we can, the clients sometimes, so yeah.” [NED C, female]

NED L described how he had been pro-active in telling the boards he joined what he wanted from his induction, which included, meeting people in key positions and spending some time ‘looking at the numbers’, sales and marketing. He explained:

“I don’t see how you can do the job unless you do it [induction]. To be fair, I know what my skill set is and they may not know. I know what I don’t know if that makes sense...What’s the culture like? What’s the motivation like? So I drive my own induction.” [NED L, Male]

The remainder had not undergone induction. NED K thought this was a ‘nice idea’ but that he had never been inducted onto a board. For NED I, instead of induction he had worked with the Vice-Chair to evaluate and carry out due diligence. NED N had undergone a process, which she described as being ‘more informal’ in that she had learnt from the experiences of the current Executives who had backgrounds in the sector. NED J explained how she had ‘inducted herself’ by asking for access to information and turning up at events where she could talk to clients.



### Sources of support: training

Training can also be an important element of induction as well as an on-going mechanism for NED development. Without exception, none of our NED interviewees had received training upon joining the boards, for a variety of reasons.

For NED G/H, the role was more about drawing upon his role as an Executive before he became an NED. He felt that his career shaped his capabilities as a NED. NED B felt she had a 'good grasp of what is going on' and that most of this was down to practice, being on the board and gaining more opportunities. She felt a lot of it was applying what she already knew and working collegiately with the board.

NED C agreed that previous executive experience was required, rather than NED training. She felt her role was more about adding value and 'keeping the ship steering in the right direction'. She also commented that it was important to draw upon your emotional intelligence and your personal values and to be well prepared to take up the role:

"Now that kind of stuff is not taught, and if you start nit picking on those things then you end up not adding value, just hold the whole thing down and everyone is going to look at you like - what does she want? It is not a classroom scenario, it's a real business and that's not the priority. The priority is to try and deliver a strategy, that's the priority. And that varies by business." [NED C, Female]

While NED I had not undergone 'specific training', he mentioned some events he had attended, for example, at the Institute of Directors. NED E pointed out that small businesses do not often have the resources to offer training. However, he believed that if there was a course he wished to attend, as part of his role, the company would fund this. NED J had attended a NED training course, which she felt was interesting but because she is an experienced Executive, she felt the learning was more appropriate for the more inexperienced NED.

NED N felt it was down to NEDs to organise their own training, especially when working with SMEs:

"It feels to me with all NED roles, my expectation would be, particularly with SMEs, you are expected to do your own training and then seek out those roles rather than seek a NED role and then get trained on the job... I think it would tend to be specialist knowledge for a particular area that the company is operating in." [NED N, Female]

When we asked NED interviewees if they had attended training organised by themselves (rather than by the company) a number indicated that they had done so, specifically in relation to their own self-development and keeping up to date with legislation.

NED K mentioned that he attended training events on the Bribery Act and other legal responsibilities required of a NED, which he viewed as his own self-development.

NED A felt it was ‘incumbent upon him’ to keep up-to-date. He was part of a corporate governance group at the professional body for his industry. He made sure he kept up to date with legislation and tax issues.

NED D was also happy to undertake NED training:

“It would be useful to do because I don’t think, most NEDs kind of got thrown into it and you know, the nature of me is to try and do the best you can but I am sure maybe there are things that maybe quite helpful.... I think I would actually.” [NED D, Female]

NED J had recently organised her own social media training and found Twitter particularly useful at events. NED N summed up the consensus on self-directed training:

“Yeah I would, but I would probably do it off my own back rather than expecting the organisation to pay.” [NED N, Female]

Finally, we asked NED interviewees whether they felt they needed any further support for their NED role from the board.

NED K’s view was that the problems and challenges of his role were so varied that he did not really know how he would go about asking for support. On the other hand, NED A explained that there was a mechanism in place if he felt he needed support and that the company would pay for that as it was written into his contract. He also pointed out the need to be independent as a NED which meant that the support mechanism was often not in place in small companies.

Others did not feel there was a need for an additional support. NED E felt the working relationship between himself and the board worked well and that there had only been a need to ask for small things, such as board papers being made available in sufficient time for meetings. Others said that they were happy to be left to ‘get on with it’ and that the boards were happy for them to do so. They also said they felt supported by the board. NED N pointed out that no additional support had been offered but that the board was very open and supportive.

We also asked NED interviewees whether mentoring or coaching had been offered to them as part of their role. The majority confirmed it had not and that this was something they would look for from their already established networks and contacts, in an informal way. It appears that (informal) networking is the most utilised form of support for the NEDs we interviewed. Networking had been mentioned above by a number of NEDs, especially in relation to their recruitment. But how important were networks as a source of support?

### NEDs and networking: A key source of support

NED A described a number of formal networks he attended in the business community in Bristol (The TLT NED network along with other NED networks, a LinkedIn NED network, the chartered accountants NED network).

He explained why these networks were important:

“They are useful in terms of maintaining contact with other people, you know. I mean a lot of the other guys who are NEDs in Bristol I have come across at one time or another either because I have appointed them when I was at [company] or they were professional advisors I worked with when I was at [company] or you just get to know them one way or another. We tend not to talk in any sort of detail about companies when we get together on the basis that would be breach of confidence. I am happy there are network opportunities there.” [NED A, Male]

NED G/H could see the importance of networking for social reasons as well as getting different viewpoints and interacting with people on an informal basis. NED E saw networking as a way to engage with third parties, wearing his NED hat and helping the company in a number of ways. NED L demonstrated the importance of his networks to the boards onto which he was recruited as a NED:

“In terms of support, my own network is my own support. What I mean by that is, if I go into a SME I have got a massive network list and out of my network list I break everybody down to ABC. And on that list there are experts in particular areas. So I will say to you now if I wanted to know about brand channel marketing I have only got one company under that heading. I have got loads of other companies that can do it but this company I can ring up for free and go and see them and call them in for free. I am not going to pay for anything but if there is something we need to do, tell me what it is.” (NED L, Male)

Interestingly, the female NEDs we interviewed appeared to have less developed networks and made less use of networking as a business activity.

NED J said she did not know where she would find NED networks, apart from the Transpire network which she had attended and had linked up with a couple of people with whom she had met up with outside of the network. She found this useful for finding other specialists and for being aware of what other NED roles were out there. NED D travelled a great deal with her main job but did attend the occasional networking event if she was in the city, although again, she said she was not aware of where and when NED networking events were being held. She also indicated that she preferred mixed gender networks, but that she would refuse to attend a golf day.

### The value of NEDs to SMEs

Finally, we explored the value NEDs believed they added to the SMEs/boards with whom they worked, whether this ‘value’ was formally assessed, and whether they felt valued by the SME. This was a key element of the research project that has not

previously been explored in academic research from both the NED and the SME perspectives.

In relation to the value NEDs believed they added to the boards/companies with whom they worked, NED K explained how he added value by setting his own objectives that are aligned with the long-term future growth of the company and with building a 'good team and a culture of that company':

"So those are the kind of things that I would add value, team building and growing a great company that people want to be part of. That's the dream scenario - have a company that people are having a great time, they are enjoying what they are doing and they are keen, enthusiastic... So I think the value I would measure myself on is, are they really growing and are the people happy?" [NED K, Male]

For NED A, adding value was more about the experience that he brought to the NED role, experience of a business situation that the board of directors had not necessarily had. He gave the example of the introduction of a share scheme, of which the other Executives had no experience. They knew it was something which they wanted to do and NED A offered his expertise and knowledge. He also felt he brought financial discipline to the business, of which some directors had no experience, alongside experience in growing a company from a small to a medium size, which entailed changes in people and business processes and the drawing up of a business plan.

NED G/H felt he could recognise where the value was in a business and what value needed to be present to reach the end goal. His skills lay with being able to quantify assets based on experience and to be able to recognise their worth in the market.

NED I felt he added value, that he was 'not cheap' but was 'good value for money'. He felt he did a good job and expected to be well paid for it. NED E said he found his value difficult to quantify but explained what he felt he brought to the role:

"I think I bring...a value is very difficult, to put your finger on one thing. I think I bring a level of experience and a track record to back that experience up. You need to have a level of credible experience. So credible experience and a critical friend of the business, not afraid to speak your mind..." [NED E, Male]

Female interviewees reported slightly different answers.

For NED B, the governance was where she felt that she added value, especially checking and making sure that some of the basics were there. This could entail ensuring there were robust contracts in place with the clients, the relevant processes and procedures in place and ensuring there was a strategy in place and being followed. She also felt she added value through challenging and being objective. She summed this up:

“So you have got no axe to grind, there are no politics in that respect because you are not part of that company. You are taking stuff on but you are there just to test, if you like, flex the envelope and test out what they are doing, why they are doing it, asking a lot of questions really. Because some of it they will come to the conclusions themselves but a lot of time because people are so busy they just never have time to just stop and sit back and just think or consider something. So it just gives that sort of breathing time to reaffirm and even just connect with some ideas. You know having these discussions can come up with ideas but then, oh right, this is what I want to go and do now because I haven’t really thought about it but now we have had that conversation.” [NED B, Female]

NED D felt she added value through being a reliable source of support for the company and through her insight into other businesses. She felt this was important because smaller businesses do not necessarily have well-developed external networks. NED N felt her value was in the different perspective she brought to the board from the commercial sector, alongside her specialist HR knowledge. NED J brought value through reassurance that the board was ‘doing the right thing’.

The support, advisory and networking roles of NEDs have been identified as a priority for what SMEs expect from their NEDs, alongside their expert knowledge and access to external resources<sup>5</sup>. Providing know-how, acting as a sounding board and having a strategic focus were also identified as important value added by NEDs<sup>6</sup> which our findings corroborate. NEDs in this study clearly add value in similar ways.

We then asked the NEDs whether the value they added was measured by the SME and how. There was very little evidence of formal performance reviews and more evidence of informal assessment of performance. Some NEDs also felt it was up to them to seek feedback.

NED K reported that he self-evaluated by taking his own yardstick to measure his own progress. In both his NED chair roles he had set objectives but these were not formally reviewed. However, he regularly sought informal feedback from the CEO over dinner, by asking if he was doing a good job and heading in the right direction:

“Self-appraisal and self-evaluation is something, I think most non execs don’t do it but I am continually, regularly asking myself and then I ask the CEOs I am working with, is it time for a change, are we going in the right direction, all that kind of stuff... I am looking to them but I probably initiate it on a more regular basis than an annual appraisal. I would be looking to see. Because sometimes you get the point where actually change is good and you can take another leap forward in the growth of the company, growth of the team [NED K, Male]

This informal approach to feedback appeared to be the norm. NED A felt that the shareholders in particular and the Executive Directors would speak up if they felt he

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<sup>5</sup> See Appendix 2: Gordon (2013), Coulson-Thomas (2006) and Barrow (2001)

<sup>6</sup> See Appendix 2: Berry and Perren (2001) and Barrow (2001)

was not adding value. The company had recently increased his remuneration, which he felt was an indication that he was adding value. He also measured his value via feedback from shareholders when he had helped them with a particular issue.

NED I had, in the past, instigated a couple of board performance reviews and he was happy with the views he gained from this about himself and the role he played on the board. NED L asked the MD/CEO to give him an appraisal, to gain feedback. He felt that feedback was very important and this could be received both formally and informally. He saw this as an opportunity to find out where he needed to improve.

NED E felt it was difficult to measure what a NED does:

“If the company continues to succeed or out performs or the strategy is enhanced, no NED will play, you are not all things, it’s not you doing it all, you are trying to enhance the team, so you can’t really measure a NED and say I did all that. You can go round and ask the team after say two years, do you think so and so has given you any value for money or whatever and you can see, but again that’s going to be very subjective isn’t it.” [NED E, Male]

NED B felt she was measured through her ideas or by pointing the company in a particular direction and that this may take the company a bit further onto achieving whatever their strategy was. She felt it depended on how you measure this, which could be tangibly (revenue, better margins) or intangibly (where she did X and there was a particular outcome).

For NED D, feedback was really in terms of a thank you, which tended to be informal. NED J sought feedback through asking the board if they were getting what they needed from her and whether there was anything else they would like her to do, questions that she asked quite often. NED N felt feedback was via positive comments by the board on what she was saying and doing. She would expect all of the board, the rest of the board to have expectations and to let her know if she wasn’t meeting them:

“If there is no process for feedback then I would probably be looking to seek it out, so I would be asking to make sure people were happy that we were on the right track. I don’t want to be wasting my time or theirs really... having worked in other SMEs and boards I am not sure that I have seen any of them do any kind of performance review with NEDs, they do just seem quite grateful for their input whatever that may be really. But that might just be the ones I have worked with. I think it’s a great idea and great opportunity to keep learning isn’t it rather than just thinking I know it all now, I don’t need to learn anything I just need to tell people what I know.” [NED N, Female]

Finally, we asked NEDs whether they felt valued by the SME. Feeling valued for what they did was clearly important for these NEDs and there is evidence to suggest that being valued at work can aid retention and enhance performance.

All NEDs felt valued by the SMEs, many believing that they were exceeding the value expected. NED K felt 'highly valued' and said that if he was not valued, he would not stay. The way he was valued took several forms:

"... so when they take your advice on board and most of the time implement it and learn from it. If they are taking positively from your involvement then that to me is an indication that you are good at your job." [NED K, Male]

NED A felt he had provided more than the value expected of him and NED L felt 'very valued' and only stayed with the board on that basis. NED E felt the same:

"... if you don't feel valued and you don't feel you are contributing, not that you are liked because sometimes you might not be liked especially to begin with, that's not the same thing. But valued by initially it has to be whoever appointed you, they have got to, especially if there is a problem, you know, the management aren't going to let you know initially, you are trying to address that by getting alongside. But if after a period of time you just don't feel you are valued then you are probably not adding any value and if you are not adding any value, well what the hell are you doing?" [NED E, Male]

NED N also felt that she was 'exceeding the value that they were expecting at this stage'. She felt very valued and that the board was grateful for her presence. NED J also felt 'very valued'. She had come from a fast paced environment and could spot when things needed to move along more quickly with her present board. NED D felt it varied between different companies in terms of how valued she felt, but she felt 'pretty valued' in most companies, whom she felt appreciated her support.

