



Private Client Services

The role of non-executive directors in private companies and family businesses

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Welcome to the second issue of PricewaterhouseCoopers' Featured Article Series by Private Client Services.

You would have received our inaugural issue in March, which we trust you found an engaging read.

By examining topics that concern you as business owners, we hope to offer you valuable insights and solutions drawing on our local and global network.

In this issue, we put the spotlight on corporate governance. A common measure used to improve corporate governance is the addition of non-executive directors to a company's board of directors. Would this work for private companies and family businesses? Our featured article explores the role of non-executive directors in private companies and family businesses and the value that they can bring to the table.

Till our next instalment, we hope you find this issue interesting and useful reading.

Ng Siew Quan

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The role of non-executive directors in private companies and family businesses

All corporate entities, no matter what size or status, will benefit from the experience that good non-executive directors can bring. Non-executive directors play a key role in corporate decision-making. They can make valuable contributions in determining corporate strategy and can provide guidance on achieving strategic goals and the allocation of corporate resources to support strategic plans. The independence, objectivity and business acumen of non-executive directors complement the detailed knowledge and experience of executive management.

Non-executive directors also play a significant role in good corporate governance. The central role of good corporate governance in business and organisations is not a new phenomenon. In the recent past, a series of high-profile corporate scandals and governance failures have raised public, political and investor consciousness of the topic and highlighted the importance of good governance and the consequences of failed governance. These debacles were not remote from ordinary people as they affected them directly, impacting their pensions and savings. Hence corporate governance has been transformed from an academic sideline to an international management, business and legal concern.

Over the last couple of years there has been an increase in the number of non-executive directors in privately-owned and family businesses. Non-executive directors provide a particularly useful role on the boards of family and privately owned businesses. They:

- Bring considerable value to these businesses through their personal skills and experience,
- Provide additional resource in determining strategy and providing support to busy owners/managers;
- Ensure that potential conflicts are minimised;
- Contribute to maintaining a focused and formalised conduct in the management of the business's affairs; and
- Provide independent advice to the management of these businesses at times of transition, particularly when ownership is being passed to the next generation of a family.

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What are the benefits of appointing non-executive directors?

The essential contribution from non-executive directors is that they bring a fresh and wider view to board discussion and decision-making.

Non-executive directors provide the board with attributes such as objective judgement and balance which may not be fully available if the board consists of full-time executives (who are busy with their managerial responsibilities). Non-executive directors should also act as a confidant to the founders or executive directors, providing advice and commenting on their ideas/plans.

The following are some of the benefits that the non-executive directors can bring to a board's deliberations and decision-making process:

- **Seeing issues in their totality**
Because of their managerial responsibilities, executive directors may not be best equipped to give proper weight to the differing aspects of issues faced by the board. Non-executive directors can usually view matters from a broader perspective;
- **Giving the external view**
As non-executive directors are not heavily involved in the daily running of the company, they can bring a wider judgement to bear on matters before the board. This is particularly useful in the context of strategic planning, or when events of special importance to the company's future, such as mergers, acquisitions and large capital projects are involved. Non-executive directors can provide new perspectives, thus helping the board to think through and challenge its underlying strategies and examine the options;



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What are the benefits of appointing non-executive directors?

(continued)

- **Providing special skills**

A company that moves into a new market, an overseas location or a new technology may need board-level counsel from an expert. The addition, for example, of a merchant banker, engineer, academic, marketing specialist, lawyer or accountant thus supplements internal resources;

- **Monitoring the operations of the company and implementing checks and balances to control the company**

Corporate ethics and good corporate citizenship are the concern of all directors; not just the non-executive directors. It is important that this role is not overstated to the extent that it undermines the overall contribution that non-executive directors can make to the company. The non-executive director should participate in evaluating the performance of the overall board;

- **Providing an independent view on potential conflicts of interest**

This means trying to ensure that the proper balance is struck between the various interests and stakeholders of a company (shareholders, lenders, employees, management, customers, suppliers, the investment community and the public at large). It assumes particular importance where the executive directors' interests may conflict with those of shareholders (for example, where directors have interests in transactions entered into by the company; on dividend policy; or where a take-over bid is received);

- **Providing contacts**

Non-executives will generally have more contact and involvement with the greater business community. This may be put to use in identifying sources of finance, or in contacts with potential customers or suppliers, with Government or with sources of professional advice.

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Are there any disadvantages in having non-executive directors?

Provided that there is an appropriate balance between executive and non-executive directors and roles and responsibilities are adequately defined, there are no disadvantages to the appointment of suitable non-executive directors to the board of a company. There are, instead, considerable advantages to be gained from improving boardroom practices and the economic and financial performance of companies through the role that non-executives can play.

There are some appointments and problems which should be avoided, including:

- The appointment of directors or executives of competing companies (for obvious reasons);
- The appointment of non-executives without sufficient expertise, experience or independence;
- Appointments merely for cosmetic reasons to enhance the apparent status of the company;
- The representation of solely sectional interests; and
- The creation of a grouping of non-executive directors who operate on their own and to the exclusion of executive directors. However, private sessions where the non-executives meet alone either as part of their committee duties or in evaluation of the performance of the chairman are important features of good corporate governance.

