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HIGH PERFORMANCE LEADERSHIP

BDO LLP

INTRODUCTION

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The role and responsibility of the Non-Executive Director (NED) is changing. As companies of all shapes and sizes grapple with tough economic conditions, the need for high performance leadership and effective senior decision-making has never been more critical. Forward-looking boards are increasingly re-thinking their approach to appointing and utilising NEDs, seeking different skills and new added value in the face of evolving risks and opportunities for their business. In doing so, companies are beginning to understand the merits in moving their NEDs from the periphery to the fulcrum of boardroom discussion.

This BDO white paper is designed to help boards and executives improve their appointment and utilisation of NEDs. It introduces a framework consisting of four core criteria which we believe defines effective NED performance in the contemporary economy and, in doing so, provides a roadmap for boards and NEDs alike to better understand the evolving NED remit and the new value that companies require and derive from their NEDs. These four core criteria are:



1. EXPANDING HORIZONS

Embedding diversity of perspective at board level



4. DIGITAL DISRUPTION

Understanding risks and opportunities in new technology



2. EVOLVING GOVERNANCE

Helping navigate changing corporate governance requirements



3. REPUTATION MANAGEMENT

Boosting and defending corporate reputation and brand

THE NEED FOR NEW NEDS

In the decade since the global financial crisis, a series of high profile corporate collapses has refocused attention not only on the governance agenda, but on the nature of effective leadership and strategy more fundamentally. In virtually every industry, companies face common threats: heightened competition and tightened margins, the impact of new technologies, the evolution of the corporate governance agenda, intensifying regulatory and media scrutiny, changing stakeholder expectations, shifting public attitudes, and more.

Against this backdrop, the role of the NED becomes ever more important. Skilled, experienced and empowered NEDs can help organisations (re)position themselves advantageously amidst complex commercial forces, seizing unseen opportunities and mitigating emergent risk. It is the task of the NED to bring 'the outside in' and voice a dispassionate external perspective at the boardroom table. In doing so, they must be able to speak truth to power and challenge the entrenched received wisdom of executive teams.

However, this best practice approach is not always fully reflected in reality. Some organisations still approach the appointment of NEDs as a tick-box exercise in which candidates are drawn from too narrow a pool of professions. Experience shows that this is a particular risk in mid-sized or entrepreneurially-founded businesses; by some high profile failures in this area of the market close personal ties and friendships can undermine the resilience of any business, once interwoven throughout boardroom decision-making.

If boards wish to position themselves most competitively, they need to think differently about how they identify, appoint, empower and exploit the abilities of their NEDs. In particular, they need to consider the extent to which their NEDs are able to help them address the four core criteria described in this paper.

EXPANDING HORIZONS

EMBEDDING DIVERSITY OF PERSPECTIVE AT BOARD LEVEL

1



High performance boards are able to draw upon a diversity of perspective in their decision-making processes. To create this pool of varied expertise, executive teams and Nomination Committees should consciously seek to appoint NEDs that complement and challenge prevailing thinking in the boardroom, rather than mirroring the aptitudes and behaviours already present.

Constructive challenge is essential in boardroom discussion. From their bipartisan vantage point, NEDs must work to break the often-myopic bunker mentality which plagues even the most skilled boardroom teams and help spark new thinking in the face of intractable problems. This diversity of perspective helps promote the cross-pollination of ideas and works to nullify the influence of deep-rooted cognitive biases which can beset like-minded teams - not least the effect of groupthink and other similar risks - and break the psychological and social conformity therein.

Boards need to be counter-balanced by a team of NEDs with the skills, gravitas and experience to not only understand each aspect of the business, but also the confidence and emotional intelligence to understand the attitudes, behaviours and risk appetites of those around the table, not least the Chief Executive. Executive teams must therefore recruit NEDs based upon their assessment of specific business need, rather than appointing like-minded individuals in their own image. To do this, boards must conduct a thorough and transparent self-evaluation and skills gap analysis, from which areas of strategic weakness can be identified and addressed by the appointment of a relevant NED.