In summary, it is clear that NEDs add value to the SMEs with whom they work, and going by the number of NED roles held by each individual NED, the demand for their services is unquestioned. The role of a NED in an SME is to add value through independence, both complementing the SME's existing skills and bringing in new skills and experience. Input into the company strategy and access to outside resources, especially via the NEDs networks, was also identified as important.

Recruitment of NEDs tends to be an informal process, mostly via networks and being approached. Interestingly, men enjoyed more access to and utilised these networks more than women. Challenges faced by NEDs were out-weighted by the extent to which they enjoyed the role. Nonetheless, challenges were present, including, the potential for conflict amongst the board and having to 'let go' because the business was not their own. The value added by NEDs, according to their own accounts, was without question but this value was not measured by the SMEs, although all NEDs reported that they felt highly valued by the SMEs with which they worked.

So far, we have drawn upon the accounts and experiences of NEDs. The aim of this comparison is to draw upon both NED and SME/Executive accounts of the value and demand for NEDs. We now turn to the accounts of the SMEs and their Executives, some of whom work directly with some of the NEDs interviewed. Throughout this section, comparisons will be made between the accounts of NEDs and the SMEs.

### Executive perspective

The interviews with all nine Executives included questions on the role of NEDs, recruitment and support processes, gender issues and SME challenges. We also asked questions on what makes an effective NED, what value they bring to the organisation and how their performance is evaluated. In this section, we will present in detail differing views from the interviewed Executives on these matters and where appropriate also highlight differences in responses across male and female Executives.

#### The Role of NEDs

We asked the Executives to define the role of a NED – particularly within an SME – and to describe an effective NED. For the majority of Executives, the role of a NED included preparation for, attendance of and contribution to board meetings as well as being available for on-going, more informal conversations and advice when needed. The exact nature of this engagement varied across the organisations included in this research but there seemed to be general agreement that a NED's time commitment was at least a day per month.

We further tried to understand what SMEs were looking for in a NED and why they had decided to take on a NED in the first place. In response, Executives often talked about the SME context of limited resources and skills shortages within small to medium-sized workforces. They mentioned their inexperience in growing organisations and/or coming to a crucial juncture in their business lifecycle where they needed external help. A crucial aspect of the NED role was therefore widely seen to be the filling of particular skills, knowledge and experience gaps.

This mirrors previous research findings that NEDs provide expertise that complements internal skills deficits in SMEs<sup>7</sup>. As such, the majority of Executives expected a NED to bring currently missing experience and knowledge as well as a bigger perspective and act as a sounding board to help them form a clearer strategy for the future and reduce the risk of decision-making.

For some of the male Executives, there was a slightly stronger focus on looking for somebody who was 'business savvy' and had been on the growth journey of an SME before. They were most explicit about the need to bring this type of business experience and knowledge to their SME.

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<sup>7</sup> See Appendix 2: for example, Long et al. (2005)



The following quotes from interviews with Executives D, G and H exemplify this well:

“I mean I would say it’s that critical friend type, which you hear a lot. Someone who is experienced and can challenge in a constructive way, can help to aid decision making, whether it’s through experience or its not direct experience from someone who has a particular commercial or finance or operational insight so they can help steer decision making and reduce the risk of poor decisions being made by eliminating them.” [Executive D, Male]

“It’s like, I don’t know, it’s a silly old phrase isn’t it, if you want to become a millionaire ask a millionaire... So I guess I would be looking to find somebody who’s been on the journey that we are wanting to go on really and is able to impart some experience to us... Potentially experience in the right sector and also I think also the other factor would be to have relevant connections that would be useful as well... Challenging the way that we do things and suggesting alternatives and things like that, I think that’s really important because in a SME, certainly for us, this is the first time we have made a business so we are using a set of rationale and stuff like that from working in blue chip companies and that’s not always right. It might be misguided; we might be missing the point. So that sort of challenge is really important.” [Executive G, Male]

“They have to be 100 per cent business savvy, really understand business. And I have had NEDs before that don’t, they think they do and you think they do but they don’t. So they have to be business savvy.” [Executive H, Male]

Whilst the female Executives also expressed a key interest in filling gaps of knowledge and skills in the SME through the hiring of NEDs, some identified slightly more strongly with the need to be constructively challenged and mentally stretched by a NED. For Executives A and F, this idea of being constructively challenged by somebody with different experience is key:

“I mean you don’t want people to just keep nodding, you want people, you are looking for wisdom and experience form other parts of their life or which they have got anyway to contribute to the discussion ... [I]t would be quite good to have a few more coming from other industries or other, having different training because you get a different perspective on things.” [Executive A, Female]

“I mean I can’t, that ability to actively listen and then challenge in a constructive way is hugely important ... I think her ability to show good judgement and commit to a decision, a steer, in a, when SMEs can be incredibly ruled by committee type places, is huge.” [Executive F, Female]

Executive J further identified a crucial aspect of a NED's role in an SME to be their oversight and advise on wider legal and statutory regulations and obligations:

"I do think there are an awful lot of SMEs that start with a really good idea and get busy very quickly and don't actually know some of their statutory obligations. And I think a NED, because they are very current, you know, from my understanding, the non-execs are current with best practice and legislation and things, so I think keeping a company compliant I think is actually a very key role really. As well as commercial experience because a lot of businesses particularly in the early days they get so busy and profitability might not, it's the turnover rather than profitability so yeah, I think that commercial viewpoint can be very useful too." [Executive J, Female]

Quite a few Executives of smaller organisations admitted and talked about their relative inexperience with NEDs. For Executive B, her understanding of the purpose of a NED was a work in progress:

"Well this is the first time I have ever used one. So, and I didn't really know what it was when I got one. All I knew was that I needed somebody who had got more experience of larger or more dynamics businesses than ours that could advise us on you know, the key processes we need to go through to grow. And what we needed to be thinking about in terms of change within the company, our relationships with our clients and how we communicate with the outside world. Basically give me an outside perspective." [Executive B, Female]

We also asked Executives whether the role of a NED may change over time<sup>8</sup>. Executive H agreed that the role did indeed vary, depending on the organisations' stage in the business lifecycle:

"The role of a Non-Executive Director, I believe ... varies depending upon the history of the company and where the company is at that moment in time." [Executive H, Male]

Finally, when we asked Executives to identify the characteristics of an effective NED, quite a few focused on the importance of the cultural fit between a NED and the organisation.

In their view, an effective NED was certainly knowledgeable, able to listen, communicate well and bring missing skills and experience. But most importantly, an effective NED was identified by Executives D and H to have passion for the SME's growth and to fit the organisation's culture, rather than seen to be driving their own agenda:

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<sup>8</sup> See Appendix 2: Scholes et al. (2010) and Berry and Perren (2001)

“Someone that is, gets the culture of the organisation, isn’t there to, I guess, drive the agenda ... so cultural fit, needs of the business and that sort of expertise from, you know, from larger businesses, from private equity work, from corporate finance, from planning and strategy, that’s what they bring to it.” [Executive D, Male)

“They have to have the ability to, it’s sort of listen to others and communicate ... so another characteristic you are looking for is passion.” [Executive H, Male]

In summary, a NED was seen by SME Executives as an important source of advice, competence and experience that they needed to bring into their organisations in order to support their business growth. This reflects strongly the resource dependency perspective on NEDs as recognised in the wider literature and mirrors previous findings that NEDs’ roles in SMEs can be largely categorised as supporting, advisory and networking<sup>9</sup>.

Whilst this included bringing in missing knowledge on statutory obligations, the focus amongst Executives tended to be more strongly on the softer skills of coaching and constructively challenging the board to realise business growth. This matches, to some extent, the attributes and characteristics<sup>10</sup> to be shared by those voted to be outstanding NEDs at the NED of Year Awards 2006. It further stresses NEDs’ potential importance for strategic decision-making within SMEs, and yet reveals their tendency to look for somebody who fits in, has gone the same journey, and may reflect owner-managers’ deep-set fear of losing control<sup>11</sup>.

Finally, this perspective of Executives on the role of NEDs in SMEs matches largely the views of NEDs highlighted earlier in this report. Hence, both NEDs and SME Executives agree that it is the independent perspective, strategic focus and new skills/ expertise (governance, functional, experience) that allow NEDs to support and challenge SME boards in their capacity as advisors and critical friends.

#### Recruitment of NEDs

Whilst the nine Executives differed in terms of experience with hiring NEDs, the majority talked about informal and flexible processes when asked about the recruitment of NEDs in their SME. This was usually through recommendations within existing networks and/or previous working relationships with their NEDs. Only three Executives had worked with a recruitment agent and/or formally assessed the skills they needed from a NED. Interestingly, even where a recruitment agent was used, this tended to be part of a wider network and as such the NED was perceived to come ‘highly recommended’:

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<sup>9</sup> See Appendix 2: Zattoni and Cuomo (2010), Gordon (2013), Coulson-Thomas (2007), Barrow (2001), Berry and Perren (2001), and Atherton and Hannon (1999)

<sup>10</sup> See Appendix 2: Dulewicz et al. (2007)

<sup>11</sup> See Appendix 2: Gordon (2013)

“We work with a recruiter who we know quite well because our son used to work in his company way back when. And he is, he has consistently found us very good people for higher posts, our ops manager and our commercial manager and so on. And so I went to him. He knew X and thought that he wasn’t actually available, but then suddenly found out that he was. The project and company he had been working with had sort of ... whatever it was had come to an end so he was available. So he suggested he made... he came highly recommended and I took his word for it really.” [Executive A, Female]

Apart from the importance of personal recommendation and hiring through an existing network, some Executives also stressed the informality of the contractual agreements with their NEDs. Indeed, not all NEDs had a formal contract and there were very few Executives who had worked with a job description when hiring their NEDs. Executive B stressed the developmental nature of the relationship with her NED given the SME’s relative inexperience in dealing with NEDs:

“So we did a very reasonable deal for her to perform the role of a Non-Executive Director and for me to get the benefits from it. I mean I am really, really early to this process as is she. So we are both kind of feeling our way around what is necessary, what’s helpful, what isn’t helpful. So I guess if I came across another hurdle that I couldn’t get over I might go, let’s take somebody on for six or seven months. It’s quite informal. I mean we plan to formalise it, it’s just at the moment neither of us really knew how it was going to pan out ... A lot of small businesses don’t know about it or if they do they think it’s unaffordable.” [Executive B, Female]

Interestingly, Executive H talked about building constructive, working relationships with externals as advisory Executives first, before considering taking them on as formal NEDs. It is important to note that his strong preference for the flexible arrangements that an advisory board offers over contracted NEDs was not mentioned by any other Executive. Yet, it could be seen as an indicator of business owner’s reluctance to give power to others (Coulson-Thomas, 2007) and the resultant difficulty that NEDs may face within SMEs:

“I would never, ever have a NED on the board to start off with, not on any company. I would form an advisory board, and then once you were certain they could delivery on the advisory board they then become a NED ... The beautiful thing with advisory boards, there’s no legal ramifications and you can bring them on the advisory board and kick them off the advisory board as you wish and it gives you that flexibility to bring people on to solve particular issues or to help you with ... but once they become NEDs it becomes a pain in the backside to get rid of them.” [Executive H, Male]

This somewhat critical stance of Executive H was also reflected in his view on remuneration of NEDs, and yet again could also be seen to reflect adequately SMEs’ resource constraints:

“If, as an SME is you are not cash rich, do not give them money, you offer them options. And if they want money don’t have them....because once they want cash I think they think there is an issue with the company.” [Executive H, Male]

Executive D’s experience with hiring a NED was a somewhat different one. Investors in his company had imposed the hiring of a Chair and driven the recruitment and selection process. Yet again, the candidate emerged through an existing network:

“We had, part of our investment, condition of investment in July was we have a chairman on board. And then within that discussion and modelling what that would look like, our prior equity investors had a budget in mind of what that would cost which is driven by their experience....it was through a network, yeah ... I mean he was known to us...” [Executive D, Male]

This over-whelming importance of a network in NED recruitment was further supported by Executive D’s observation that the best candidates are known and cherry picked:

“But I imagine the best candidates will be asked rather than have to aspire to be one, which will come from a career which has been high profile I would say.” [Executive D, Male]

On the other hand, Executive C addressed a downside of this focus on personal networks when he warned of the danger of recruiting friends:

“We wanted to find people who showed an interest or made an investment into our business, emotionally or in time, beyond what would be seen as normal ... I don’t think most SMEs would know where to start and if you are not careful you end up just going to your friends.” [Executive C, Male]

Executive F adds to this critical perspective on networks when she addressed their dominant white, male profile:

“The recruitment process for a NED was all very, a bit white male, you know, fairly limited to the little black book and there was a finite amount of them in Bristol, they all patted each other’s backs.” [Executive F, Female]

In summary, the picture that emerges from the Executive interviews is one depicting a largely informal process where the best and most experienced NEDs are known and embedded in often strong white, male networks. This experience of the interviewed Executives was shared by the NEDs, who also indicated that recruitment was informal, mostly via male dominated networks and often led to equally informal contractual arrangements.

This seems to indicate a somewhat narrow pool of NED candidates and may pose problems to SMEs, and indeed female NEDs, who lack knowledge of or access to

these networks – an issue so far under explored by other research studies. The Executive interviews further showed that, as suggested in the literature on NEDs, the reasons for hiring NEDs were either a matter of agency, i.e. investors having representation on the board, or due to a resource/skill that the SME needed<sup>12</sup>.

