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## SESSION III: THE QUALIFICATIONS, TRAINING AND RECRUITMENT OF DIRECTORS

### THE SELECTION AND TRAINING OF DIRECTORS

Presentation by

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## <sup>1</sup> A. The Work of a Board

### *The purpose of a board*

The board is the ‘mind and will’ of the company. The constitutions of most companies contain a provision which states that “the business of the company will be managed by the directors, who may exercise all such powers of the company”, or words to this effect. Executive powers are therefore vested in the board as a whole.

In practice, the board delegates executive responsibility to the executive directors, especially the managing director who heads the management of the business. This does not, however, negate the board’s ultimate responsibility for the company’s affairs. In addition, the board often reserves certain powers to itself as a way of limiting the powers of executives.

When selecting or training directors, therefore, it is important to understand the context in which they will work, that is, the board. A potential director should be judged in the light of a judgement about his/her contribution to the board tasks.

The Institute of Directors, based on a study of good practice involving several hundred UK directors and many boards, defined the board’s purpose as:

*The key purpose of the board is to ensure the company’s prosperity by collectively directing the company’s affairs, whilst being accountable to its shareholders and meeting the appropriate interests of relevant stakeholders.* (IoD{1999}).

It is for the board to judge, on a case-by-case basis, which stakeholders it treats as “relevant” and which of their interests it is appropriate to meet, taking into account the law, relevant regulations and commercial considerations. This is a summary view.

### *The tasks of a board*

To ensure that the company prospers, the board must address some key tasks and ensure that they are carried out effectively.

The four key tasks of the board identified in Institute of Directors [1999] are to:

#### **A. Establish vision, mission and values**

In order to carry out this task the board must

- A.1 Determine the company’s vision and mission to guide and set the pace for its current operations and future development.
- A.2 Determine the values to be promoted throughout the company.
- A.3 Determine and review company goals.
- A.4 Determine company policies.

#### **B. Set strategy and structure**

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<sup>1</sup> The views expressed in this paper are those of the author and do not necessarily represent the opinions of the OECD or its member countries. This paper is subject to further revision.

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This involves

- B.1 Reviewing and evaluating present and future opportunities, threats and risks in the external environment; and current and future strengths, weaknesses and risks relating to the company.
- B.2 Determining strategic options, selecting those to be pursued, and deciding the means to support them.
- B.3 Determining the business strategies and plans that underpin the corporate strategy.
- B.4 Ensuring that the company's organisational structure and capability are appropriate for implementing the chosen strategies.

### C. Delegate to management

In order properly to address this task, the board should

- C.1 Delegate authority to management, and monitor and evaluate the implementation of policies, strategies and business plans.
- C.2 Determine monitoring criteria.
- C.3 Ensure that internal controls are effective.
- C.4 Communicate with senior management.

### D. Exercise accountability to shareholders and be responsible to relevant stakeholders.

That is, the board should

- D.1 Ensure that communications both to and from shareholders and relevant stakeholders are effective.
- D.2 Understand and take into account the interests of shareholders and relevant stakeholders.
- D.3 Monitor relations with shareholders and relevant stakeholders by the gathering and evaluation of appropriate information.
- D.4 Promote the goodwill and support of shareholders and relevant stakeholders. "Manage" shareholder/stakeholder relations.

## B. Two Relevant Features of a Board

### *The board of directors and management*

Direction is not management. The relationship between the board and managers is complex, dynamic and company-specific. But there are a number of areas which illustrate the differences between the responsibilities of directors and those of managers:

