THE ROLE OF NON-EXECUTIVE DIRECTORS IN THE GHANAIAN SME SECTOR

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Abstract

This paper reports on the role of NEDs among Ghanaian SMEs. The results of this study revealed that less than half of the SMEs sampled engage the services of NED. The study also revealed that relatively larger SMEs are more likely to employ the services of NEDs. We also found that over 80% of the SMEs with NEDs were either growing or growing rapidly. NEDs' contributions were also found to be multi-various and cut across the range of SME board functions. The study showed that most SMEs acquire NEDs mainly through informal personal contacts such as family, friends of a director, business friends rather than through formal arrangements.

Keywords: *Non-executive Directors, Board of Directors, SMEs, Ghana*

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1. Introduction

The role of non-executive directors is a growing area of management research. Previous studies have reported more on the role of non-executive directors (NEDs) of large companies (see Bank of England, 1988, Main and Johnstone, 1993; Conyon, 1994 and Samuels et al, 1996). Firm size is widely recognised as an important influence on the relevance and role of external or NEDs. In large companies, the role of the external directors is more often likened to a regulator or a policeman (Barrow, 2001). They are there mainly to represent the interest of shareholders and overseeing the activities of executive directors.

Borrow (2001) identified the most visible role of NEDs in big firms to be when they are dragged into controversies over pay and contracts, or when the managing directors of public companies treat the company's assets as their own. They also help in settling board disputes and play an active role in hiring and firing the chief executive.

However less attention has been given to the role of NEDs in SMEs. In SMEs, the resources, stewardship and control offered by directors may be very different from and more direct than in large firms. Few attempts have therefore been made in examining the role of NEDs in UK SMEs (see Graham and O'Neil, 1977; Mileham, 1995b, 1996; Deakins et al, 1999; Berry and Perren, 2001). This paper addresses this need by presenting results from a developing country context. The study seeks to examine the role or importance of NEDs in Ghanaian SMEs. The issue is of critical significance given the important role SMEs play in the Ghanaian economy. Small enterprises have been noted to contribute about 85% of manufacturing employment (Steel and Webster, 1991) and account for about 92% of businesses in Ghana.

The structure of the remainder of the paper is as follows: The second section provides a review of the theoretical framework on the role of NEDs. The following section explains the methodology employed for the study. The empirical results are presented and discussed in the fourth section. The final section concludes the discussion.

2. Theoretical Framework

2.1. Corporate Governance

Different authors on corporate governance have given different definition on the subject. Mayer (1997) defined corporate governance as ways of bringing the interests of (investors and managers) into line and ensuring that firms are run for the benefit of investors. According to Deakin and Hughes (1997), corporate governance is concerned with the relationship between the internal governance mechanisms of corporations and society's conception of the scope of corporate accountability. Corporate governance also is seen as the whole set of measures taken within the social entity that is an enterprise to favour the economic agents to take part in the productive process, in order to generate some organizational surplus, and to set up a fair distribution between the partners, taking into consideration what they have brought to the organization (Maati, 1999). It has also been defined by Keasey *et al* (1997) to include 'the structures, processes, cultures and systems that engender the successful operation of the organizations.'

We can therefore infer from these definitions that, different systems of corporate governance will embody what are considered to be legitimate lines of accountability by defining the nature of the relationship between the company and key corporate constituencies. Corporate governance systems may be thought of as mechanisms for establishing the nature of ownership and control of organizations within an economy. In this context, 'corporate governance mechanisms are economic and legal institutions that can be altered through the political process - sometimes for the better' (Shleifer and Vishny, 1997). Company law, along with other forms of regulation (including stock exchange listing rules, and accounting standards), both shape and is shaped by prevailing systems of corporate governance. The impact of regulation on corporate governance occurs through its effect on 'the way in which companies are owned, the form in which they are controlled and the process by which changes in ownership and control take place (Jenkinson and Mayer, 1992). According to Deakin and Slinger, (1997), ownership is established by company law, which defines property rights and income streams of those with interests in or against the business enterprise.