#### Support mechanisms

We were also interested to find out more about support mechanisms for NEDs within SMEs. Similar to our findings on recruitment processes, the dominant response from Executives was that there were very little if any support mechanisms in place. Inductions of NEDs were described as largely informal conversations with Executives and predominantly focussed on providing the NED with a sound introduction to the company:

“From our point of view, they know what they are doing, they are experienced people at board level and lots of their companies. It’s more about understanding the company and understanding how we do what we do.” [Executive D, Male]

There was a further widely held expectation of the experienced NEDs to be the ones asking questions. Indeed Executive H suggested it was, after all, the NED who should do the coaching. Executive G further felt that any more formal process would be irritating:

“No I suppose there’s not really... but there are a couple of conversations held - this is what we do, how would you contribute? ...the NED should do the coaching.” [Executive H, Male]

“I guess we would just talk them through the business plan and what we are doing and identify any materials they wanted ... it would really irritate me if there was so silly formal process would had to go through, filling out forms or something like that. I wouldn’t do it if that had to happen ... but yeah, just face to face meetings and talking through things and, you know.” [Executive G, Male]

Female Executives A and B shared the above views of the male Executives, yet also added that if the need arose they would consider providing more formal support or training:

“I mean, my view is if you are asking someone to come onto the board, that person would have had more experience than we have had, for example, which is why you ask them to come on. So you can gain from that experience. But if the individual felt they were falling short in any areas, then of course we would look at it and talk about support, but at the moment there isn’t.” [Executive A, Female]

“She is not a great big separate thing that’s coming in to, you know, cause problems. I mean apart from, you know, me describing the business, talking about the issues that we had, introducing her to the staff and their roles but no real

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<sup>12</sup> See Appendix 2: Coulson-Thomas (2007) and Deakins et al. (2000)

training ... I mean, if I had had a few more then yes but my own experience is her, so I wouldn't even know what to train her in. No. She has found her own mentors and coaches as part of her own professional development and she has told me about that." [Executive B, Female]

Interestingly, Executive C's organisation had taken a remarkably different route than the other SMEs. Following their more formal skills needs analyses and recruitment processes, they seemed to engage in annual review processes that Executive C identified to be part of the NEDs' support mechanisms:

"What I like about it is we have got a very open culture, not only for the business but for the board. And what we try to do is built very strong relationships between the wider management team ... Everyone has got full job descriptions, formal report, informal end of year review and then there is kind of a formal assessment of the board using a standard document that we have worked with for the last couple of years." [Executive C, Male]

In summary, there was largely strong agreement that NEDs did not require formal support and that informal inductions to the company and on-going conversations with other Executives were the most effective ways of integrating NEDs into SMEs.

This is corroborated by what the NEDs told us; they required and looked for very little support from the SME and held the view that any further training should be their own responsibility. The NEDs referred to their networks as their key source of support.

A recurring issue here seemed to be the limited financial resources of SMEs and limited experience in working with NEDs that were also a contributing factor to the absence of formal support mechanisms in most companies.

### SME challenges

We asked Executives about the key challenges their SME was currently facing and whether NEDs could help them in addressing these challenges. The immediate responses to this question tended to focus on the tough competition that SMEs were facing locally, nationally and internationally as well as the impact of Brexit on their future.

Throughout the interviews, Executives expanded on the impact of particular challenges that SMEs face due to limited funds, resources and tough competition on their working relationship with NEDs.

Executives C, D and H talk below about the perceived financial risk of hiring a NED and the difficulty in justifying the need for a NED when funds are tight:

"The downside I think is sometimes you can almost bring more rigour to the business than you may want when you, SMEs are by their nature time and resource poor. You are building, you are committing to a level of working and a

governance, which you maybe don't understand the full extent of until you are in it. And I think that's why you have got to be so clear on the benefits." [Executive C, Male]

"I don't, I mean, the things strictly for SMEs, if it's not part of an investment round where you have head room, it's whether you can justify it and if you haven't got the scale, can you justify the input of a NED that, is that the best use of your funds." [Executive D, Male]

"We had a chairman that basically turned up to meetings and when everything was good praises and when anything was bad it was always my fault, you know ... I had a chairman at another company and it turned out he was on 22 boards." [Executive H, Male]

These resource constraints further brought out statements on the need for a NED to understand these specific pressures of SMEs and to bear them in mind when making suggestions. Executive G added that as an SME you have to be certain of the value added of a NED and remunerate them accordingly:

"So like you know, real examples of this would be, that it would be alright for someone to turn up and say you need to do this, this and this. And our answer would probably be, that's very nice but I don't have a spare three people to do that or £¼ million to spend in doing it, so what do we do? The challenges are very different because we don't have any money. And we don't have lots of resources ... I guess we would expect to remunerate them but it would have to be in proportion to the size of our pocket in you know what I mean and the value we see we are getting from them. I think when you have got limited budgets you need to protect your overhead spend quite carefully. So we would only spend a limited amount on a NED unless we could see very quickly to specific value they were adding for us." [Executive G, Male]

In addition, and in reflection on previous sections in this report, it seems further important to note Executives references to SME's lack of access to or knowledge of NED networks. As Executive F put it:

"I just don't think having a NED role is that front of mind with most owners of SMEs I suppose. And I suppose anything that you do to help people recognise the value of the role is a great thing." [Executive F, Female]

In summary, the competitive and resource constrained nature of SMEs, recognised previously by Long et al. (2005) as an important contextual factor for NEDs, was found to have a significant impact on viewing the recruitment of NEDs as potentially risky or too expensive. In addition, a lack of knowledge about the role and value of NEDs and lack of access to key networks may deter SMEs from hiring NEDs.



### The value of NEDs

A key aim of this research project was to understand what the value of NEDs is within the SME context. As such, we asked Executives what they saw as the main benefits and downsides of having a NED on the board and whether they value the NEDs they currently had.

The response from Executives to these questions was overwhelmingly positive. They felt that their NEDs had and were adding real value, particularly where there was a good cultural fit between NED and SME and where the NED could fill a crucial skills, competence or experience gap in the SME.

The key benefits of having a NED were described by Executive B as bringing an outside perspective and acting as a catalyst for change:

“Well I guess you know they can be a catalyst for change. They bring an outside perspective that feels more objective so that when there is disagreement in the business their objective view is valued. They bring experience from other industries and other working environments ... the main benefits are all what I said before, objectivity, experience, knowledge of other sectors and ability to put us in a, in perspective of just business not the business that we do.” [Executive B, Female]

For Executives C, D and J, a clear value added was also the wider perspective that a NED brought; the kudos and the connection to a wider outside network:

“The network, their ability to connect you I think is really important ... and also I think the thing they bring above all else is just perspective. There is the reality and it is meant as a compliment that it’s sometimes a few grey hairs and that’s no bad thing.” [Executive C, Male]

“I think that helps us when we are trying to raise money recently, to show that we are quite professional in the way that we operate because of the board structure. I think that’s a good signal to have ... it helped massively actually because they had that respect and that weight of reputation that came with them...” [Executive D, Male]

“I think benefits, I think we are able as a business to progress quicker because we do have that strategic and objective view that takes us out of the day to day and enables us to look at the long term.” [Executive J, Female]

When asked how Executives evaluated the performance of a NED, some mentioned that a formal assessment of this would be rather difficult. Instead, Executive D suggested that it is clear whether a NED adds value or not when looking at their contribution to board meetings:

“I think at the contribution to board meetings, I think you would miss them if they weren’t there, I think that when you would probably think it’s not working out ...

when a board meeting is good you get a real buzz from it, they might be sort of, hopefully sort of mentally stimulating but you should get a bit of a buzz and if it's not then it's a bit flat and very procedural..." [Executive D, Male]

When asked what she would do if that relationship was no longer working, Executive J was clear that it was likely to lead quickly to a mutual agreement with the NED to part ways:

"I think being in business does make you approach those tricky situations, I think I would be, and also, the NED will know that the relationship wasn't working so it's much better for them to find the right company as well as for you to find the right NED." [Executive J, Female]

Those Executives who had previously spoken about the perceived financial risk of having a NED, stressed again that the value of a NED also depends on the level of remuneration in relation to the NED's ability to bring something in that nobody else can provide. The quotes below by Executives G and H illustrate these points:

"Yeah remuneration could potentially, definitely would wouldn't it. It would all be about perceived value. Is this person going to be worth more than we have got to pay them? It would be about perceived value and the uncertainty of that as well. The risk in that, you know, what's the chance that this person will be worth more than we have got to pay them?" [Executive G, Male]

"...and I think you have got to be really, they have to be able to do something you can't do, you really can't do." [Executive H, Male]

Executive F also suggested that independence is an important value that a NED brings to the organisation but warned that this independence and by consequence the value of a NED had a certain lifespan:

"Oh my goodness, how does that pan out long term? Actually because it slightly seems to me that probably the NED role has a bit of a lifespan, when it is no longer an independent position. You know if you have been working with a company for three or four years, you're friendly aren't you?" [Executive F, Female]

In summary, all Executives were positive about the value that NEDs add to their SME. This was particularly focused on the external networks and reputation they bring as well as the internal skills and knowledge gap they may fill. Bringing a wider perspective and stretching others mentally during board meetings was also highlighted as a benefit and seen to lead to better strategic decision-making.

These ways in which a NED may add value to SMEs reflects previous findings in the literature<sup>13</sup>. Yet the potential financial risk was mentioned again, and it was clear that a NED who does not add value would be let go quite quickly – an issue underexplored in the extant literature.

However, this should not be a concern of the SMEs in relation to our group of NEDs who appear to add value to the SMEs with which they work. Interestingly, Executives did not talk about governance expertise as a value added, whereas some of the NEDs in this research perceived this, alongside the skills, expertise and networks they brought as a key value for SMEs.

### Gender issues

A final area of interest in this research was perceived gender differences in relation to the role of NEDs in SMEs.

The above findings throw light on a small number of differences in the actions, experiences and perceptions of male and female NEDs but there were no significant gender differences found between male and female NEDs in this (albeit small) qualitative study. However, we felt it important to explore the reasons why women are so poorly represented amongst the NED population, as highlighted in the context section, especially as this study reveals no major gender differences between the NED roles performed by men and women.

Our findings suggest that it could be a problem of supply and that this is exacerbated by women's lack of access to the NED networks. This section therefore explores the NED view on why women are so poorly represented amongst NEDs and possible solutions to remedy this, before going on to explore whether SMEs/Executives perceived any differences in the value and performance of male and female NEDs and their views on why women are under-represented.

### Gender: The NED viewpoint

NED K saw women's under-representation amongst the NED population as a generic problem in terms of there being fewer women on boards who could ultimately become NEDs. While he felt the need to be more proactive in getting more women into board/NED roles, he also felt that there were not enough women putting themselves forward. He gave the example of two women he had encouraged to take up more senior positions but who did not want to take up the challenge.

NED A acknowledged the problem of the 'glass ceiling' and felt that to become a NED you needed to be a fairly senior person in a business. He also talked about the lack of access to networks for women:

"I think from my experience, a lot of NED appointments are done via personal contacts, people who know somebody who knows somebody who knows you. I mean you do see adverts for NEDs; I am not at all convinced how many jobs are

<sup>13</sup> See Appendix 2: Gordon (2013), Scholes et al. (2010), Long et al.(2005) and Berry and Perren (2001)

actually filled by a general advert. So maybe it's, the trouble is if it's the pale and stale males that are sort of running that process that's only going to be self-perpetuating." [NED A, Male]

He also commented that he felt women were not putting themselves forward for NED roles. He suggested approaching recruitment consultants in Bristol, as a starting point.

NED N also saw the problem as partly attributable to existing networks being used to recruit new NEDs. She also felt that women may not consider a NED role because there were so few senior women in organisations, especially in director roles, which meant that women automatically ruled themselves out of a NED role. This, she felt, should not be the case and that it was more to do with a lack of awareness of what the NED role entails, which in turn could be attributed to the lack of networking. She felt there was a myth that the NED role entailed having finance/accounting knowledge.

Lack of access to networks was also an issue for NED D, who began by commenting that she felt men naturally put themselves forward for roles more so than women, who may wait to be asked. She felt that men talked about this more as a future role. In relation to the networks, she made reference to a 'NED recruiter:

"They [company] are a NED recruiter, they are just down the road and they have drinks for networking for NEDs and new NEDs, you know quite often find new roles. And that quite often will be pretty much 100 per cent men in there. So those networking events where people are finding their roles, they haven't got a female representation in there. I mean it's not 100 per cent, but it's probably pretty much nine out of ten I would say. I think maybe that is because that particular types of drinks are focused on corporate finance community and that is still, it has improved but it still fairly male dominated. But I guess NEDs come from all types of backgrounds." [NED D, Female]

NED E also saw the problem aligned with women being under-represented at senior management and board levels generally, and that NEDs tended to come from a pool of proven senior managers and directors. He felt that the disparity would 'wash its way through over the time' but that this would not happen soon enough. NED J also saw the correlation between the under-representation of female directors and female NEDs.

NED G/H also wanted to see more women in NED roles as he believed they could bring a different viewpoint and approach to board discussions. He felt that the increasing numbers of women qualifying as accountants would filter through to the boardroom but he also perceived a problem with women taking time off to have children:

"...some of them do tend to take time off for babies and whatever, because basically men don't take time off for babies usually. So in that sense I think that

does damage their ability or frankly changes their minds in terms of what they want to do in terms of quality of life and meaning of life ... you know automation and technology may make it a breeze to stay home, have kids and do work. I don't know. We will find out." [NED G/H]

NED B also felt that problem lies with the population reducing when people go on maternity leave and do not return or returned part-time to find a role that fits in with the hours and do not return 'in the mould of an executive environment'. She also talked about the 'comfort factor' and the 'group think' of male boards and that it would take another generation before change starts to filter through.