- **Prosperity.** Responsibility for the long-term prosperity of the company rests with the board of directors, not the management.
- **Decision-making.** Directors have to make the important decisions which determine the future of the company and how it relates to its 'stakeholders' and the legal/regulatory framework. Management is concerned with implementing those decisions and the policies that follow from them.
- **Duties and responsibilities.** Directors are required in law to apply skill and care in exercising their duty to the company. If they are in breach of their duties or act improperly, directors may be made personally liable in law.
- **Accountability to shareholders.** The directors are responsible to the shareholders and may be dismissed by the shareholders. Managers are not.
- **Leadership.** Day-to-day leadership of the company is in the hands of the managing director or chief executive, but he or she acts on behalf of the directors. It is the board of directors who must provide the intrinsic leadership and direction at the top of the company, including the determination of its values and ethical position. The management must enact that leadership ethos, taking its direction from the board.
- **Company administration.** Directors are responsible for the company's due administration. The related duties can be delegated to management, but this does not relieve the directors of ultimate responsibility for company administration.
- **Statutory provisions.** There are numerous statutory provisions in most countries which can create offences of strict liability under which directors may face penalties if the company fails to comply. Employee relations, health and safety, taxation, consumer and environmental protection are examples of areas where directors may be liable under statute.

### *Collective responsibilities*

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In law, all the directors are jointly and severally, together and individually, responsible for the conduct of the company. If a decision has been taken by the board, then the directors are held liable for that decision together and as individuals.

In general terms, therefore, members of a board should accept collective responsibility for the decisions of the board as loyal members of the board. On all but the most important issues, a director whose view has not carried the board should accept the board decision. On the other hand, it is not open to a director to hide behind the decision of a “strong” managing director or to say that he personally did not agree with the board’s decision.

This does not mean that a director should not be prepared, if necessary, to express disagreement with colleagues, including the chairman or managing director, but it does mean that he or she should accept that resignation or dismissal may sometimes be the ultimate consequence of sustained protest on a matter of company policy, conscience or principle.

### C. Directors’ Knowledge

Each company and each board is unique; it is therefore impossible to produce a comprehensive and definitive list of all the elements of knowledge and understanding that a director should possess. Nevertheless, some key areas of directors’ knowledge and understanding are known. The areas of knowledge which are recommended are the result mainly of research. Many focus groups of experienced directors and academics contributed to defining a minimum set of the knowledge and techniques required by company directors. A fuller description is given in IoD (1999).

Three areas seem to be particularly important:

#### Governance

A director should be aware of his or her role and appreciate the crucial differences between management and direction. Directors should have an understanding of the legal framework within which they operate. A director should have a good understanding of a board’s operation and how to ensure its effectiveness.

#### Strategic business direction

Being charged with determining the company’s strategic direction, a director should know and understand the issues and processes involved in formulating, implementing and controlling the company’s corporate and business strategies.

#### Finance

A director should have a sound background knowledge of company accounting, financial language and concepts, and relevant financial tools and techniques. At the least he should be able to read a balance sheet, to understand the differences between management & financial accounts, and to ask searching questions of the finance director.

### D. Personal Attributes

A board works only intermittently. On the one hand, it is essential that board members are prepared to collaborate with colleagues on the board, but on the other it is equally important that they maintain their independence of mind. A proper balance of personal attributes exhibited by the directors will help to ensure that it can work as an effective group.

Research (see Dulewicz {1994} and Dulewicz et al. {1995}) has identified a number of desirable personal attributes of directors. These may be classified into six groups relating to specific aspects of company direction. They are relevant to a director’s role, whether as chairman, managing director, executive or non-executive director.

The groups are:

Strategic perception

Decision-making

Analysis and the use of information

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Communication  
Interaction with others  
Achievement of results

Other characteristics are also found to be useful attributes for directors to have:

- 7 Courage/strength of character
- 8 Common sense
- 9 Tenacity
- 10 Diplomacy/tact
- 11 Wisdom
- 12 Intellect

Many of these attributes are components of **leadership**, by which is meant the ability to conduct the company's affairs, govern, guide and motivate others. The board of directors leads the company and whether it does this well or badly depends in part upon the personal attributes of its members.

No single individual will have all the personal attributes listed, but each of those deemed necessary for a particular board should be possessed by at least one director. Ideally, there should be a good balance of individuals, whose strengths and weaknesses are complementary.