Corporate governance describes how companies ought to be run, directed and controlled. It is about supervising and holding to account those who direct and control the management. For an SME, it is about the respective roles of the shareholders as owners, the directors (both executive and non-executive) and the managers. It is about setting rules and procedures as to how the company is run. The main corporate governance themes that are currently receiving attention are:

- adequately separating management from the board to ensure that the board is directing and supervising management, including separating the chairperson and chief executive roles;
- establishing the independence of the auditor and therefore the integrity of financial reporting, including establishing an audit committee of the board
- ensuring that the board has an effective mix of executive and non-executive directors

2.2. The Role of Non-executive Directors

Non-executive directors are expected to perform a wide range of tasks. The responsibilities could range from an informal sounding board that full time board members can turn to in times of need, through to helping with specific executive or operational functions. Sometimes non-executive directors may even assume a full role on part-time basis in small or new firms. These may be to evaluate and oversee the implementation of an accounting system, a bonus scheme or undertake specific sales mission, perhaps in an overseas market. However, the most common roles that an NED in a small and medium-sized enterprise is likely to encounter are discussed below:

Advice on financing growth

The supply of new finance is constantly needed by SMES. There is empirical evidence which suggest that founders of small firms are particularly weak and often ignorant of types of sources of finance open to their firms. Most of the time, they do not know how to position themselves correctly to be viewed favourably by these sources of finance (see Barrow, 1999). 3i/Cranfield (1992) asserts that too many small firms exist on unplanned short-term and therefore more expensive and risky borrowings than is healthy.

Encourage Certain Standards of formality and discipline to be followed

Firms which are small in size almost always tend to be informal in the way they operate. This means that important management activities such as board meetings, performance reviews and strategic discussions either do not happen, or if do they occur in a disorderly manner without even the whole board's participation. The presence of an NED ensures certain standards of formality and discipline are followed. This is the view held by 3i 3i/Cranfield (1992) whose research of the companies they invested in found out that 85% held full board meetings every month. Because of the high risk associated with being a high tech firm and the strength of company law, an NED would be more involved in companies where proper boardroom procedures did not exist.

Offer Impartial Advice

The Cadbury Committee (1992) recommended that SMEs could benefit tremendously from impartial advice by independent NED. Samuels *et al* (1996), asserts that up to a quarter of NEDs owe their loyalty to an outside financial institution. Thus they are bondmen under obligation to report back to their institutions. Where, the NED has a substantial shareholder membership, for example a business angle, partial advice is inevitable.

Help with strategy formulation and implementation

The preparation of strategic plans, projections and budgets and their successful implementation is certainly the implicit duty of the directors. This notwithstanding, there is some evidence that strategic business planning is not conducted professionally in some SMEs. A study conducted by Grant and Thornton (Amiri, 1992) showed a poor planning in 54% of SMEs and no business plans at all in 30%. However, 3i/Cranfield (1992) demonstrated clearly in a study that small firms with plans performed better than those without plans. Therefore, this is one important area in which an NED with appropriate knowledge and experience can start to add value to SMEs relatively quickly.

Networking to build strategic alliances and long-term relationships

Whereas by definition many new SMEs are run by young business founders with limited range of contacts, a big business may have the opposite mix of people-many old people who have been in business for years and no young blood. Thus an NED can be a useful addition to a young team. However, the NED need to have relevant experience or interested in the business and be able to offer insights into how things really work in the industry in question. It is really in these areas that an NED can add real value to a young business (Barrow, 2001).