NED I commented that two of the four boards of which he was currently a member were all male. He said he was very aware of the imbalance and that it 'wasn't right'. He did, however, comment on the couple of levels down, the managers outside of the board, where there maybe women who could eventually join the board.

NED L also commented on the lack of numbers of female NEDs that he had met on boards (in his entire career, he had not worked with a female NED). This led him to the conclusion that there are not many female NEDs around and that women tended to become NEDs in the public or charitable sectors, rather than in the business sector. He also commented that in some board communities, it was male dominated because that was the way they [men] liked it.

The main reasons for women's under-representation amongst the NED population, from the NED point of view, appeared to be because there just are not enough women around/experienced at Board level. Some NEDs also pointed to the fact that women have children and thus experience a change of focus and priorities and also that the problem could lie with the maleness of networks used to recruit NEDs that tend to exclude women. The NED view was split between saying women do not want NED roles (men) and women being excluded from these roles (females).

In terms of actions to address the gender imbalance amongst NEDS, NED K felt there was a need to 'be more proactive and reach out to candidates'. He offered an example of having a shortlist of candidates for a financial director role on one of the boards he worked with and putting the female candidate forward (who subsequently joined the board). He felt more people should do this.

This, however, was a viewpoint not shared by the other interviewees. NED A felt it was up to women to put themselves forward and that recruitment had to be based on merit and education. He was against the imposition of rules and regulations on companies to hire women. He believed that change would be generational and that the situation would change eventually.

NED E was against any kind of positive discrimination, such as quotas. He referred to women he had worked with in a number of businesses whom he described as 'tremendously capable and had got there on merit'. He also felt the situation would remedy itself eventually. This optimism was also shared by NED B who felt that

although there was still a long way to go, as more people became aware of the problem, things would start to move on.

NED J believed that we would eventually see change:

“...I don’t think there’s as much as a non-desire for women to get on as there was when I was younger. I think there is very much now a lot of openness and certainly the next generation doesn’t really see where it came from in the first place. So I think it’s something that will sort itself out rather than social engineering.” [NED J, Female]

NED D referred back to the problem of women’s under-representation and that there were fewer women in the pipeline to become NED Chairs in SMEs because there were fewer women at board level. NED L agreed that past board experience would be helpful in terms of expectations and there being a ‘fear of the unknown’ without such experience, although she did not agree that board experience was an absolute pre-requisite to taking on a NED role.

Although all NED interviewees acknowledged the under-representation of women and some of the reasons for this, they were almost unanimous in believing that this would change eventually and that positive discrimination was not required to achieve this.

The view of businesses cited in the Davies Report<sup>14</sup> fits with the ‘voluntary’ approach to increasing women’s numbers on boards, which entails businesses taking a number of actions, which does not sit well with the NED view that change would happen over time. While this is the case to a certain extent, it is due to businesses being actively engaged in making this happen.

#### Gender: The Executive viewpoint

We began by asking whether Executives saw a difference in the value and performance of a male compared to a female NED and asked for their view on board diversity.

Responses to these questions were split – amongst male and female Executives – where some saw clear gender issues and a need for greater gender balance on boards and others thought that it was a matter of personality and skill rather than gender that affects NEDs’ performance.

Executives A, D and J, for example, stressed the importance of a focus on individuals’ skills and personality rather than their gender:

“So I think it’s sort of down to the individuals to whether, it’s down to the individual much more than the sex I think as to whether people fit in or not ... it must depend what sort of industry you are in. You know, surely in advertising or

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<sup>14</sup> See Appendix 2: Davies (2015)

fashion or a few of those you would have as many women as you have men, surely ... so from that point of view there may be many fewer women who have been managing directors and therefore fewer who are equipped, feel they are equipped to be a non-exec ... but I don't think there's any difference between male and female intelligence and all that sort of thing. It's just a matter of knowing your subject matter and having maybe, I think you really need to get to know the other directors particularly those who work in the company." [Executive A, Female]

"I don't think so. I think it just depends on their experience really and what they are bringing to it ... so if it's female NEDs, but they have the operational experience then that's what it is, it's not about gender thing." [Executive D, Male]

"Speaking as someone who has a board of three women, I would say it was more about skill balance rather than gender balance personally. I think so long as you have got the people that have the right skill set and look at the momentum within that business to be honest." [Executive J, Female]

On the other hand, Executives B and C expressed strong views in favour of promoting board diversity and argued that women bring greater soft skills to the board:

"Well yes it is actually. I mean my industry is a male dominated industry and it has taken me 30 years to feel like I am treated like an equal ... also I proactively employ women and I proactively look, you know, X wanted to get experience as a Non-Executive Director and we will ultimately have a list of outcomes and we have already got a list of objectives." [Executive B, Female]

"I think mixed teams perform better, I think that we get more empathy, I think you get more listening and I think when you have got 70 per cent of your workforce that are women, then there are things that man maybe don't understand despite their best intentions ... she can have a better conversation, it's just around getting in touch with who you are talking to, and therefore you need the right people to do that." [Executive C, Male]

We were also interested to hear the Executives' views on why women are under-represented in the NED population. This provoked an interesting response where both male and female Executives often said they were not sure, not experts in this area, or had not thought about this. When questioned further, like the NEDs we interviewed, Executives often identified a reduced pool of female senior managers as the reason for fewer NEDs. Executives C, D and F saw this connected to maternity leave, women's lack of promoting themselves and their lack of access to male networks:

"There is the obvious reason I suppose, the kids, often the non-exec roles, you can't be until you are a senior exec or senior director and we know the problems the UK has had for a long time, in that there haven't been enough women in

senior positions in organisations full stop ... Women don't naturally put things, women of that level don't for whatever reason traditionally don't put themselves out there as much or value their skills maybe as much as they should in the external market. I think men have had a better network or ability to get linked into non exec appointments." [Executive C, Male]

"It's not really my area of expertise. If I were to guess I would probably say that career breaks that women have because they have children is going to mean that fewer get to the top of organisations." [Executive D, Male]

"It's the same as it is for the boards, people hired people like who they are and that seems to be prevalent in the NED set up. You know I did say, maybe I am wrong, that kind of old boy network ... Well I think and I understand the arguments against, that it should be around talent and all of that but I think you have got to break the ceiling really. And I think to do that most of the time you have to do something quite dramatic to you know, people aren't going have the talent and the experience the necessary skills if they aren't put into the roles are they?" [Executive F, Female]

In summary, there was agreement across all Executive interviews that women were indeed under-represented as NEDs and that this shortage in female NEDs was likely to be due to the under-representation of women senior managers in many sectors. Women's careers breaks, limited access to key, male networks and lack of self-promotion were seen to be contributing factors. There was then a real split between those Executives who saw this as an issue and wanted to promote greater board diversity, compared to those who were more focused on personality, knowledge and skills composition of a board.

Overall, NEDs and Executives agreed on the reasons behind women's under-representation amongst the NED population and also that positive discrimination should not be utilised to change this.

### Advice to aspiring NEDs and SMEs looking for a NED

#### The NED perspective

Finally, taking into account the wide range of experience and expertise of the NEDS we interviewed, we asked, what advice they would offer to a first-time, aspiring NED. This advice will be useful to anyone considering taking on their first NED role and to NED training providers.

Advice from NED K was to 'get some training' to at least understand the legal side, responsibilities and governance of the role. Training could be completed with companies such as the Institute of Directors and Transpire. He talked about the dangers of people not really understanding the role of a NED:

"Quite a lot of people really do not understand what they are taking on. I talk to a lot of people and say, do you know you are legally responsible and you will be in the dock standing next to the CEO if it all goes wrong? And the number of people



who are surprised at that. Go and get some training, find out what you are taking on. That's the only first step you should take really. And then I would ask them, do you really, really want to do it?" [NED K, Male]

NED A also recommended formal training, which he had undergone himself to find out what makes a good NED:

"So I have the benefit of that and I am sure, well I know there are other courses around if you know where to look which do that sort of thing as well. That would probably, I have seen NEDs in action so it was probably something I was interested in and I was thinking of doing anyway and those courses kindly confirmed that what I was thinking of was probably the right thing for me to do and that could probably benefit other people." [NED A, Male]

NED G/H felt that an aspiring NED should get some practice, perhaps in a charitable organisation, where they should get involved for the experience rather than the money:

"If you go into a charitable environment, which I think is not a bad thing to do, it's a bit of *pro bono* work. It will give you experience and what it will show you is that it will give you confidence that you don't have the answer to everything but you have some pretty useful experiences and skills that typically aren't present in the organisation that you are talking about." [NED G/H, Male]

He also felt that the aspiring NED should be careful to take up only what they wanted to get involved in and ensure the chemistry was right with the people they would be working alongside. It was also important 'to have professional indemnity insurance' due to being at risk.

For NED I, it was a combination of the above. He also felt that gaining feedback was important, perhaps through a coach. NED L believed that the aspiring NED would need to be of 'a certain age', in order to have sufficient experience to take up a NED role. He identified a set of questions he would ask the aspiring NED:

"I would just say, why do you want to be a NED, what's your driving force in the first place? Why do you actually want to do this? And I point out to some people, you know, NED roles these days it's not for people who can't be bothered to get another job, they just want to go and sit on a board. That's not what it's all about. And I would say, what's your, why do you want to do it, what can you offer? Work out what sort of company you want to get involved in and I go where angels fear to tread ... If you are an exec and want to become a non-exec, you are going to mix the two are you because that's dangerous. Being an exec and a non-exec, do you know the difference? I have made a career of just being a NED since I left. So that's the advice I would give." [NED L, Male]

NED E felt that the NED role was not for everyone and that no-one should take on the role for the money. He felt it was more about giving something back, through

applying experience. He believed that taking on a NED role for the right reasons would be more rewarding. Further advice was not to take on too many NED roles at once (over promise and under deliver). Honing skills was also important, especially in terms of communication and people skills.

The advice from NED B was to 'start networking':

"So I would say to go start networking because it's, to me it's a bit like a parallel universe. It's a bit like you have to have an equity card to get in but you need to get in to get the equity card. So the first port of call is very much anybody you know then almost like asking them who they know so that you really start to broaden out your, not only your current network but beyond that of people who are in non-exec roles already. And get a real feel for their advice, their experiences, their story as it were and then and I think all the basics of the CV has to be very different to an exec CV. And people say you know, the head-hunting route, it's a bit like the devil you know and you may have to do that but eight out of ten is through somebody, you know, has given you the opportunity through the network rather than the head-hunter who phones you up." [NED B, Female]

She also felt it was important to be clear about the value you can bring as a NED by getting to know who else is on the board of a particular company you may wish to join, where would your skills, experience and personality fit? NED J felt the aspiring NED should be focused on the two or three things they could bring to a board and to be clear about this with the company. NED N felt it was important to gain a clear understanding of the role beforehand and to join a board where the NED can add value through their skills or because of a particular board dynamic.

The importance of a good 'NED CV' was paramount for NED C, alongside a 'good NED pitch'. She also felt that caring about what you can contribute was important, what makes you relevant to the boardroom. Secondly, she felt that LinkedIn was essential in terms of making yourself connected to as many people as possible, including head-hunters. Thirdly, networking was identified as important in relation to reaching out to head-hunters and with other NEDs to ensure they know you are looking for a NED role. Asking the right questions was also important for NED D, in terms of what the role entails and how much time commitment is involved.

We then asked the NED interviewees what advice they would offer an SME when looking for a NED. This offers a valuable insight from experienced NEDs who are already working with SMEs which, again, should be useful for training providers.

#### Advice to an SME looking for a NED

NED K believed this depended upon the stage of the SME and whether it had a board. If it did not, then they should get a good Chair who knew how to build a board in terms of getting the key people together, looking at strategy, plans, processes, problem-solving. That would be the makings of a board. He also commented that if there was already a board, then the chair should be the person

who could help to build a board and then that chair should recommend what skills were needed on the board:

“Ok what skills are we missing, what are we going to be doing, what do the next few years look like, what can we bring in, what additional horse power so to speak? That’s basically what I tell them.” [NED K, Male]

For NED L, it was similar advice. He recommended sitting in front of the MD and asking why they thought they may need a NED, which skills, knowledge and experience were in short supply on the board, i.e. in terms of opening doors, sales and marketing, branding, accounting or technology:

“It’s a case of almost like Dragons Den really. Just go through it all to work out and finish it, what exactly is it you want and having decided on what skills and knowledge, what sort of person do you want to work with? The NED needs to be very supportive.” [NED L, Male]

Similar advice came from NED G/H. His advice would be to first of all take soundings in terms of what skills you were looking for from a NED, i.e. sales, finance, etc., and whether the SME was looking for someone as a mentor. How the NED was rewarded should also be carefully considered and whether that would be via equity or payment. He also pointed to the shelf life of a NED:

“And don’t think they are for life because business goes through different levels and different stages of development and you need different skills. What you don’t want to do is keep the old skills when they have reached the end of their shelf life.” [NED G/H, male]

The working relationship between the NED and the board was also important for three interviewees. NED A could see the value in taking time and trouble to find somebody who the board was ‘going to get on with’. This, he felt, was particularly important for an SME/family business, where the CV may not be the best criteria but instead working with someone you could get along with and form a personal relationship:

“What I do find is that a lot of big companies, people have trouble transferring skills and experience down to small businesses. If you have got somebody who has always worked and always had secretaries, five support staff, a runner and goodness knows what else, frankly he isn’t going to survive in an SME environment. So it’s important I think that you match people to environments.” [NED A, Male]

Spending time getting to know the prospective NED was also important for NED I. This would involve working through the plan, asking for feedback on the plan, looking at the numbers. Discussing the style of working would also be important, as well as taking up references. He felt it was a little like a ‘trial marriage’.