### E. Board "Fit"

The board needs to be an effective group; it is not a club, nor a committee. A great deal of attention should therefore be paid to the composition of the board to ensure an effective and broadly based working group. No two companies are the same and the composition of a board should reflect an organisation's uniqueness, its particular needs and the specific context in which the company operates. There should, therefore, be a regular review of the board's composition to ensure that the required mix of attributes is available to address the future issues that are likely to face the company and the board.

In general terms, this means that boards, with the particular involvement of the chairman, should:

- ◆ Define the need for and timing of changes in board membership; a review of board composition needs to be regularly carried out to ensure that the correct mix of age, skill, experience and personality is available.
- ◆ Select, appoint, induct, develop and remove board members as appropriate.
- ◆ Define and review each individual's roles and responsibilities and how these inter-relate between directors.
- ◆ Identify, and correct where necessary, any gaps and/or undesirable overlaps between board members' roles and responsibilities.
- ◆ Determine relevant board committees, and their terms of reference, life-span, leadership and membership.

Among the many criteria the board should consider in devising the most effective board, two are critical: the size of the board and its configuration.

#### *The board size*

Boards vary in size and there is no hard-and-fast rule about the size of the board. The number of individuals on the board will vary depending upon such factors as the size, age, ownership, and financial profile of the company.

In general, start-ups and smaller companies are likely to have small boards, since decision-making tends to be focused around the owner-director/manager(s). If the company is relatively small and privately owned, then the board is unlikely to have institutional or major investors associated with it. Instead, the board will more likely reflect tight management and control, that is, a heavy representation by the senior management team, perhaps bolstered by external individuals who either have a stake (financial or otherwise) in the business or a recognised expertise.

As companies develop, however, it is important that the capability of the board grows. This may necessitate recruiting new executive directors with particular expertise to fulfil the changing needs of the company and the board, and non-executive directors too can make a significant contribution.

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The number of members of a board can have a significant bearing on its effectiveness. A board's proper functioning requires group decision-making. It is recognised that the size of the group affects the group's dynamics: too small and the dynamics are lost; too big and the dynamics overwhelm the group's ability to make effective decisions. The size of the board can affect the opportunity for an individual to make an impact: too many members, and the meetings can become protracted and cabals can emerge; too few directors, and there may be a shortage of the necessary talents, knowledge and experience.

Boards in the UK have an average size of 6 directors. Boards of publicly quoted companies average about 8 members, with the larger companies averaging 12 directors.

### *Board configuration*

A key consideration is the balance between the number of executive directors and non-executive directors.

## F. Selection of Directors

### *The selection process*

Finding the right person to be a director is not easy. Because of the many differences between companies the requirements will vary from company to company. The appointed person will change the balance of board membership. It is vital to give ample consideration to the kind of person wanted and the contribution which is required. The resulting profile for the new director may be complex.

An example of a simplified appointment process is:

#### **Identification of a board capability gap**

The first question is: What does the board need? Before the selection process begins, it is important to determine what roles the new person is to fulfil as a board member and what personal qualities and attributes would be appropriate. An analysis of these factors for existing board members can help to identify gaps. The chairman or the nominations committee should identify the gaps and start to build up a picture of the sort of person that the board is looking for, perhaps, for example, someone with international experience, e-commerce experience, or great analytical skills.

#### **Develop a personal specification**

Look at the knowledge, skills and personal attributes required of a director. Add these and any others that are high on your list of priorities to the specification. Bear in mind the roles of directors.

#### **Develop a search plan**

The search should be planned carefully, perhaps using both personal contacts and professional recruitment consultants.

#### **Get to know the person**

Cultivate a relationship; personal contact and knowledge of the candidate is essential. If the potential new director is from outside the company, take up references other than those offered. Try to establish if the person will fit into the board.

#### **Discuss terms**

Discuss relevant details with the prospective candidate.

#### **Appoint**

Make the appointment.