Prepare the business for an exit

Many SMEs have been established with a view to some form of exit within a few years. Even companies that have gone public are considered as being in a state of transition in terms of value. It is expected that more substantial business will acquire the business up and put in more resources to exploit its full potential. Big firms are usually not eager to be acquired but, a small firm that is keen to exit; independent directors can play a crucial role in adding value. Cotter et al (1997) sort to examine the effect that having independent directors, that non-employee directors without existing or potential ties to the firm other than their directorship, had on the outcome of acquisition negotiations. They concluded that independent directors were more likely to resist takeovers. This is done to extract a higher premium for the business. It was also seen that the proportion of independent directors was directly related to the target shareholder gains.

Bring a breadth of managerial experience early in the firm's life

The management of many internet firms is usually younger and in some cases there is rarely a management team in place for small firms. Just as every staff need leading, managing and motivating. However, many SMES are founded and led by people with little or no experience of managing anything, let alone a business that takes on board several hundred employees within two years of starting up. Many cash-strapped SMEs may find it hard to believe, their basic problems lie elsewhere; most likely flawed management processes. This is where NEDs with a depth of management experience gained somewhere can play a major role in keeping an SME on track for profitable growth (Barrow, 2001). Research on listed firms has shown that strategy influences corporate performance (McGahan & Porter, 1997) and external board members challenge strategies by management (Pettigrew & McNulty, 1995). Thus the existence of external board members could lead to better management decisions.

Preparing the company for an IPO

NED has a leading role to play to get a firm in the right condition for a successful IPO. Indeed there is enough evidence that venture capitalists favour NEDs in SMEs who have had first-hand experience in the IPO process. The need for an experienced pair of hands is very important in an IPO process.

3. Methodology

This paper focuses on the role of NEDS in Ghanaian SMEs. A questionnaire survey was carried out based on a sample of 200 firms drawn from the National Board for Small Scale Industries' database and that of the Association of Ghanaian Industries. The selection of sample was based on criteria set by Regional Project on Enterprise Development (RPED) for SMEs in Ghana. That means firms with less than 100 employees were included in the study sample. The firms were randomly drawn from all industrial sectors in Ghana.

The field survey was carried out between February and August 2005. Out of the total of 200 questionnaires sent out, 91 were received from respondents representing a response rate of 46%. Whilst this might not seem a high percentage, empirical studies involving SMEs have been known to generate far lesser percentage response rates. Data obtained from responses was entered into a "SPSS" database application for analysis. Descriptive statistics were used in the presentation and analysis of empirical results.

Table 1. Percentage of Number of Respondents(n=91)

Firms Surveyed	Percentage	Freq
Firms with NED	48	44
Firms Without NED	52	47
Total	100	91

4. Presentation and Discussion of Results

Table 1 shows that 44 SMEs, representing 48% of sample had employed the services of NEDs while the remaining 47 (52%) did not. The discussion of the findings of this study is limited to the 44 SMEs who had NEDs on their board of directors. However, we have also included a discussion of the reasons why the remaining 47 SMEs do not have NEDs.

Table 2. Percentage of Businesses with NEDs in Age band (n=44)

Age	Percentage	Freq
< 1 year	4	2
1 – 5 years	14	6
6 – 10 years	23	10
Over 10 years	59	26
Total	100	44

The answer to the question of whether or not there are firm age patterns is reflected in Table 2. The table shows clearly that there is a trend between the age of firms and the likelihood of having an NED on the Board. The result shows that as the firm matures, the more likely it increases its NED size. For instance, whereas only 4% of the firms with NEDs were less than one year old, as much as 59% of those with NEDs were found to be older than 10 years. This confirms the generally held view that older SMEs which are more likely to be larger would likely have NEDs on their Board (Smallbone and North, 1995). The result also supports the GHN's (1997) survey findings that suggest that older firms may be more likely to have NEDs.

Table 3. Percentage of Businesses with NEDs in employee number bands (n=44)

No. of Employees	Percentage	Freq
Less than 5	9	4
6 – 29	48	21
30 – 99	23	10
More than 100	20	9
Total	100	44

Table 3 shows that close to half of the businesses in the 6-29 employee band have NEDs. The result seems to suggest a break point around 30 employees. Larger SMEs appear to be those with more than 30 employees. Even so, it is reasonable to conclude that larger SMEs are more likely to have NEDs considering that the majority of businesses with NEDs were either in the 6-29 band or beyond. This result suggests that policy makers should target NED assistance at firms that have emerged from 6-29 employee band and beyond.