NED E felt it was important not to expect a NED to 'solve the unsolvable'. While the NED could help the business, they were not there to do the Managing Director's job. Realistic goals and being open were important for NED I:

"So SMEs should be prepared to hear things they don't want to hear and then not just squirrel it away, he won't be back for a few weeks. So listen. The whole point of having someone there who has got a bit of credibility, listen to them. Again, whoever is appointing your NED, if I was an MD, I would ask them why they are doing it and I want to be told. And if they just say - because we feel x, y, z - fine I understand, I can address those issues but at least you know what the NED has been told. What can I, the whole point of the work of TLT and whatever, what is the end goal, what is your objective. Is there one?" [NED E, Male]

NED J could also see the importance of relationships in terms of spending time with the prospective NED and ensure there was a similar shared ethos:

"They have got to appreciate your culture ... Yes. And it's like all of these sorts of relationships, you know, you might be called in to look at one thing but actually when you look under the bonnet it might be something quite different that's really needed." [NED J, Female]

She also talked about barriers to SMEs taking on NEDS of which she felt there were two (1) perceived expense (2) business confidentiality. She felt these were more perceptions than reality:

"It doesn't have to cost you a lot of money, it doesn't have to cost you anything and over time it might cost you something but it doesn't have to cost you what you think it's going to cost you. And the other thing is, they are not there to tell you what to do. And having worked with SMEs for a long, long time with different hats, yeah I have seen a few NEDs come and go off of boards before because or not even make it onto there in the first place because they don't want to be, you know, the CEO is very protective over it and says yes, I need help and you said what about going in blah, blah distinctly, what about getting a NED and the barrier has been, I don't want to be told what to do and I don't want someone interfering, well then find someone who doesn't." [NED J, Female]

NED N felt that more SMEs should take on NEDs and that they should reach out beyond their existing networks to do so. Unlike the other NEDs, she felt the role should be advertised and, like the other NEDs, she felt the SME should be very clear about what they wanted, be that a particular skill or dynamic the board was trying to achieve.

The need for clarity around the role was also expressed by NED B. From her own experiences, she explained how some SMEs may be looking for a mentor who has 'been there and done it'; or someone to open doors for them, or a sales person. The purpose of a NED was:

“...to challenge what they [the SME] are doing. It’s not just about I need someone to go and sell my business, there is the, its being clear, it’s a governance role and it is about challenging, making sure that the company meets their objectives that they have set and does it in an ethical and integral way, with integrity and that sort of thing and challenging in terms of the way in which the company operates. So it’s not for the individual, it’s about the overall good of the company.” [NED B, Female]

She also pointed out that a NED in an early start-up phase might want slightly different people than as the company gets more established.

NED C also felt that finding a NED should be ‘a proper process’ in that the SME should not rely on the ‘golf course network’. She felt the decision to hire should come from a balance list to ensure diversity of thinking.

NED D would recommend tapping into networks in Bristol and being clear on the budget they had available to hire a NED:

“So I think they need to be quite clear on what type of NED they wanted and what they want them to bring because you could have someone with good sound business sense who can give you an overall picture. Some need industry support, some need someone who knows that industry to help them. I think the company needs to be clear what they want. But I think it’s a good thing for them to do.... I don’t know whether actually companies think I need a NED especially small ones. I think they are focused on cash and running their businesses. I think maybe they are not thinking I need to get someone in that could help me. And I think also maybe perhaps business has bad experiences and think that was a waste of money, didn’t get any value from that at all.... and also you know, one person is not necessarily going to have all the things you want. I think that is an expectation that people have, is that person can fix all my problems and they can’t always. And that’s why you may need to have more than one when you get bigger.” [NED D, Female]

## CONCLUSIONS

Whilst the role and value of NEDs in listed companies is a well-researched phenomenon, we have, to date, minimal insight and clarity on the role and importance of NEDs to SMEs. Our study makes a significant contribution in this regard, as it examines a number of key issues around the role and value of NEDs to SMEs from the perspectives of the NEDs and Executives in selected SMEs.

The conclusions in this report are based on an extensive literature review (see Appendix 2) and the analyses of the in-depth interviews with NEDs and Executives over the course of three months. The conclusions are presented based on the following six key points:

1. What is the need for NEDs in the SME market?
2. What is the recruitment process for NEDs and who determines who is hired?
3. How are NEDs integrated into the board/company, for example, through networking, mentoring, and induction programmes?
4. What does a NED role entail in an SME?
5. What are the challenges for NEDs and their organisations?
6. What are the terms of engagement in relation to NEDs?

### What is the need for NEDs in the SME market?

The unique focus on both NEDs' and Executives' perspectives in this study enabled us to explore, in great detail, the value that NEDs can add to SMEs and the challenges for SMEs to recognise and utilise this value to its fullest potential. It allowed us to explore so far under-explored questions such as, why NEDs work with SMEs, what they get out of the role, the support they draw upon (i.e. networks) and the value they personally bring to the role.

Previous studies showed that although SMEs contribute to economic growth, they are constantly challenged by competition and a changing competitive environment, including the impacts of technology, innovation and regulations. All these present formidable challenges to SMEs amidst an increasing squeeze on margins. SMEs are also resource challenged and have significant skills gaps to deal with the myriad of challenges they face.

Our study concludes that NEDs are a source of support for SMEs as they can fill existing skills gaps and provide external perspectives to SMEs. These are seen to contribute to SMEs' strategic development and growth. Indeed, our study demonstrates that SMEs recognise their challenges and appreciate their consequences, if nothing is done to address them. SMEs in the study further recognised limited resources and lack of sufficient internal expertise as crucial factors in their growth.

SMEs identified that having external perspectives through NEDs on their boards was important to their performance and helps transitioning to the next stage of the company's growth. They made specific references to NEDs as a 'critical friend', a

‘sounding board’ and a ‘source of external perspectives’ that are important to their growth.

### What is the recruitment process for NEDs and who determines who is hired?

Apart from the role and value added, the study also sheds light on the ways in which SMEs recruit NEDs. We found that in the vast majority of cases NEDs are employed through informal networks. The recruitment is usually through their social and business networks or recommendations from past employment contacts and associates, which are often white, male dominated. As such, there is rarely any contractual agreement on several important issues that may impact on their interaction. In addition, it restricts the scope for diversity on the board and denies firms access to the full spectrum of a talent pool from which to recruit NEDs. Both SME Executives and existing NEDs agreed on these points.

These findings suggest that SMEs either have limited awareness on how to formally recruit NEDs or do not have the resources to take on the layers of administrative and legal processes that may be associated with formalising the recruitment of NEDs. Whilst informal routes to the employment of NEDs may be appropriate for certain SMEs, it is imperative to note that lack of contractual arrangement may undermine NEDs’ accountability since there is no job description in the first place. SMEs and NEDs working together without a formal contractual arrangement must also recognise that this exposes them to uncertainty and conflict. This informal recruitment approach may also undermine independence and objectivity.

### How are NEDs integrated into the board/company, for example, through networking, mentoring, and induction programmes?

The study also explored whether and how SMEs support NEDs and enhance their integration into their business process and culture, for example, by way of training and induction for new and existing NEDs.

The majority of the NEDs and SME Executives in this study suggested that NEDs used their informal networks to garner the support they needed to function in their roles. SMEs only provide informal induction by way of information on the business, its performance and other basic information to integrate NEDs into the business. This practically implies that existing and aspiring NEDs have to invest in building and expanding their own networks and the quality and variety of support they can obtain from them to support their NED roles. A further implication is that, given the complexities and dynamics of the SMEs competitive environment, NEDs have to constantly re-assess their portfolios of skills and expertise to identify changing needs and locating sources for the acquisition of necessary core skills to ensure the deliverance of top-end value added to SMEs. This may require broadening their sources of support beyond their informal networks and may necessitate financial commitment to training and personal development.

### What does a NED role entail in an SME?

Overall, both NEDs and SME Executives agreed that it is the role of a NED to bring an independent perspective, strategic focus and new skills/expertise (governance,

functional, experience) in order to support and challenge SME boards in their capacity as advisors and critical friends. Executives also expressed a clear preference for NEDs that have good understanding of their business and sector, and that have passion to share their experience of working in successful organisations with a particular SME. Access to the NED's networks is further seen as important, as is experience that enables the NED to constructively challenge decisions, with a specific duty to steer the business to achieve its strategic objectives.

Both NEDs and Executives agreed that when NEDs fulfil their role, they bring kudos and great value to the SME, particularly during times of growth and change. Indeed, NEDs felt that it was their ability to influence the growth and success of an SME, as a NED, that they enjoyed most. Interestingly however, our study showed that SMEs do not tend to formally evaluate NEDs' performance. These findings have far reaching implications for SMEs currently using NEDs and those hoping to use NEDs in the future.

These findings in the context of SMEs currently using NEDs, suggest the need to support greater recognition of their value addition and appraise their strategic contributions to their firms' development. SMEs new to NEDs must identify their expected value proposition from NEDs and how they anticipate they would contribute to these. These findings imply that existing NEDs must continue to sharpen their independent, critical and constructive perspectives to provide value enhancing support to SMEs they work with. Aspiring NEDs must realise that SMEs appreciate NEDs that are alert to the specific needs of their businesses and are able to provide alternative perspectives that help them to articulate the pathways to their strategic objectives.

### What are the challenges for NEDs and their organisations?

Both NEDs and Executives in this study recognised the potential barriers to the value NEDs can bring to SMEs. The research revealed that although the interviewed NEDs are thoroughly enjoying their roles, they are not without their challenges and some of these are quite formidable. They seem to centre on corporate fit and embeddedness of NEDs into the culture of the SMEs. Some NEDs expressed these in terms of handling conflicts and others referred to it as dealing with organisational politics. These challenges are further complicated because NEDs have to recognise appropriate boundaries in terms of their roles and responsibilities and knowing when to 'let go', recognising that they are not in control and should not be making the final decision for the SMEs.

The volume of work and the time commitment also featured in the views of NEDs as challenges of the role. On the other hand, Executives' perspective on SMEs' challenges focused on limited resources, increasing global competition and layers of regulations and how to grow the business in the context of an increasingly tough operating environment for which the NEDs seemed to be a crucial part of the solution.



### What are the terms of engagement in relation to NEDs?

The research has demonstrated the great informality with which SMEs engage with NEDs. This informality cuts across the various key stages in their interactions. The research revealed a number of factors that account for this level of informality including the limited resources that SMEs have, the lack of awareness about the scope of support and areas of expertise that NEDs can bring to bear on SMEs, all reflecting the relative infancy of the use of NEDs in the SME market.

### The Gender Dimension

Finally, our study sought NEDs and Board members' views on the main reasons for women's underrepresentation amongst the NED population and ways in which this imbalance can be addressed. Both NEDs and Executives attributed the low number of female NEDs to the equally low number of women at senior/board level, which they felt was linked to women's career breaks or career change due to having children as well as limited access to key, male networks used to recruit NEDs. Overall, NEDs and Executives agreed on the reasons behind women's underrepresentation amongst the NED population and also that positive discrimination should not be utilised to change this.

## RECOMMENDATIONS

There appears to be no set pattern and little formality in relation to how SMEs select NEDs and at what stage they appoint them on their development trajectory. This is set against a trend towards increased formality, driven by the needs of a combination of the investor community and central government. Recruitment is predominantly from a narrow 'male dominated' skills pool, with perceived cost and value added, the dominant considerations, though there is little evidence that this is actively measured/formally managed by the SMEs. Recruiters and trainers, working with SMEs and NEDs need to work together to create a better mutual understanding of how these relationships operate, identify appropriate/affordable solutions, broaden the talent pool and create a better balance at board level. **The following recommendations have been formulated to specifically address these critical findings.**

The SMEs interviewed universally see the benefits of having a NED on the board and recognise their importance in terms of bringing an alternative perspective to the business, opening up new opportunities, acting as a sounding board and being a critical friend, eventually becoming an integral part of a more formalised governance structure/process. The recruitment of a NED and the timing of that recruitment does not follow a set process. **It is recommended that subject to the adoption of the recommendation immediately below, those involved in recruiting and training NEDs consider an organised and targeted marketing campaign, advising SMEs about the potential value of working with a NED, supported by the evidence presented in this report.**

There is clearly a link between the scale of an organisation and the need for formal processes and procedures in relation to its operation and governance, set against a long term and on-going trend of review (Cadbury, Hampel, Higgs etc) and codification and the introduction of ever more legislation (Corporate Governance Code 2016). The difficulty lies in how and when this applies across the lifecycle of a business, particularly given the rapid growth trajectory of some businesses, in some sectors. SMEs will by their very nature be more informal but perhaps not as universally informal, as was found with the research cohort, which may itself be a function of the fact that the NEDs were primarily appointed for what they could add to the business rather than governance *per se*. The current understanding of how and when this increased formality should apply across the growth trajectory to optimise the governance approach, is not as well understood as it should be. **It is recommended that the recruiters and trainers work with a selection of SMEs and NEDs to identify and map the trigger points for the stepped changes that occur, as the SME/NED relationship moves increasingly towards a more formalised governance role. This would build upon the current research findings and require close collaboration between the critical parties to this process, to establish the transitioning stages and timing for what an SME should be looking for from its NEDs, as the business grows and becomes more complex. This should be clearly understood before the further recommendations in the report can be fully and appropriately implemented.**