BDO has worked with a prominent mining company, whose Audit Committee benefitted enormously from the collaboration between two key NEDs: one a former partner of an audit firm, the other from a natural resource engineering background. The insertion of the engineering professional into the audit function demonstrates clearly the value of diverse perspective at board level. It enabled the Audit Committee to bolster itself with precisely the on-the-ground scientific knowledge the company's business model is built upon and thus examine future revenue projections and investment decisions more critically.

Diversity of perspective is built upon a range of factors: not only differing professional training and skill sets, industry backgrounds, age and experience, knowledge of different business models, but also behavioural profile, risk appetite and social group skills. However, the majority of NEDs still come from a relatively narrow subset of professional disciplines such as accountancy. Boards must do more to augment such traditional (and still important) NED skill sets with additional perspectives, not least those found in increasingly important fields such as technology and reputation management (both explored in detail below).

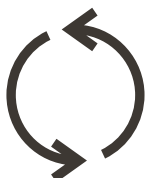
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EVOLVING GOVERNANCE

HELPING NAVIGATE CHANGING CORPORATE GOVERNANCE REQUIREMENTS



It is a core responsibility of every NED to help guide a board in relation to its corporate governance responsibilities. To do this, NEDs must understand deeply the legal and regulatory framework within which the business operates and the accountabilities of the directors. Moreover, NEDs must take responsibility themselves for ensuring they are up-to-date with all relevant developments affecting the company's governance and compliance record.

Just as boards are being increasingly scrutinised over their thinking around how they identify, appoint and empower NEDs, so too are NEDs themselves facing tougher questions around their performance and how effectively they position themselves to provide maximum value in their roles - not least around corporate governance issues. However it is not uncommon to observe NEDs, even those at high profile public companies, being unaware of critical new developments in the corporate governance regime. For example, the far-reaching changes proposed by the Competition and Markets Authority are not understood by the same NEDs on even the largest companies.

The corporate governance regime continues to evolve and NEDs must be positioned to advise accordingly. Good governance now encompasses an array of business-critical issues, from social impact to long-term strategy, and can no longer be viewed simplistically as a financial bill of health. Correspondingly, the role of the NED is also diversifying in line with the new responsibilities boards face.

In 2016 the UK government acknowledged in its Green Paper on corporate governance reform that "something has to change" after several high-profile incidents had heavily impacted the public's trust in business. Following the Green Paper consultation, reforms in The Companies (Miscellaneous Reporting) Regulations 2018 came into effect from January 2019 and boards should now be looking ahead to 2020 and the first round of reporting under the new regulations, which include new requirements for company strategic reports and director reports.

This has a significant impact on the role and responsibilities of NEDs, with a critical aspect being stakeholder understanding and workforce engagement. For example, the updated UK Corporate Governance Code (2018) recommends using one of the following methods to engage with the company's workforce:

- ▶ a director appointed from the workforce
- ▶ a formal workforce advisory panel
- ▶ a designated non-executive director.

It is no longer sufficient for NEDs to be the gadfly voice at board level. They have a fundamental role in assessing the operational effectiveness of a business and working as the conduit for stakeholder (both internal and external) feedback to the board and onward to investors and shareholders.

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Effective NEDs understand that good governance encompasses an array of business-critical issues. It is no longer simply a financial bill of health.

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REPUTATION MANAGEMENT

BOOSTING AND DEFENDING CORPORATE REPUTATION AND BRAND

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It has become increasingly important for boards to consider the building and protecting of corporate reputation as an essential - yet often overlooked - driver of long-term business success. To do this, boards must view corporate reputation as a distinct management concern to be addressed overtly at every step, not as the accidental by-product of other decisions made.

The risks of not doing so are high. Across industries, businesses large and small are operating in complex landscapes defined by intense media scrutiny, empowered stakeholders, and ubiquitous digital and social media exposure. Aon's 2017 global risk management survey revealed reputation and brand damage as the top-ranked risks for businesses, for the second year in a row. In this landscape, every decision made bears a reputational impact, whether good or bad. Like any risk, reputational risk can never be eradicated entirely; it must instead be mitigated and managed carefully.

NEDs are well-positioned to add clear value in helping put 'corporate reputation thinking' at the heart of board discussion. Effective NEDs have a strong 'external orientation': they must understand the shifting patterns of market and public sentiment around core issues critical to business operations. They have a keen sense for how the company's actions will play in the eyes of different stakeholder groups and can quickly comprehend the wider context and the (often unseen) ramifications of any executive proposal put forward. In doing so, they 'bring the outside world in' and further break down pervasive bunker mentalities in the boardroom.