### *Selecting the chairman*

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The key criterion for a chairman should be an ability to run and control the meetings of the board of directors. This ability will be based on a sense of what is important to the meeting; knowing when decisions can be taken rapidly and the agenda moved on; sensing when a subject demands and warrants debate; spotting when arguments are becoming repetitive and being able to end debate. The chairman should have an ability to introduce subjects, to control debates, to ensure arguments are fairly represented and an ability to sum up discussions. Above all, in so far as the chairman is able, he should be skilled at building consensus.

The chairman will also chair general meetings of the company and this will require presence and communication skills.

The chairman should also be capable of presenting the company to the external world: he should be the principal ambassador of the company. As such he should have standing in the circles in which the company operates.

### *Selecting executive directors*

Executive directors' skills will be in leading key areas of the business and presenting in a coherent manner at board meetings performance reviews of the areas of business for which they are responsible. That being said, their presence on the board should not be related solely to their particular business interest. Even when a person has won his spurs by accepting a high level of responsibility as an executive or manager, it does not necessarily follow that the person will be able to fulfil effectively the rather different role of director.

For this, executives must possess a number of additional characteristics and personal qualities. Above all, however, they must show an ability to understand and review the business as a whole. They must be capable of looking beyond the confines of their own particular discipline or background and have the breadth of vision and thinking necessary to help the board address policy and strategic issues as well as all the operational matters.

Whether an executive director is selected from within the same company or group, or recruited from outside, some education and training in the role of the director and how the board works will probably be necessary. However, as with all training, selecting the right person first, with all the attributes for the job, is an essential pre-requisite.

### *Selecting non-executive directors*

It is extremely important to be clear as to what is the proper contribution of non-executive directors to a company. The overriding consideration is that they participate to the full in the board's joint deliberations. At the same time, however, they have a supervisory or monitoring role, particularly in resolving situations where the executive directors may have a conflict of interest.

The particular contributions that non-executive directors may make are:

- to widen the horizons of the board in determining strategy, both by applying the fruits of a wider general experience and by bringing into board discussions any background of relevant special skill, knowledge and experience which the board might otherwise lack;
- to take responsibility for monitoring management performance and the extent to which the management of the company is achieving the results planned when strategy was determined;
- to ensure that the board has adequate systems to safeguard the interests of the company where these may conflict with the personal interest of individual directors;
- to determine the remuneration of the executive members of the board;
- to ensure the presentation of adequate financial information, whether or not a formal audit committee exists.
- to play a key role in the appointment of the chairman and managing director;

Given these tasks, what characteristics should the non-executive director possess?

- ◆ Experience of a larger, unrelated but relevant, enterprise, with knowledge of company matters and board competence gained in another environment, is often needed.
- ◆ Selecting someone with a sound track record is usually wise, since opinions at the board table will benefit from the weight of that experience.

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- ◆ A sharp business mind, with an ability to focus on the matters in hand without historical or day-to-day distractions, is essential.
- ◆ Essentially, a non-executive director should provide an independent and impartial view of the board's considerations and decisions while also identifying strongly with the company's affairs. It is essential therefore to look for strength of character and an ability to stand back from the issue being considered, combined with an essential pragmatism and an ability to compromise.
- ◆ Finally, the board's total effectiveness can benefit from outside contacts and opinions. Companies will therefore often seek non-executive directors who have a suitable network of experienced contacts.

However, above all, non-executive directors should be "independent". This means that they should bring great objectivity or impartiality to the board's deliberations. In order to be able to do this – or, perhaps, in order that the public has confidence in their impartiality - it is generally felt that non-executive directors should have no contractual relationship with the company and should not be under the control or influence of any other director or group of directors.

Not all non-executive directors need be independent in this sense. The lawyer or accountant who comes from a company which may provide services to the company on whose board he or she sits as a non-executive is not "independent" but may nevertheless make a valuable contribution to the board. No doubt many non-executive directors who are not "independent" in the strict sense above are still able to exercise independent judgement. However the point is that there are certain issues where independence is required, particularly matters where the interests of the executive directors and the company might diverge. It is important that at least some non-executive directors do not have interests directly at stake.