Invariably, the NEDs interviewed had been recruited through informal networks and in a number of cases, were personally known to the recruiting SME, which in itself calls into question the potential independence and impartiality of the NED, a key tenet of the Cadbury Report. In addition, we found that this informality may be denying access to women, as most of the networks used for recruitment were male in nature. Lastly, this recruitment process was invariably carried out without a formal job description, which in itself would provide clarity of understanding/expectations between the SME and NED. **It is recommended that SMEs appoint professional head hunters and/or NED training providers, to find their NEDs, working with a formal job description. This should reflect the SMEs stage of development and the emphasis of its requirements (e.g. helping the growth of the business or improving formal control/governance).**

The research highlights the perceived benefits of having a NED on the board of an SME, which are by and large, similar to those articulated in the Cadbury Report. However, it is clear that cost and added value are critical issues for these SMEs, along with whether or not having a potentially costly, formal process will give them better value for money. **In the circumstances, we would recommend that the recruiters and trainers work with selected SMEs and NEDs to develop a 'low cost', standardised recruitment process, with the requisite accompanying documentation (based upon the existing on-line models currently in operation in the executive recruitment market). This would enable SMEs to access a wider talent pool and address some of the issues associated with informality, referred to in the recommendation above.**

The SMEs interviewed felt that they obtained good value from their NEDs, despite the fact that none of the NEDs had a formal job description or annual targets or indeed, an annual appraisal. This would seem to indicate that this 'sense of gaining value' is probably a function of their personal relationships, rather than a set of objective tests. **It is recommended that a performance appraisal process be utilised by SMEs, to validate the value added and confirm that the skills and orientation of the NED match with the position of the SME on its growth/development curve, particularly in relation to an increasing requirement for improved governance/control.**

The NEDs in this study were not given or required to undertake training upon joining this particular group of SMEs and the SMEs themselves, felt under no obligation to provide training. However, when we asked NEDs the advice they would offer to an aspiring NED, their key recommendations were to 'get some training' and to 'network'. **It is clear from the NED feedback that they believe there is a requirement for training but there is a lack of clarity around who should organise/fund this. We therefore recommend that training be delivered in a more targeted manner, with responsibility for acquiring/funding that training being split according to the following criteria, with a focus on two key groups:**

- **Aspiring/first time NEDs, who should accept responsibility for securing/funding what the NED recruiters and trainers identify to be the base level of training required to be a NED.** This would enable them to 'learn the ropes' and focus upon a number of critical areas identified in the review (e.g. building a NED CV, breaking into established networks, understanding the critical legal responsibilities and of the role, etc.). This could be facilitated through a supporting coach/mentoring scheme, and 'shadowing' of more experienced NEDs at board meetings.
- **Established NEDs should receive training funded by the SME they support, to enable them to transition their role as that business grows/develops/formalizes and ultimately enable the SME to determine whether or not a new/replacement NED is required.** Our interviewees were typically representative of this group, possessing existing board and business experience (in SMEs). The proposed training would include, self-development, keeping up with current legislation (e.g. the Bribery Act) and an increased emphasis on corporate governance generally. Social media training was also recognised as a key skill. Critically, some of the NEDs interviewed recognised the importance of improving their conflict management skills, 'letting go' and resisting the temptation to take control of the business, dealing with the volume of work and time commitment expected by the SME.

In the reports on Corporate Governance produced to date, there is an increasing emphasis on having balance within the Board from both gender and business perspectives. In view of the fact that most of the networks currently used to identify and recruit NEDs are dominated by men, then gender imbalance will remain an on-

going issue and perpetuate what some regard as a narrow and self-serving skills pool. *It is recommended that the NED recruiters and trainers develop and distribute material to enable SMEs to see the value of gender diversity from both business and recruitment option perspectives. To address the issue of the dearth of female NEDs, it is recommended that these recruiters and trainers pro-actively encourage female executives (through a 'What About You' programme) to become NEDs, possibly linked to the offer of basic training at a discounted cost.*

## Future Research

In relation to future research, this could address three key areas:

1. The development of a NED skill requirement indicator toolkit for potential NEDs. It would be useful to carry out broader research that seeks to identify the core skills that a potential NED should have. This is different from their duties or values, but factors that enhance the delivery of value when they get into post and something they can develop before getting into post. This should be of immense benefit to both individuals seeking NED roles and those already in existing NED roles. It may also be a useful guide for listed companies. Identifying the specific skills required for this important role will be extremely useful to the individual but also importantly to the firms taking them on. This would be a useful next step in the research process and for training providers. A toolkit would enable individuals to benchmark themselves.
2. NED value added indicator toolkits for potential SMEs. This could be used to identify NEDs value addition to organisations, including SMEs. Whilst the current study uncovered that NEDs add value and suggest that these are in the area of strategic development amongst other, this is generic and SMEs may want something specific and concrete. A study that helps to identify in what spheres of operations and the nature of the value NEDs add to firms will be useful. This will extend one of our recommendation in which SMEs are required to do a NEDs need analysis and can compare their need with NED performance post appointment. A toolkit therefore provides a structured way of doing this.
3. A further, larger, qualitative study comparing the roles of NEDs in listed companies and SMEs, including a gender analysis. Many of the initiatives borne from the Davies Report (2015) and applied in FTSE companies, could also assist in increasing the numbers of female NEDs in SMEs.

## APPENDIX 1: DEMOGRAPHICS

### NED demographics and career background

Ages of the NEDs interviewed ranged from forty-one to sixty-nine years, the youngest being forty-one, with an average age of fifty-six. All interviewees were white British/white other, married or living with a partner, six had children. None disclosed a disability.

Interviewees were asked for their highest level of qualification. Three had left education after secondary school, but had completed further academic (e.g. degree, MBA) or professional qualifications (e.g. FCA, ACCA, CIM) later in their working lives. At the time of interview, one NED had an HND/HNC, and the others held either an undergraduate or postgraduate degree.

Participants were also asked for some advanced information regarding their remuneration as a NED, and this was explored further during the interviews. Three NEDs drew an annual salary for their roles ranging from £20,000-£52,000 (NEDs A, I and L) and two of these (NEDs L and I) had additional equity/share options. Three (NEDs B, E and G/H) declared a preference for share options or equity over a salary. Two charged a daily rate (NEDs C and K) and one (NED N) received a nominal amount of £2,000 per year. Two had no paid remuneration from the business – NED D drew a salary from the management company who charged the SME a monthly retainer of £1,000, and NED J was given access to licenced material and events by the business.

Table 1: NED Remuneration Package

NED	A ♂	B ♀	C ♀	D ♀	E ♂	G/H* ♂	I ♂	J ♀	K ♂	L ♂	N ♀
Remuneration	£35-27.5k	Share Option	£1,000 Daily Rate	N/A	Share Option	Equity Option	£20k + Equity	N/A	£750 Daily Rate	£20-£52k + Equity & Share Options	£2k

\*NED for two SMEs included in our interview sample

Table 2: Board demographics

Board	A ♀	B ♀	C ♂	D ♂	F ♂	G ♂	H ♂	J ♀	O ♂
Directors (of which female)	8 (2)	2 (1)	5 (1)	3 (0)	4 (1)	3 (0)	2 (0)	2 (2)	
NEDs	2	1	4*	2**	1	1*	2	1	

\*Advisory role \*\* Appointed by investor

## APPENDIX 2: CONTEXT

This section of the report summarises previous published research on the role of NEDs, which sets the context for the current research study.

### Non-Executive Directors (NEDs) in Small and Medium Enterprises (SMEs)

Over the last few decades, Non-Executive Directors (NEDs) have increasingly represented a key mechanism for ensuring corporate accountability and increasing board effectiveness (Zattoni and Cuomo, 2010). According to Dulewicz et al. (2007: 1056), this has been particularly driven by a, 'series of public reports – Cadbury (1992), Greenbury (1995), Tunrull (1999), Smith (2003) and Higgs (2003)' – that have helped to define the role and importance of NEDs in the UK. Following corporate scandals, the recommendations of these public reports were implemented through, 'a series of codes issued by the UK's Financial Reporting Council' (Dulewicz et al., 2007: 1056) and NEDs became a requirement for listed companies (Boxer et al., 2016).

### Who are NEDs?

Thus, NEDs are important in the current corporate architecture given the spread of corporate collapse and the urgent need to mitigate recurrence of future corporate misbehaviours. NEDs are external experts with significant experience whose involvement in a company is mainly their provision of guidance, expert advice and oversight functions on the management of the firm. These oversight functions require significant levels of objectivity and consequently NEDs, at least in listed companies, should not have any recent employment, business or familial relationship with the organisation or any key member of its top management.

On this point, the Cadbury report (1992) and the UK corporate governance code (2016, section B.1.1) defined the role of a NED. It indicated that corporate boards should include independent directors who, apart from their directors' fees and shareholdings, are independent of the management and do not have any form of business or other relationship with the company which could materially interfere with the exercise of their independent judgement. The section further states other conditions that could potentially affect a Non-Executive Director's objectivity

NEDs have the same level of responsibility as the Executive Directors for the strategic outcomes of the firm but less influence on the day-to-day operations of the business. Ultimately, NEDs, as part of the board, are the primary custodians of the company and undertake significant responsibilities and risks, including litigation risks, if anything should go wrong in a company they serve. Given this, the Companies Act (2006) binds NEDs and stipulates the legal and statutory responsibilities of directors in companies.

However, the UK corporate governance code (2016) also provides a number of important principles and specifies actions that companies should take to facilitate the discharge of these responsibilities whilst mitigating directors' risk exposure. On this issue, section A.1.3 of the code provides that, 'the company should arrange appropriate insurance cover in respect of legal action against its directors'.

Furthermore, NEDs have the right to access the company's documents, contact its management and shareholders and are able to ask questions and seek clarity on issues. More importantly, the code in sections B.4.1-2 also requires companies to organise formal induction and training for their new and existing directors. These include funding directors' attendance at specific training and procurement of expert advice on technical or new/emergent issues that could enhance their contribution and decision making on the boards' deliberations.

### The NED selection process in listed companies

A fundamental concern in maintaining NEDs' objectivity relates to their selection and appointment. It is imperative to ensure that the selection process is honest, transparent and efficiently undertaken within the specific requirements of the company in mind. Companies should have a clear framework of interaction and communication that does not infringe on NEDs' objectivity or make them in any way subservient or compromised in the provision of their oversight functions on the management due to their selection and retention process. Whilst this may be theoretically possible, it is practically difficult, given CEOs' influence in organisations (Hickman, 2014; Doldor et al., 2012).

The UK Corporate Governance Code provides that the selection and appointment of NEDs should be by the nomination committee. Section B of the main principle of the UK corporate governance code (2016) provides that, 'there should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.' Section B.2.1. requires that the nomination committee should lead the search and section B.2.2 indicates that the search and selection should recognise the current balance of skills in the board and with a view to enhancing these. Section B.2.3 indicates that appointments should be for a specific period. Board selections should have due recognition for board balance and diversity. In practice, companies often outsource the nomination process to recruitment consultants (Hickman, 2014; Doldor et al., 2012) or use informal networks. In order to ensure transparency whilst maintaining flexibility, the code provides in section B.2.4 that where a firm has used a search company and the appointment had not been formal, then there should be a disclosure in respect of this in the nomination committee's report in the annual report.

### The NED selection process in SMEs

The NED selection process in SMEs is probably more complicated than the formal structure in a listed company. In this sense, Deakins et al. (2000) note that selection of external directors could be influenced by two considerations, which they categorised as agency and resource dependency bases. The authors suggest that the need by venture capitalists to have representation on the board of the backed company often motivates the agency basis. This basis could result in conflict between CEOs and NEDs of such companies.

On the other hand, SMEs could select their NEDs based on their needs and the potential external expert resources that NEDs could facilitate for the company. In this situation, it is plausible to expect that this could lead to consensus between the

CEO and NEDs. However, Deakins et al. (2000) note that the dynamics between CEOs and NEDs is not that simplistic and that whether NED appointments are backed or not backed by venture capitalists does not explain these modes of interaction. This report explores the selection process for NEDs in SMEs further under the section on the challenges to the value of NEDs in SMEs.

### NEDs' roles in companies

Theoretically, agency and resource dependency theories provide some justifications for the role and importance of NEDs in companies (Zattoni and Cuomo, 2010). Agency theory (Fama and Jensen, 1983) suggests that where ownership and control of companies are separated, individual agents (i.e. company directors) will act opportunistically and are strongly motivated, 'to take profit from the information asymmetry between them and their principals' (i.e. shareholders) (Zattoni and Cuomo, 2010: 64). NEDs, in their roles as independent agents on boards of directors, are then seen as a primary mechanism for controlling top management's actions to secure shareholder value maximisation (Zattoni and Cuomo, 2010).

Resource dependence theory (Pfeffer and Salancik, 1978), on the other hand, informs the view of NEDs as a resource that provides advice, expertise and experience on the board of directors. It stresses the importance for NEDs to draw on these abilities and experience to support top management in their strategic decision-making and, 'provide external legitimacy and networking' (Zattoni and Cuomo, 2010: 64). Based on this theoretical reasoning, Zattoni and Cuomo (2010: 65) argue that the, 'key antecedents of Non-Executive Directors' effectiveness are a) the degree of independence, b) the level of knowledge and skills and c) the economic incentives to behave properly.' They go on to suggest that the independence of NEDs allows them to see things differently and that their experience and functional and/or firm-specific skills enhances innovative, creative decision-making on boards of directors.

The role, value and importance of NEDs, predominantly in listed companies, has been evaluated by many studies in the UK and globally and some consensus seems to exist. It is agreed that the primary role of NEDs is to provide an independent viewpoint on issues of strategy and corporate governance (Cadbury, 2002) as well as providing skills, expertise and alternative perspectives that enable a balance of interests in the boardroom (Waldron and Burman, 2007). Dulewicz et al. (2007) analysed the nomination documentation for the 2006 NED of the Year Awards, and suggest that an outstanding NED displays high levels of integrity, ethical standards in their own behaviour and lead on corporate governance matters. Outstanding NEDs also promote investors' confidence, spend a considerable amount of time mentoring, developing and advising colleagues and work as team builders. This, Dulewicz et al. (2007) argued, allowed outstanding NEDs to challenge colleagues and enable consensus, hence displaying critical faculty and critical thinking abilities.