Table 4. Percentage of Businesses with NEDs in Turnover bands

Turnover ('m)	Percentage	Freq
< 250	19	8
250 – 500	9	4
500 – 750	11	5
750 – 1000	11	5
More than 1000	50	22
Total	100	44

Table 4 presents a similar and much clearer trend when turnover is used to measure size. It can be seen from the table that up to 50% of the businesses with NED have turnover exceeding ¢1,000 million. This supports the conclusion above that larger SMEs are more likely to employ the services of NEDs. Policy makers should therefore target NED support at SMEs that have turnover going beyond ¢1,000 million.

Table 5. Percentage of Businesses with NEDs in Exports bands

Export	Percentage	Freq
Yes	41	18
No	59	26
Total	100	44

Tables 5 and 6 present the percentage of SMEs with NEDs engaged in exports and the value of the exports. Up to 41% of the businesses are involved in external trade. Thirty- nine percent of the exporting firms with NEDs export less than ¢250 million, 17% export value range between ¢260-1,000 million. Those whose export value exceed ¢1,000 million cedi equivalent constitute 27%. This means that most SMEs produce mainly for the local market and could be supported to explore the export market more vigorously to earn more income and create employment.

Table 6. Percentage of Businesses with NEDs in Exports value bands

Exports ('m)	Percentage	Freq
< 250	39	7
260 - 750	17	3
760– 1000	17	3
More than 1000	27	5
Total	100	18

Table 7. Percentage of Businesses with NEDs in particular Industries

Industry	Percentage	Frequency
Manufacturing	43	19
Mining	5	2
Printing & Publishing	9	4
Automobile	5	2
Information Technology	2	1
Trading	14	6
Pharmaceuticals	2	1
Construction	14	6
Agriculture	6	3
Total	100	44

Table 7 shows the relationship between particular industries and the likelihood of NED involvement. It appears that manufacturing businesses are more likely to have NEDs in view of the fact that 43% of the businesses with NEDs were found in this sector. The other sectors that are also likely to have NEDs are Trading and Construction who had 14% each. It should be noted that pharmaceutical and ICT sectors only had one business in this particular sample, as a result not too much could be diagnosed from the fact that only 2% of them had a NED.

Table 8. Gender

Gender	Percentage	Freq
Male-owned	73	32
Female-owned	27	12
Total	100	44

Table 9. Ownership

Ownership	Percentage	Freq
Foreign-owned	27	12
Ghanaian-owned	64	28
Jointly Owned	9	4
Total	100	44

Tables 8 and 9 show the ownership structure of businesses with NEDs. It is obvious that most of the SMEs are male-owned and also owned by Ghanaians. The result shows that 73% of the sampled firms with NED are owned by male. It is however, not clear whether there is a relationship between gender or nationality and NED involvement. Table 9 shows that 64% of the firm are owned by Ghanaians. Future research may explore that possibility.

Table 10. Reported Growth or Decline for Businesses With NED

Growth/ Decline	Percentage	Frequency
Growing Rapidly	20	9
Growing	62	27
Stable	9	4
Declining	9	4
Total	100	44

Although some research that specifically tried to measure the effect of NEDs on SME performance found no clear relationship, it is generally suggested that NEDs have a positive effect on the performance of SMEs (eg. Clarke, 1998). The finding of this study as presented in table 10 appears to support the general view that NEDs may have a positive impact on SME performance. Twenty percent of the SMEs with NEDs were found to be growing rapidly while 62% were growing. This means that over 80% of the firms with NEDs are profitable. However, comparing the performance of SMEs with NEDs and those without NEDs may be more helpful in determining the extent to which NED involvement affect performance.