### *The Combined Code recommendations*

The Combined Code [1998] requires listed companies to report compliance with, or explain non-compliance with, the following provisions:

*The board should include non-executive directors of sufficient calibre and number for their views to carry significant weight in the board's decisions. Non-executive directors should comprise not less than one third of the board (A.3.1).*

*The majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement (A.3.2).*

The Combined Code recommends that for quoted companies

- ◆ there should be a minimum of three non-executives on a board, one of whom may be the chairman of the company provided he or she is not also its executive head.
- ◆ two of the three non-executive directors should be independent in the sense above.
- ◆ non-executive directors should be appointed for fixed terms and their re-appointment should not be automatic.
- ◆ non-executive directors should be selected through a formal process and this process and their appointment should be a matter for the board as a whole.
- ◆ a nomination committee (composed of a majority of non-executive directors and chaired either by the chairman or by a non-executive director) preferably should carry out the selection process of non-executive directors and make proposals to the board.
- ◆ remuneration committees should be made up exclusively of non-executive directors.

## G. Developing Board Effectiveness

### *Induction and inclusion*

An effective induction is essential for all new directors if they are to play their proper role within a reasonably short time-scale. New executive directors taking up a board position for the first time can find it quite daunting to be

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expected to make a contribution across all aspects of the business when in fact their primary experience base often relates to one specific function only.

Newly-appointed non-executive directors should have some planned periods to see the facilities and employees of the business at first hand and to spend time with the executive directors to understand their work.

Just as important is an induction by the chairman into the board's affairs, the style of the board, how issues are dealt with both inside and outside the boardroom and the way that reports and information are dealt with. All board members need to share the responsibility for bringing the new member up to speed as quickly as possible.

The company secretary can also play a useful part in this familiarisation process. It is most important that new directors familiarise themselves with the company's constitution, where the secretary can act as a useful guide.

### *Developing directors*

No matter how experienced a director is, he can never be too highly qualified or too experienced to ignore the need continually to enhance his professional competence. It is essential that directors do not allow their skills and knowledge to become obsolete which, in times of rapid and substantial changes in technology, legislation, knowledge, competitive pressures and social priorities, they can all too easily become. It is good practice, therefore, for directors to undertake a programme of systematic maintenance, improvement and broadening of knowledge, experience and skills, and the development of personal qualities helpful in the execution of their professional duties throughout a career – in other words, continuing professional development (CPD).

Executive directors must learn not to rely on the power and rights that are a consequence of their managerial seniority, nor the strength they may have as a result of any exclusive technical knowledge they hold. An important part of every executive director's development is to loosen the power and rights that he or she is seen to have as a manager, delegating these to others more, while raising his or her perceived strength as a director, concerned with policy, strategy, the security of the company, resource provision and motivation. This is a broadening process for each executive director, which at the same time helps to weld the board into an effective group to address the broader policy and strategic issues, away from the narrower confines of specialist management.

### *Succession planning*

If a company is to succeed it will be necessary for serious consideration to be given to how and when key directorships are to be filled when the holders retire. Succession planning both for emergency cover as well as for a longer time horizon, say five years, is a most important part of a board's monitoring task.

This entails knowing the plans of directors – for example, for how long they intend to work - so that successors may be groomed.

The positions of the chairman and the managing director are crucial. The appointment of a new chairman and/or managing director to a listed company will be a matter of major significance to the markets and may well have a significant effect on share values.

The loss of an entrepreneur owner or family director often puts the future ownership and survival of the company in jeopardy. In these cases the succession of the company may be decided by the entrepreneur or the wider family and the board has no input. The succession of the company needs to be discussed somewhere and not ignored. The failure to plan succession is one of the most frequent causes of the demise of family companies, with only a small minority of European family companies reaching the third generation.

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