Yet, alongside this positive picture, there is also some recognition of the potential problem of the 'independence paradox' (Clifford and Evans, 1997; Hooghiemstra and Van Manen, 2004). It highlights that NEDs' independence is questionable given their part-time status in companies and reliance on information provided by the Board of



Directors. Furthermore, it is likely that independence might not be the defining quality of NEDs in other corporate settings such as SMEs, where there is no distinction between the ownership and management of a corporation.

### What is an SME?

SMEs are not an homogeneous group and their definition and characterisation differ considerably. For accounting and auditing purposes, a firm is an SME if it meets any two of the three size related criteria of turnover, balance sheet asset and number of employees. Table 1 below presents the classification of enterprises to SMEs, based on these criteria.

Table 3: UK Thresholds for SME starting April 2008 Criteria

	<b>Small company</b>	<b>Medium company</b>
Turnover	£6.5m (€8.8m)	£25.9m (€35.0m)
Balance sheet total	£3.26m (€4.4m)	£12.9m (€17.5m)
Average employee	50	250
	<b>Small group</b>	<b>Medium group</b>
Aggregate turnover	£6.5m net or £7.8m gross	£25.9m net or £31.1m gross
Aggregate balance sheet total	£3.26m net or £3.9m gross	£12.9m or £15.5m gross
Aggregate average employees	50	250

On the other hand, the Office for National Statistics (ONS) uses the number of employees as a basis for categorising businesses into SMEs. In this sense, it considers businesses that employ between 0-9 staff as a micro-entity, businesses with 10-49 employees as small, those with 50-250 employees as medium and firms with more than 250 employees as large, as presented in Table 2 below. SMEs operate across sectors and their ownership structure varies from a family owned business to partnership and unlisted private companies.

Table 4: Office for National Statistics threshold for SME

<b>Business type</b>	<b>Number of employees</b>
Micro entities	0-9
Small	10-49
Medium firms	50-250
Large	250+

SMEs are, 'the backbone of the European economy, acknowledged as a constant source of ideas, innovation and entrepreneurial skills, the principal providers of existing jobs and the main source of new employment' (EC, 2006: 1). According to the Department of Business Innovation and Skills (2013), 'SMEs represent 99.9 per cent of private sector businesses and provide employment to an estimated 14.4 million people, which is 59.3 per cent of private sector employment. Their estimated combined annual turnover of £1,600 billion accounts for 48.1 per cent of private sector turnover'

## Corporate governance regulation for SMEs

Despite their economic significance, compared to listed companies, there is no standard or universally accepted corporate governance guidance for SMEs. However, several institutions and organisations in the UK and globally have made remarkable efforts at providing guidance to help SMEs consider the importance and adoption of corporate governance best practices. Notable amongst these organisations includes the UK Institute of Directors (IoD), The European Confederation of Directors Associations (ecoDa), The Quoted Companies Alliance (QCA) in the UK, The British Standard Institute (BIS) and the International Finance Corporation (IFC).

The overarching theme that connects the guidance provided by all these bodies is the importance of a robust and transparent mechanism for directing the activities of a firm in such a way that fulfils the objectives of the founders and its other stakeholders whilst recognising the limitation of an SME. In this sense, all the organisations are unanimous in suggesting that good corporate governance arrangements in an SME have the potential to enhance their performance and growth. They suggested that these may be achieved through improved internal control, reduction in cost of capital and easier access to credits. In achieving these, they identified the importance of having an external, independent perspective through having a NED or an advisory board that can discharge similar functions.

## NEDs in SMEs

Whilst the interest in understanding the role and benefits of NEDs is not new, recent studies on these issues within unlisted, SMEs are scarce (Gordon, 2013; Gabrielson, 2007; Long et al., 2005; Berry and Perren, 2000; Hampel, 1998; Mileham, 1996). Studies that have explored NEDs in an SME context agree that the role of NEDs tends to be somewhat different to that in the context of listed companies and that independence is indeed not of primary importance. Furthermore, available evidence seems to discuss SMEs' NED needs in the context of, and in comparison to those of listed companies, failing to recognise their uniqueness (Rosie et al., 2016; Berry and Perren, 2001). Yet, NEDs in the SME sector are no less important (Brenes et al., 2011), considering SMEs' contributions to the economy. Moreover, many practical issues relating to the use and integration of NEDs in SMEs also remain under-researched (Lampel et al., 2014; Kraus et al., 2013; Brenes et al., 2011).

The extant literature on NEDs in SMEs broadly presents two sides of the argument for the roles and benefits of NEDs in SMEs 1) the demand-side and 2) the supply-side arguments. The demand-side argument focuses on the need for NEDs by SMEs whilst the supply side argument addresses the benefits that NEDs can actually provide to SMEs.

## SMEs Demand for NEDs

SMEs' need for NEDs varies considerably depending on many factors, including their ownership (e.g. family owned, private unlisted companies, and joint venture), management structure (founder-manager, family-managed, and professionally managed), priority (hold to sell, public listing, and internationalisation), size and their life-cycle stage (start-ups, established SMEs and Initial Public Offering (IPO)).

Nonetheless, SMEs' limited resources provide incentives for their need for NEDs as they are able to benefit from the expertise of NEDs without having to hire them as part of their full-time staff (Long et al., 2005).

The growing sophistication of modern economies and globalisation with its attendant fierce competition further compounds this need (Gabrielsson, 2007). These inadvertently give rise to increased regulations and compliance issues amongst other complexities (Gordon, 2013; Gabrielsson, 2007) constantly getting in the way of running the business for which SMEs do not have the resources to obtain internally.

However, it seems there is a consensus on what SMEs expect from NEDs and this can be broadly categorised into supporting, advising and networking roles (Gordon, 2013; Coulson-Thomas 2007; Barrow, 2001; Berry and Perren, 2001; Atherton and Hannon, 1999). In this sense, many owners and directors of SMEs seem to look up to the NEDs as a source of expert knowledge and external resources that they can use to complement their limited internal resources to support their business growth and development.

On this, Coulson-Thomas (2006) suggests that NEDs in SMEs could be instrumental in their growth and support them to achieve significant future development. Long et al. (2005) indicate that NEDs provide core expertise that complements internal skill deficits in SMEs. Berry and Perren (2001: 165) suggest that, consistent with findings from Atherton and Hannon (1999), SMEs expect NEDs to provide them with 'know-how, control, sounding board, know-who, strategic awareness and strategic focus'. Similarly Barrow (2001), in the case of hi-tech companies, notes that the roles of NEDs have changed significantly from being a 'police', and internal 'inspector' (Coulson-Thomas, 2006:253), protecting the interests of the external financier such as venture capitalists, to a broad range of support depending on the enterprise's life-cycle (Scholes et al., 2010; Filatotchev and Wright, 2005). The author identified advice on financial growth, formality and discipline, impartial advice, strategy formulation and implementation, networking to build strategic alliances, preparing business for exit, breadth of managerial experience, and preparing the firm for IPO, as some of the key functions that SMEs expect from NEDs. In addition, NEDs in SMEs are particularly valued as advisers and provide missing expertise, experience and vital access to external networks (Deakins et al., 2000).

SMEs' need for NEDs also varies depending on their size and priorities (Scholes et al., 2010; Berry and Perren, 2001). Whilst smaller SMEs may benefit from initial 'hand-holding' and 'sign-posting' support from their NEDs, the need of a larger SME experimenting with delegating control will be different. For example, a firm transitioning from a founder-managed or family-managed to a professionally-managed firm may look to the NEDs for support with formalising their board processes or Executives that can act as the 'critical friend' providing external perspectives that may be missing internally. On this theme, Berry and Perren (2001) suggest that SMEs' needs are different due to the difference in their life-cycle stage (Scholes et al., 2010; Long et al., 2005) and it is important to tailor NED support to

the specific need of each SME. They further indicate that whilst smaller SMEs may prefer support with issues such as financial planning and growth, larger SMEs may value 'outside objectivity, structured board procedures and having a prestigious name on the board'(p.166).

### Supply-side argument

Whilst there seems to be a consensus on the SMEs' need for NEDs, empirical findings on the actual benefits that NEDs deliver to their SMEs are mixed, which is probably due to the heterogeneous nature of SMEs. This implies that each SME is unique with a distinct set of challenges and opportunities. Moreover, NEDs' support does change with the changing needs of the SMEs, which in some cases may mean the replacement of an existing NED with a new NED with the specific skills that the firm needs at that point in time. An important area in which previous studies have found NEDs to be very influential in SMEs is their ability to support firms' strategic development (Gordon, 2013; Scholes et al., 2010; Long et al., 2005; Berry and Perren, 2001). This is because as Gordon (2013) suggested, SME owners and managers are often pre-occupied with the day-to-day running of the business which prevents them from giving due attention to the long term strategic view of the firm. Brunninge et al. (2007) further suggested that even when they have overcome their inertia to take strategic decisions, wider considerations, including family issues, inadequate exposures and knowledge, get in the way of their strategic decision-making.

According to Gabrielsson (2007: 511), these strategic decisions, which may include product innovation, frequent and extensive commitment to technology and proactive competitive orientation, are crucial in SMEs' survival and growth in an increasingly competitive environment. This emphasises that NED support is crucial for SMEs growth and survival through their external perspectives and expertise (Scholes et al., 2010; Long et al., 2005).

Empirical evidence supports the value creation role of NEDs in SMEs. In this sense, Brunninge et al. (2007) found that the presence of NEDs in SMEs is positively associated with firms' strategic change. Gordon (2013) further argues that whilst there is at present no legal requirement for unlisted companies and SMEs to have a NED, studies show clear benefits of NEDs in small companies because they lead to an increase in companies' ability to grow and make effective strategic decisions.

Gabrielsson (2007) distinguished between NEDs' demographic representation on the board and actual involvement in decision control. He further suggested that it is the actual NEDs' involvement rather than their mere presence that makes a difference in the SMEs strategic decision-making. However, Fiegenger (2005) reports that the board's participation in SMEs' strategic decision making is conditional on the firm's size, the number of other outside directors presently on the board, the strategic issue under consideration and the extent of ownership and power controlled by the CEO. The author found that NEDs are more likely to be involved in the strategic decision of larger SMEs who are in transition or in potential downturn, and where the CEO's ownership or power is low.

## Challenges to the value of NEDs in SMEs

Despite the resounding positive views on the value of NEDs to SMEs, their integration into SMEs may not be seamless. The literature suggests a number of challenges to the integration of NEDs and barriers to NEDs delivering value-adding functions in SMEs.

### Trust

Notwithstanding the value that NEDs can bring to SMEs' strategic decision-making, Fiegenger's (2005) findings reflect the broader caution that other authors have expressed about the role of NEDs in SMEs. For example, Coulson-Thomas (2007) found that SME owners prefer to take strategic decisions themselves and fear losing control to outside directors. A more fundamental issue, beyond the fear of losing control, that could potentially undermine the relationship between NEDs and founder-managers of SMEs, is trust. Absence of trust between the two parties could make the expected value addition from NEDs unrealisable. In the absence of trust, SME managers and owners may see NEDs as unwanted outsiders rather than a critical friend.

In this sense, Rosie et al. (2016: 369) explored the trust relationship between NEDs and MDs in SMEs in the UK on the backdrop of the potentially changing roles of NEDs and how their involvement in client's companies are shaped by the changing interactions between the parties and the central role that trust played in these. They found that the role of NEDs in the SMEs examined, changed from 'an effective agent acting rationally on behalf of the company to an ineffective agent acting subjectively on behalf of the MD'. They further note that these social interactions, which challenged the role of the NEDs and affected the perceptions of trust between the parties, adversely affected and indeed threatened their individual self-esteem. They argued that NEDs in SMEs should not be in position for so long, to avoid compromising their objectivity.

### The NED selection process in SMEs

Whilst Rosie et al.'s (2016) findings in respect of trust and the suggestion for rotation of NEDs in SMEs are instructive and well meaning; the reality of these for many SMEs, especially small ones, may be different. This may be because the majority of small SMEs have just one NED on their boards and the cost of maintaining this one NED is probably significant to them, let alone being able to afford changing their NEDs on a regular basis. Westhead (1999) conducted a study on the factors associated with unquoted company's employment of NEDs and found that owner-manager firms are less likely to employ a NED while older firms are more likely to employ a NED compared to younger firms. Similarly, the larger the size of the firm, the higher their likelihood of employing a NED. Furthermore, family owned firms or firms in which the Executive Director has higher share ownership are less likely to employ a NED.

Continuing on the theme of the NED selection process, Coulson-Thomas (2007) notes that many SMEs have just one NED on their board and indeed that their selection is usually informal. However, available evidence seems to corroborate

anecdotes in suggesting that there is a link between trust and the selection process of NEDs in SMEs, apart from cost consideration. It seems that many SMEs prefer the informal route in selecting their NEDs, who are often friends or trusted past employees who are asked to stay on in Non-Executive roles as a *'quid pro quo'*.

The fear of the unknown is also a consideration that management of SMEs have when selecting their NEDs. A relevant concern here includes how the new NEDs would affect the existing atmosphere in the board and in the company, and the fear that they may be disruptive thus getting in the way of running the business (Gordon, 2013). Many owner-managers also fear being restricted in their freedom to take decisions about their business as they deem fit, which may be against their primary objective for being an entrepreneur in the first instance (Coulson-Thomas, 2007).