Among professional services firms, BDO has itself been progressive in its approach to NED appointments. In 2017, the firm appointed highly experienced former journalist Jeff Randall to a NED role, to provide precisely the reputation management perspective a business like BDO requires. His appreciation of public, stakeholder and media attitudes around key issues enables him to challenge senior decision-making from an invaluable position and ensure that a 360-degree viewpoint is adopted in all leadership thinking.

The growing need for corporate reputation management at board level is becoming more apparent in the evolution of the UK Corporate Governance Code, which now more than ever stresses the need for boards to consider the effects of its decisions on all relevant stakeholders, not least employees, customers, suppliers and the wider public. Under new corporate reporting requirements, boards must consider all sources of value in its business model - including intangible assets such as corporate reputation and brand strength.

Yet not all NEDs are positioned to perform this reputation management role effectively. In part, this is a function of training and professional experience: the majority of UK NEDs are from a financial, legal or macro-strategy background, disciplines in which individuals are rarely asked to consider questions of corporate reputation.

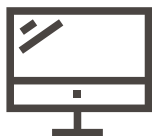
In contrast, there are very few NEDs across UK boards from professions in which reputational thinking is a core requirement of the role, such as corporate affairs or stakeholder relations and communications. This imbalance creates a skills and perspective gap at most boardroom tables; a gap which boards must seek to fill either through the appointment of relevant individual NEDs, or by seeking to inculcate every executive and NED position with the awareness and responsibility for corporate reputation management thinking.

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NEDs must 'bring the outside world in' and break down the bunker mentalities that can pervade boardroom discussion.
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DIGITAL DISRUPTION

UNDERSTANDING RISKS AND OPPORTUNITIES IN NEW TECHNOLOGY



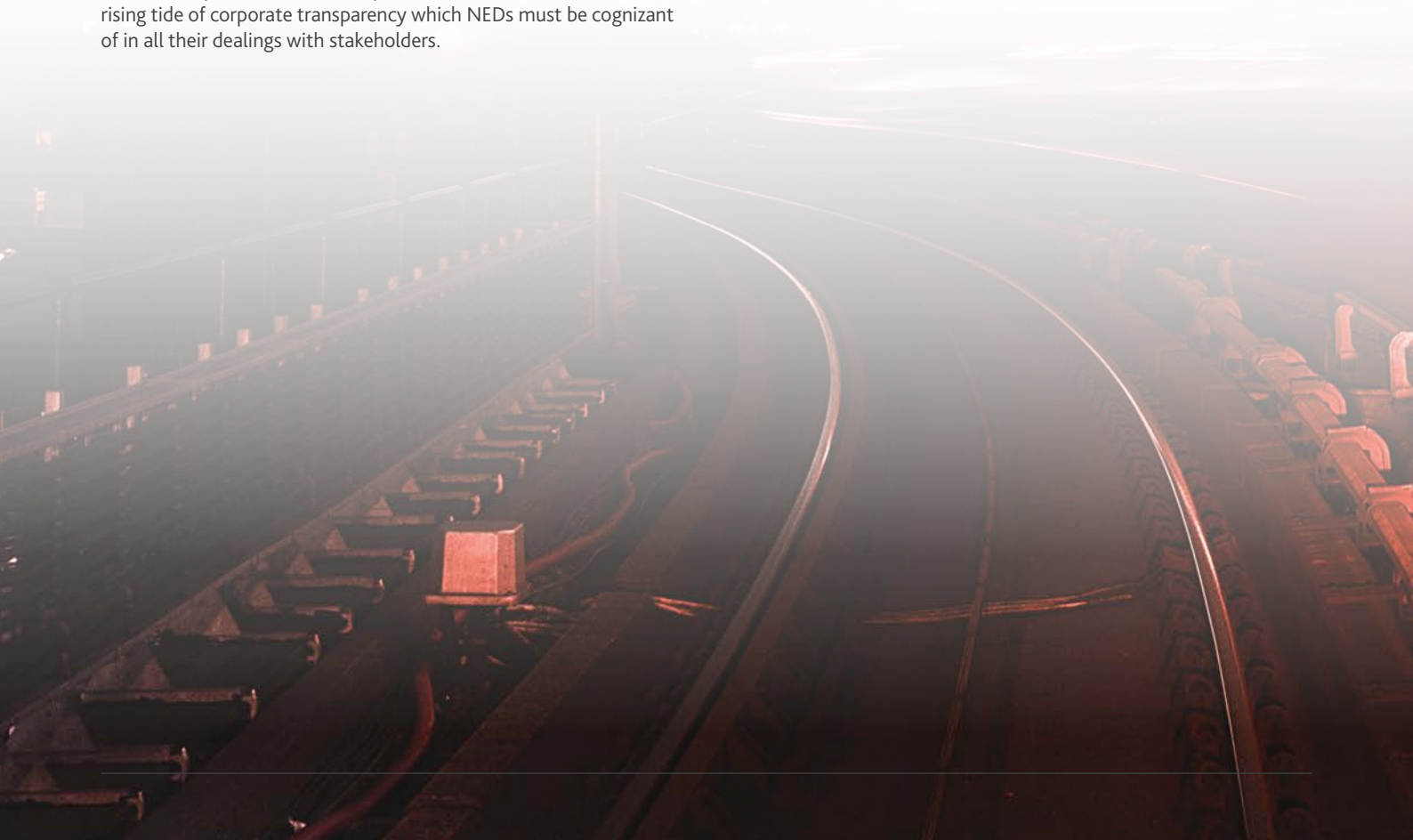
The impact of disruptive new innovations and technologies is being felt in virtually every sector and industry. From Virtual and Augmented Reality, to Artificial Intelligence, blockchain and the many applications of Industry 4.0, established thinking and modes of working are being routinely challenged by the potential (and often as-yet unclear) influence of emergent technologies.