Table 11. Profile of Managing Director

CEO's level of education	Percentage	Frequency
Secondary	7	3
University	84	37
Secondary plus vocational	2	1
Secondary plus polytechnic	7	3
Total	100	44

Does the profile of the managing director matter? The results of this study suggest that yes, it does matter. The profile of managing directors as presented in Table 11 shows that up to 84% of businesses with NEDs are managed by university graduates. This means that businesses with well-educated managing directors are more likely to have NEDs on their Board. This confirms previous research that suggests the chain of causality may be that more educated individuals are managing directors of larger businesses and that larger companies are more likely to have NEDs (see storey, 1994). However, the analysis in Table 11 shows that this cannot simply be explained away by managing directors with higher levels of education running larger businesses.

Table 12. Level of Involvement of NED in operations

Level of involvement	Percentage	Freq
Highly involved	31	14
Involved	41	18
Some involvement	16	7
Hardly involved	5	2
Not Involved	7	3
Total	100	44

Table 12 shows the extent of involvement of NEDs in the operations of the SMEs. This survey suggests that NEDs are deeply involved in the operations of the businesses. While 31% indicated that NEDs are highly involved, 41% also said that NEDs are involved with another 16% indicating some involvement. This means that more than 88% of the respondents involved SMEs in the operations of their businesses. It appears then that SMEs would normally expect their NEDs to be involved in their business operations. Hampel (1998) suggested that NEDs might have a more hands-on involvement in smaller-scale SMEs, but the results of this study show that NED involvement in operations may not be limited by size.

Table 13. Contribution of NED

Contribution	Percentage	Frequency
Outside Objectivity	35	16
Strategic Planning Process	24	11
Finance Expertise	19	8
Operational Expertise	7	3
Structured Board Procedures	5	2
Helped With Growth Problems	5	2
Provide Impartial advise	5	2
Total	100	44

Table 13 outlines the contributions NEDs bring to SMEs. All of the NEDs contributions identified in the survey are supported in the existing literature (see Cadbury, 1992; Dunne, 1997, Hampel 1998). The NED contributions suggested in this study fit well into six areas of SME board function identified by Altherton and Hannon (1999): know-how, control, 'sounding board', know who, strategic awareness and strategic focus. Thirty-five percent responded that NEDs contribute outside objectivity, 24% on strategic planning process and 19% bring financial expertise on the board. Those with operational expertise are 7%, structured board procedures, assistance with growth problem and provision of impartial advice constituted 5% each. Policy makers therefore need to be aware of these contributions when recommending support for SMEs. The study appears to suggest that NEDs with expertise in strategic planning and finance would be more welcome and helpful to SMEs.

Table 14. Where NEDs are found

Where NEDs Were Found	Percentage	Frequency
Family Members	23	10
Friends of a Director	27	12
Business Friend Suggested	13	6
Introduction From Bank	11	5
Introduction from Auditor	5	2
Family Member suggested	7	3
Business Club/Association	5	2
Introduction from Solicitor	2	1
Local Business Links	7	3
Total	100	44

Table 14 shows the sources of NEDs. The survey indicates that most SMEs acquire NEDs through informal personal contacts such as family members (23%), friends (27%) and business partners (13%). The literature on owner-manager network lends support for the importance of informal personal contacts (see Curran et al 1993). The formal contacts contribute less than 50% with the introduction from the bank taking 11%, Auditors 5%, business club 5%, solicitor 2% and local business link 7%. This result is consistent with the literature which underscores the importance of informal personal contacts as a source of NEDs for SMEs.

