

# Why SMMEs need to invest in NED

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In the wake of recent executive scandals, one expects that board nomination would be rigorous, systematic, and considered a key strategic action so as to ensure your board performance remains under close scrutiny. Alas, this is not the case.



Non-executive directors (NED) are a legal requirement for organisations listed on the JSE and should play an integral role in establishing corporate governance. Furthermore, independent external advisors can play an integral role in the growth and competitiveness of SMMEs, where founders do not have the capacity to bring on a spectrum of permanent experts but require support or counsel from outside their field of expertise. But the role of the NED has exploded into an 'unfillable' position due to its excessive requirements. The NED needs to be a technical expert, all-rounder, financial guru, legal genius, corporate governance whizz, while being objective and independent with extensive experience, the highest moral code of a saint, and committed and passionate, etc. Even the most talented and seasoned executive cannot reasonably meet the lengthy requirement list.

In return for being this polymath NED, with extensive responsibility and an extremely high workload, is a high potential personal risk and modest financial rewards and benefits. Why, therefore, would anyone take on the daunting task of a NED position? It is in the aspiration of credibility as an executive to be considered a leading professional, for the prestige of a portfolio career.

## Why firms are in dire need of help

The purpose or intention of the NED position is to bring in objective individuals who are able to challenge strategy and executive member decisions, advocate accountability, validate the integrity of financials, keep risk in check, and bring to the boardroom table valuable networks, expertise, skills and scrutiny. Sadly, boards do not always focus on the benefits of finding the most suitable NED with high-value contributions but appear instead to focus on meeting minimum legal requirements. This is essentially turning a key strategic decision into a compliance checklist, and in doing so, forgoes the endless benefits of heavy-hitting, well-balanced, and rigorously appointed NEDs capable of furthering and supporting board performance.

It is paradoxical that the purpose of the NED is to engender corporate governance, one of the key pillars of which is

transparency, and yet the process, protocol and selection criteria adopted to appoint NEDs remains vague, subjective, inconsistent and by definition un-transparent. In the wake of recent executive scandals, one expects that board nomination would be rigorous, systematic, and considered a key strategic action so as to ensure your board performance remains under close scrutiny. Alas, this is not the case and sadly the appointment process for non-executive board members in South Africa remains in its infancy. And, because of these poor nomination trends, NEDs being appointed focus on completing work allocations and provide a superficial interrogation and monitoring of the executive board members' behaviours and performance.

## **The solution begins with mindset**

The focus of the NED role has been to challenge executives. This archaic and damaging description instils fear of an effective NED and does not encourage, but instead deters, the board to take NED selection more seriously. A truly sad state of affairs with the reality being that instead of executives being challenged where necessary and thereby having the opportunity to grow and develop, these are missed. This is a serious disadvantage for committed executives who want the proper advice of experts who would, in turn, positively impact and therefore contribute to their career development.

## **The betterment of remuneration, nomination and appointment trends**

Looking at remuneration trends, while NED remuneration is improving with above inflation growth, the fact remains that remuneration is not commensurate with the responsibilities and personal liability taken on with the NED role. Remuneration ought to be performance-based. Underpaying non-executive directors is counter-intuitive and risks deterring top talent or discouraging commitment and work ethic. Transformation in the representation of previously disadvantaged groups needs to remain high on the agenda. Progress has been made, change will not be instant, but huge strides still need to be made, with less than 25% of NEDs represented by females and less than 40% represented by black professionals. The PWC 2017 Non-Executive Directors Practice and Remuneration Trends report found that 6% of chairpersons are female.

Establishing board nomination, risk, and audit sub-committees and ensuring sufficient objectivity, is paramount. A systematic selection process needs to be followed and monitored. This process ought to be well documented, objective and conducted with rigour. The executive committee arguably has too much work-related responsibility to give this process due attention. However, there appears to be a reluctance to invest in expert executive search advice, advertising, or training to build the optimal board and this is often attributable to cost saving. It is extremely rare to find a budget allocated for NED appointment. Moreover, executive search firms may provide a guarantee of objectivity and access to networks outside the scope of the existing exco.

Where budgets are present they are seldom a budget expected for a key hire. However, the unbiased view offered by external advisors in board appointments sends a positive signal to shareholders, as they provide key market intelligence. The use of external agency in the selection, appointment, and auditing of boards is an effective way to mitigate the risks of incompetent NEDs or assembling a board that isn't an optimal mix of talent as they provide a pool of appropriate candidates which may not be attainable through an open application process and may not even be actively searching for a position (which is typically around 60% of the market). You do not need a good enough NED, you need a really great one.

## The squeaky wheel gets the grease

Small and medium-sized enterprises are a key driving force being South Africa's GDP growth (36% in the 2017 year) and contribute to employment creation. Sadly, 70-80% of SMME's fail within the first five years of inception, most often due to cash flow problems, a lack of market or an inability to serve market needs, poor operational and financial planning, and a lack of funding appear to be the drivers behind South Africa's staggering SMME failure rate. There is a massive need for the owners or founders of SMEs to have access to affordable external advisors in that generally founders are technical experts. There needs to simultaneously be a change in the receptiveness of small business owners to the use of external advisement in that currently external advisement is perceived as an expense as opposed to an opportunity to invest in talent.

*“ So, in summary, SMMEs are vitally important to the economy but most fail, and yet there is a reluctance to bring on any help. There is no logic to this. SMMEs need to open themselves to the commercially minded to engage, brainstorm, and ask for help. ”*

In closing, the perceptions of the NED construct need to be shifted as their appointment can contribute greatly to Exco's performance and the position ought to be given strategic importance. Given that no individual professional can reasonably be expected to meet the long and often contradictory list of NED attributes and skills, it is consequently essential to persevere towards a balanced board where the NEDs collectively meet this impossible spectrum of requirements. From the perspective of smaller unlisted firms, my opinion is that these SMMEs need to stop isolating themselves. NEDs and external advisors not only challenge but provide business leaders with new lenses with which to view their business. Choose those lenses wisely, or you may land up in the dark.

## ABOUT THE AUTHOR

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