It seems that many of the issues raised above centre on the integration of NEDs into the organisation, and how to handle the dynamics of this process. There is a significant gap in the existing literature related to this issue. Whilst listed companies may be able to provide training and induction for their new NEDs thereby making the transition and integration seamless, SMEs are probably not able to afford such 'luxury', especially where they are not able to directly link such costs to their overall, usually, short term performance.

Another potentially important factor in the SMEs' NED selection decision, which seems neglected in the extant literature, is their awareness and knowledge about the NEDs' availability, sources and procedures for selecting NEDs. Whilst the role of Executive Search Firms (ESF) is prominent in the selection process for NEDs in larger companies, it seems that SMEs will also benefit from similar services. This will at least provide some assurance of the availability of a reliable supply of adequately qualified NEDs, and an idea of the process when they get to the stage where they are considering their adoption in their business.

### NEDs: A gender perspective

Globally, women comprise 24 per cent of senior management roles, predominantly in finance, human resources, corporate affairs, marketing and sales. In the UK, 45 per cent of female Executive Directors are financially qualified and a total of 65 per cent have a financial background (Grant Thornton, 2013). Women comprise 32 per cent of senior and middle managers in the UK (ILO, 2015).

The lack of women on the boards of Financial Times Stock Exchange (FTSE) companies has been brought into sharp focus by the Davies Reports (2011, 2012, 2013, 2014, 2015). The Five Year Review (Davies, 2015) states that, 'there are more women on FTSE boards than ever before' and that women now comprise 26.1 per cent of FTSE 100 Executives, which is just in excess of the target of 25 per cent set in the original Davies report in 2011 and represents a doubling of women's representation on FTSE 100 boards from 12.5 per cent in 2011. The target to reach for the numbers of women on FTSE boards by 2020 is 33 per cent. Despite the increase in women at Non-Executive level and Executive levels in FTSE companies, the latter numbers remain low, at 9.6 per cent. As at October, 2015, the number of

female NEDs on FTSE 100 boards was 260 (31.4 per cent of all NED positions). There were just three women chairwomen, five female CEOs and the total number of women in directorships was 1097. In terms of prior board experience, 29 per cent of new female appointments to FTSE companies had academic board experience, 58 per cent had prior 'not for profit' experience, 80% had private company board experience and 78 per cent had previous listed board experience since their first FTST appointment. There was a breadth of experience in Non-Executive roles but less so in Executive roles.

The targets set by Lord Davies do not differentiate between Executive and Non-Executive appointments, perhaps because bodies such as Women on Boards and the Chartered Institute of Personnel and Development (CIPD) recognise that increasing the numbers of female Executive Directors is a tougher challenge when compared to increasing the numbers of Non-Executive Directors. The CIPD (2015) has called for a separate target to help increase the proportion of women in Executive Director positions. This would reveal the true rate of progress in the FTSE 100 and may perhaps give added impetus to the pressure on the government to reconsider its policy of 'no quotas' to increase the numbers of women in senior management in the UK.

Why does senior management continue to be male dominated and why should this concern us? Senior managers as decision-makers tend to have access to power in organisations, especially resource power (Kanter, 1977), make key business decisions and also important decisions about the running and funding of public services. Women's relative absence from this decision-making process means that business management is 'male-centric' and that the voices of women are not heard at these levels. Many have argued, for example, Davidson and Burke (2011) that having more women making decisions should help to change the character of those decisions and that those decisions would be more likely to take women's needs into account.

The argument that boards with female representation are 'better for business' has been well rehearsed and couched within the business case argument that this should lead to increased profits and improved corporate governance. Gender balance is increasingly seen as being 'good for business', and at management and board levels, makes financial sense (ILO, 2015). Other business case arguments include the view that selecting leaders from a wider pool of men and women means that organisations get to tap into a wider pool of talent, especially as women now comprise just over half of all university graduates in the UK. Increased numbers of women at the top of organisations in itself would send a message to other women that it is possible for them to progress into these positions and highlights that female role models and mentors are available.

According to a (2015) CIPD survey of HR professionals, the benefits of the improved representation of women at board level include: women bringing a different perspective to the boardroom; a closer reflection of wider society and the company's client base; improved business performance; women at the top serving

as positive role models; increased innovation and creativity; and promotion of the organisation's reputation externally as a diverse employer.

A considerable amount of research has been published on the lack of gender diversity on corporate boards and in management generally (e.g. Durbin, 2015; Kelan, 2012) which has greatly enhanced our understanding of the experiences and perceptions of men and women at management levels. We are also witnessing a proliferation of interest in senior women in the media, through both social media (for example, YouTube and TED talks) and the publication of government and EU reports.

The debate on targets and quotas to increase the numbers of women in senior positions has also gained traction with a number of countries already introducing either voluntary targets or mandatory quotas, although the UK persists with voluntary targets. There are also a plethora of bodies and networks that have been set up specifically to support senior women and to encourage more women into senior management. The Female FTSE, compiled at the Cranfield University International Centre for Women Leaders, continues to make an invaluable contribution to the development of our understanding of where we are currently with these issues. The 'voluntary' approach to increasing the numbers of women on boards at Executive and Non-Executive level is the preferred approach by British businesses, who overwhelmingly say that they can fix the problem on their own (Davies Report, 2015). There is very little appetite for quotas.

Overall, it seems that within a UK SME context, there is still a dearth of empirical, qualitative studies that explore the value of NEDs, particularly with a view to the complexities of their part-time status, their relationship to owner-managers and investors and indeed critical explorations of the role of gender and diversity. The current research project both complements and goes beyond established research on NEDs in SMEs. In this study, we look at elements of the NED role not previously explored (why NEDs work with SMEs, what they get out of the role, the support they draw upon (i.e. networks) and the value they personally bring to the role). The comparative perspective between NEDs and SMEs/Executives is a key element in the analysis.

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## APPENDIX 3: NED questions

### Background

Can you briefly tell me about your working life and career to date?

### Being A NED

How would you define the role of a NED?

#### How did you become a NED?

- *How much experience do you have of a NED role?*
- *How did you prepare yourself for a NED role?*
- *How did you find out about becoming a NED?*
- *How did you identify organisations looking for NEDs?*
- *How easy was it to be paired with an organisation?*
- *Were you approached/did you apply/how recruited? (i.e. through informal networks, head-hunters, etc.)*
- *What were the selection criteria, i.e. was a level of sector or functional experience required?*
- *Who made the decision to hire you?*
- *Is the role remunerated? At what level? Does this include equity?*
- *Do you feel the remuneration is commensurate with the demands of the role?*
- *What was the length of contract offered for your current role?*
- *Were the reasons for your appointment made clear, i.e. was the 'need' for a NED on the board of this company explained to you?*
- *What has helped you most in becoming a NED (e.g. experience, qualifications)*
- *How easy/difficult was it to become a NED?*

#### Why did you want to be a NED?

- *Why a NED in an SME?*
- *Where else have you been/are you currently a NED?*
- *Do you feel there is a need for NEDs in the SME market? Why?*
- *Was this planned?*
- *How many NED positions do you hold?*
- *Where? Are these voluntary or paid?*

#### Can you describe what you do as a NED?

- *To whom do you directly report?*
- *How many people on the Board/gender composition of board?*
- *Was there a NED job description/defined duties and responsibilities before appointment?*
- *Was this an accurate description of what you do now?*
- *What knowledge and skills do you need as a NED?*
- *What in practice does your role entail? Areas of responsibility?*

- *How much of a commitment does the role entail (i.e. hours, administration, reading papers, etc.)*
- *How much of a say do you have in decision-making? Is your voice heard?*
- *Do you feel comfortable in challenging Board decisions?*
- *How do you resolve any contentious issues in Board deliberations?*
- *Is any of the above different in an SME when compared to the non-SME sector?*

#### **Describe the challenges around being a NED?**

- *What do you most enjoy about being a NED?*
- *What do you least enjoy about being a NED?*
- *(WOMEN ONLY) Are you the sole woman on the board?*
- *(WOMEN ONLY) How does it feel to be the only/one of a few women on the board?*
- *Does the Board/Chair do anything to empower your participation?*
- *(WOMEN ONLY) Do you ever feel isolated as a woman on the board?*
- *Why do you think women are under-represented amongst the NED population?*
- *Can anything be done to address this?*

#### **What support do you get as a NED?**

- *How much information were you given by the company prior to joining the board as a NED?*
- *Did you undergo induction? How long? What did this entail?*
- *Have you undergone training, provided by the company? Internal, external?*
- *Do you get the opportunity to update your training/development?*
- *Do you feel that you require more training for your NED role?*
- *Have you been assigned a mentor or coach since joining the Board? (if yes, who is your mentor and how has this helped)?*
- *Have you organized/funded any of your own NED training? If so, why, where, cost?*
- *What further support do you feel you need to support your NED role, that you haven't already received?*
- *What about networking – do you get the opportunity to network with other NEDs and members of the company?*

#### **How strong are your working relationships?**

- *Do you feel integrated into the Board of this company?*
- *Do you ever feel excluded, professionally and/or socially?*
- *How do you build relationships with other Board members?*
- *Do you network regularly with board/company members?*

#### **Value, Performance & Satisfaction**

##### **What value do you feel you add to this SME as a NED, in order of priority? Why?**

- *How does the SME know/measure the value that you add and can you give me any examples?*
- *Do you get an opportunity to offer your own 'unabridged' feedback to the Board?*

- *Do you think that you are listened to?*
- *Who assesses your performance?*
- *Do you feel you have met the expectations of the role?*
- *Do you feel you are providing the value expected of you as a NED?*
- *How realistic was the job description? Have you got involved in other areas of the business?*
- *Do you get regular feedback too?*
- *How valued do you feel as a NED for this SME?*
- *Do you think there are other ways you could have contributed to the company?*

### **Potential Changes**

#### **What would you suggest could be done to enable you to be more effective as a NED?**

- *If you were asked advice on how to become a NED, by someone aspiring to take up a NED position, what would you advise?*

*What advice would you give to an SME aspiring to appoint a NED?*

## APPENDIX 4: SME Executive questions

### Background

**Tell me about your business and its key objectives?**

### NED Role

**How would you define the role of a NED?**

**How many NEDs are currently on the Board and what do they do?**

- *When did you first have a NED on the board?*
- *Why do you have NEDs on the board? What was the need for a NED?*
- *What are the critical functions(s) they perform in priority order?*
- *What are the expectations of the role of a NED on the board of this company?*
- *Does this depend upon the business lifecycle (i.e. would you recruit NEDs at different stages and for different reasons)?*
- *What are the current challenges for the SME market?*
- *How can NEDs help to address these challenges?*

**How do you recruit NEDs?**

- *What was the main driver for the recruitment of NEDs?*
- *Is there a NED job description/defined duties and responsibilities?*
- *Do you know who drafted this?*
- *How were potential candidates identified (i.e. Board member networks; head-hunters, etc.)? Formal or informal recruitment process?*
- *How easy was it to find the right candidate(s)?*
- *What were the selection criteria, i.e. was a level of sector or functional experience required?*
- *Who determines who is hired?*
- *Is the role remunerated? At what level? Does this include equity?*
- *Do you think your NEDs are appropriately rewarded for what they do?*
- *What was the length of contract offered?*

**What does a NED role entail in an SME?**

- *What level of commitment do you expect from a NED e.g. time?*
- *What specific knowledge and skills do you look for in a NED?*
- *Are there any skills in short supply at the moment?*
- *Are NEDs in short supply?*
- *Are you comfortable with a NED challenging Board decisions?*
- *How do you feel personally when challenged by a NED?*
- *How important is it for the NED to be independent from the business (i.e. no personal or family ties)?*
- *In your experience is any of the above different to the non-SME sector?*

### **What support do you give your NED(s)?**

- *How much and what type of information do you give to NEDs prior to joining the company and before board meetings?*
- *Do you offer induction? How long? What does this entail?*
- *Do you offer NED training? What does this entail? In-house/external? Cost?*
- *How do you identify the training needs of NEDs?*
- *Do you assign mentors or coaches to NEDs when they join the Board? If yes, internal/external? Who pays?*
- *How do you ascertain whether NEDs require training, extra support and coaching/mentoring?*
- *How do you try to ensure that NEDs are integrated into (1) the company and (2) the Board? How important is this?*
- *Do you facilitate networking opportunities so that NEDs can meet other NEDs/company members?*

### **Value & Performance**

#### **What value do you think a NED brings to your organisation?**

- *What are (1) the main benefits and (2) downsides of having a NED on the board?*
- *What, in your view, are the characteristics that make an effective NED (e.g. integrity, high ethical standards, good listener, ability to challenge, sound judgement, etc.)*
- *Can you provide examples of tangible benefits to the organisation from having a NED(s)?*
- *How would you rate the performance of your NED(s)? Has this met or fallen below expectations?*
- *Is this linked to their reward in any way?*
- *If a NED is not providing the value expected, what action, if any, would you take?*
- *Has the NED involved his/herself in the areas expected (in the JD)?*
- *What other areas have they been involved in?*
- *Do you offer regular feedback to NEDs?*
- *Overall, how much do you value your NED(s)*
- *Do you have any reservations about using NEDs on your board?*

#### **Is any of this similar or different, depending upon whether the NED is a man or a woman?**

- *Do male and female NEDs bring different skills, experience, perspectives? If so, how do they vary? Examples?*
- *Why do you think women are under-represented amongst the NED population?*



## Potential Changes

### What would you suggest could be done to enable your organisation to optimise the value of what NEDs have to offer?

- *In fact, do you think NEDs are useful for SMEs?*
- *If yes, at what stage in their development (by reference to turnover, market, employee, risk or other criteria) should an organization consider appointing NED(s)?*
- *Is gender balance within the board something that you consider as a potential benefit to overall decision making?*
- *What about board diversity more generally?*
- *What advice would you give to anyone aspiring to become a NED?*