Independence enhances sustainability, confidence and credibility

Privately owned companies would benefit greatly from having fully independent, non-executive directors on their boards, providing them with objective input, insight and oversight of their businesses.

While most privately held companies are not required by law to have independent non-executive directors, there is a major advantage in them appointing independent directors who have no direct stake or day to day role in the entity, but can contribute through their industry specific experience and knowledge.

Although public companies need to have independent non-executive directors to serve on their statutorily required audit and social and ethics committees, only private companies with a Public Interest Score in excess of 500 for two of the preceding five years need to have an independent chairman of their social and ethics committee. The King report on good governance, applied by the Johannesburg Stock Exchange to companies listed thereon, further recommends that the majority of non-executives should be independent.

Independence engenders and enhances sustainability, stakeholder confidence and credibility. It also adds to the level of good corporate governance. But there is independence and there is independence. It should not be treated simply as a box-ticking exercise. What is needed are independent directors who are indeed independent, who are perceived to be independent and who always act independently. This is where the value lies.

Personal bias

When someone has a significant stake in a company, is a consultant to the company, or is in some other way involved in day-to-day activities of the company, it is tricky for them to fully discharge their fiduciary duty to act in the best interests of all stakeholders without at least some level of personal bias. Significantly, the aim of having truly independent non-executive directors is to ensure that they are acting in the best interest of all stakeholders.

The primary role of independent non-executive directors is to examine decisions and act independently when making judgments on them, acting as the 'conscience' of the board and management. It is also their role to resolve conflicts of interest and bring in objective 'outside' views. However, it is critical to balance the benefit of non-executive directors against the cost of having them, i.e. the fees that are paid to them for their services.

Ideally, independent non-executive directors must be targeted and identified as suitable people who bring value to the board. The Institute of Directors is playing a value-adding role here by running director development programmes, increasing the number of people who can be considered for non-executive directorships.

When it comes to proper independence, it needs to be realised that this should not be token or in any way tainted. There have been some interesting judgments in the US relating to friendships with executives and the application of the business judgment rule. In one case, a non-executive on a board was judged to be acting too closely in relationship to the company's CEO; in another case, non-executive directors were found to have not complied with the business judgment rule by relying too much on management information and not making their own informed decisions.

Objective decisions

One of the major issues with independence is that it must not just be theoretical, but put into practice. This means unfettered discretion, unbiased opinions and totally objective views and decisions. Even if not required to by law, or any regulatory body, privately owned companies can also benefit enormously from receiving independent opinions on important strategic matters and other areas of their business.

Through increasing the involvement of independent thought and decisions, these companies can effectively add value to their operations because they are deemed to have objective oversight and guidance from non-execs who are acting in the best interests of all stakeholders.

The bottom line is that it is not just publicly listed companies that benefit from having independent, non-executive directors. Large unlisted companies where ownership is to some extent removed from management can also gain substantial advantage from going the route of utilising independent views, opinions and judgement, if appointed for the right reasons, at a cost that is offset by their contribution.