Boards need to not only be aware of these burgeoning technologies but be able to understand the risks and opportunities therein and make bold-yet-prudent decisions around how best to embrace the right technology, in the right manner. At the same time, the sometimes-radical change programmes associated with the adoption of new technological solutions require careful management, particularly when they have material impact on employees. As a key contributor to employee and stakeholder engagement, NEDs have an important role to play in ensuring that employees are brought along in the journey during periods of technological change.

Boards must also look to use NEDs to help manage the growing risks surrounding cyber security and data breach. With cyber security now a critical boardroom concern, a working knowledge of data security and management processes is now a virtual necessity for executive teams and NEDs alike. At the same time, the impact of GDPR cannot be underestimated in terms of its transformative effect not only on IT security but also on stakeholder management processes. The notification procedure, for example, has further contributed to the rising tide of corporate transparency which NEDs must be cognizant of in all their dealings with stakeholders.

A 2019 survey conducted by Harvey Nash, in conjunction with the London Business School, revealed cyber security and digital innovation as the top two issues on the agenda for boards, ahead of prominent issues such as globalisation, remuneration and diversity. As boards grapple with this growing technology agenda, they must look to their NEDs as a source of new expertise - and diverse perspective - in issues of innovation.

Encouragingly, data suggests boards are beginning to take this step. Research by consultancy Korn Ferry found that the number of digital NED appointments (NEDs with a background in digital roles, such as Chief Information Officers) in the FTSE 350 has increased from 4.3% of all appointments in 2007 to almost 15% in 2017. We expect this percentage to increase further year-on-year, as questions of technology, innovation and cyber security become ever more prominent on board agendas.



CONCLUSION

The four core criteria laid out in this paper are designed to help executive teams understand how the role, responsibilities and required impact of Non-Executive Directors are changing. The conduct of boards and the efficacy of executive decision-making has never been under greater scrutiny. As a result, there has never been greater need for NEDs to perform effectively and add new value where and when it is needed most.

Undoubtedly, the long-established skills and character traits of the 'traditional' NED role remain critically important to board success - not least in the policing of a company's bottom line financials. However, as the economic and stakeholder landscape continues to evolve, the time has come for boards to update and augment their approach to the selection, appointment and empowerment of NEDs. In doing so, they must put diversity of perspective, good governance, corporate reputation and digital innovation thinking at the heart of their NED strategy.

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