Non-executive directors cannot do their job properly and would be ill-advised to accept an appointment, unless the following conditions are met:

- Regular board meetings are held;
- Decisions are taken by the board as a whole and not by executives, or indeed by non-executives, without reference to the board;
- Matters requiring decision are properly supported by adequate board papers distributed to directors sufficiently in advance of meetings; and
- Information reasonably required by directors is not withheld, either inadvertently due to incompetence or deliberately as a result of bad faith.



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How can companies find suitable non-executive directors?

Like all new directors, a non-executive director would normally be selected directly by the existing board.

Personal contacts and recommendations can be an important way of identifying suitable candidates. For example, the chairman often has a principal role in identifying suitable people who would be prepared to offer their services; existing non-executive directors, due to their contacts, may be able to suggest others; and professional advisors to the company may be able to help by recommending candidates. But there will be times when outside help is needed. The Singapore Institute of Directors is a national body for company directors in Singapore which provides a range of services including assisting with identification of suitable candidates of the right calibre and background to be non-executive / independent directors for companies in Singapore.

Non-executive appointments are often made from those who are still engaged in industry, commerce, academia, banking and the professions. Those who have recently retired are often another important source.

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Education for non-executive directors

The responsibilities and legal requirements that directors, including non-executive directors, face are becoming increasingly onerous. Therefore, those who take on directorships need to be adequately prepared to carry out their respective duties.

To address the ever increasing importance of good governance, it is essential that non-executive directors are well-informed and keep abreast of legal and regulatory developments.

Every organisation including not-for-profit entities should ensure non-executive directors are given a comprehensive induction programme which should preferably include spending time in the organisation, meeting employees and observing practices and procedures. New non-executive directors should have the opportunity to meet the major stakeholders of the organisation. In addition, an in-depth information pack should be provided, including documentation on all aspects of the organisation – from its mission statement and code of ethics to its long term strategic planning. It is also important to provide non-executive directors with a letter of appointment outlining their role, responsibilities and terms and conditions.

All organisations should have a process in place to monitor new regulatory developments and brief non-executive directors on the impact both on the organisation and on themselves as individuals. This can be done on an individual basis or organisations may opt to run training seminars for groups of non-executive directors. Such seminars may be run internally if the resources and expertise are available or else outsourced to external specialists. However, non-executive directors must also take individual responsibility for keeping pace with new requirements.

In addition to both “on-site” induction programmes and a comprehensive information pack, non-executive directors may wish to participate in external training subject to requirements and existing knowledge and expertise.

The individual legal responsibilities that non-executive directors face cannot be treated lightly and this has manifested itself in a wide variety of courses and training seminars aimed specifically at board members. The Singapore Institute of Directors runs a wide range of courses covering governance, the role of the directors and business strategies, as well as provide timely and comprehensive information on issues and developments pertinent to company directors. In addition, many of the large legal and accountancy firms or their professional associations run courses or seminars on corporate governance and related topics. This is also a useful way of informing and updating non-executive directors.



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What questions should I ask myself before accepting an appointment as a non-executive director?

- What is the company's current financial position and what has its financial track record been over the last three years?
- What are the key dependencies (e.g. regulatory approvals, key licences, etc)?
- What record does the company have on corporate governance issues?
- If the company is not performing particularly well, is there potential to turn it round and do I have the time, desire and capacity to make a positive impact?
- What are the exact nature and extent of the company's business activities?
- Who are the current executive and non-executive directors, what is their background and their record and how long have they served on the board?
- What is the size and structure of the board and board committees and what are the relationships between the chairman and the board, the chief executive and the management team?
- Who owns the company i.e. who are the company's main shareholders and how has the profile changed over recent years? What is the company's attitude towards, and relationship with, its shareholders?
- Is any material litigation presently being undertaken or threatened, either by the company or against it?
- Is the company clear and specific about the qualities, knowledge, skills and experience that it needs to complement the existing board?
- What insurance cover is available to directors and what is the company's policy on indemnifying directors?
- Do I have the necessary knowledge, skills, experience and time to make a positive contribution to the board of this company?
- How closely do I match the job specification and how well will I fulfill the board's expectations?
- Is there anything about the nature and extent of the company's business activities that would cause me concern both in terms of risk and any personal ethical considerations?
- Am I satisfied that the internal regulation of the company is sound and that I can operate effectively within its stated corporate governance framework?
- Am I satisfied that the size, structure and make-up of the board will enable me to make an effective contribution?
- Would accepting the non-executive directorship put me in a position of having a conflict of interest?



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What questions should I ask myself before accepting an appointment as a non-executive director? *(continued)*

Sources of information

- Company report and accounts, and/or any listing prospectus for the recent years;
- Analyst reports;
- Press reports;
- Company website;
- Any corporate social responsibility or environmental report issued by the company; and
- Rating agency reports

Published material is unlikely to reveal wrong-doing; however, a lack of transparency may be a reason to proceed with caution.

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