Table 15. Reasons for not having NED

Reasons	Percentage	Frequency
NEDs Not Necessary	43	20
Lack of Expertise	4	2
Unaware of NED	6	3
Not Got Around to Arranging yet	15	7
Cost of NEDs	6	3
NEDs Lack Inside Knowledge	4	2
Did Not Think of Appointing One	4	2
Disruption of Directorial Team	4	2
Breaches of Privacy	9	4
Poor Previous Performance with NEDs	4	2
Total	100	47

Table 15 outlines the reasons why some SMEs do not have NEDs. Some SMEs do not have NEDs because they are concerned about breaches of privacy or have not been able to arrange for some yet. Six percent of those without NEDs suggested that it is more expensive to engaged NEDs, 15% say they have not got around, 9% responded that it will lead to breach of privacy, 6% are not aware NEDs and 4% say lack of expertise, lack of inside knowledge, disruption of the direction as the reasons for not appointing NEDs. But the single most important reason why many SMEs do not have NEDs is that they are considered unnecessary. Policy makers would therefore need to educate SMEs about the positive contributions NEDs can bring to their businesses.

4. Conclusions and Managerial Implications

This study examines the role of NEDs in the Ghanaian SMEs sector. The results of this study revealed that less than 50% of the SMEs sampled engage the services of NED. They complain it is expensive employing the services of NEDs and that their services are not needed. Considering the positive role of NEDs on corporate boards, it is disturbing to find that more than half of the SMEs are without NEDs. The study also revealed that relatively larger SMEs are more likely to employ the services of NEDs. We also found that over 80% of the SMEs with NEDs were either growing or growing rapidly. NEDs' contributions were also found to be multi-various and cut across the range of SME board functions. The study showed that most SMEs acquire NEDs through informal personal contacts such as family, friends of a director, business friends rather than through formal arrangements. Perhaps, the most positive finding was that there was a high level of awareness of NED among the sample firms.

There is a trend between the age of firms and the likelihood of having an NED on the Board. Also, larger SMEs, with more than 30 employees, are more likely to have NEDs. As the firm matures, the more likely it increases its NED size. Thus, the older SMEs which are more likely to be larger would likely have

NEDs on their Board. Policy makers should therefore target NED assistance at firms that have emerged from the 6-29 employee band or that have turnover going beyond ¢1,000 million.

Most SMEs produce mainly for the local market and could be supported to explore the export market more vigorously to earn more income and create employment. Manufacturing businesses are more likely to have NEDs. The other sectors that are also likely to have NEDs are trading and construction.

Majority of NEDs are owned by males. It is however, not clear whether there is a relationship between gender or nationality and NED involvement. Future research may explore that possibility.

It appears that NEDs may have a positive impact on SME performance. Most SMEs with NEDs were found to be profitable, and either growing or growing rapidly. However, comparing the performance of SMEs with NEDs and those without NEDs may be more helpful in determining the extent to which NED involvement affect performance.

The study also reveal that NEDs are deeply involved in the operations of the businesses as more than 88% of the respondents involved NEDs in the operations of their businesses. It appears that SMEs would normally expect their NEDs to be involved in their business operations. Hampel (1998) suggested that NEDs might have a more hands-on involvement in smaller-scale SMEs, but the results of this study show that NED involvement in operations may not be limited by size.

The NED contributions suggested in this study fit well into six areas of SME board function identified by Altherton and Hannon (1999): know-how, control, 'sounding board', strategic awareness and strategic focus. The more useful contributions are: outside objectivity, strategic planning skills and financial expertise. Thus, NEDs with expertise in strategic planning and finance would be more welcome and helpful to SMEs.

Policy makers need to be aware of these contributions when recommending support for SMEs.

Informal personal contacts such as family members, friends and business partners are the major source of NEDs. The formal contacts such as bankers, auditors and local business link contribute much less. This lends support to the literature which underscores the importance of informal personal contacts as a source of NEDs for SMEs. It would be helpful for policy makers to take this into consideration when recommending NEDs for SMEs.

The single most important reason why many SMEs do not have NEDs is that they are considered unnecessary. Policy makers would therefore need to educate SMEs about the positive contributions NEDs can bring to their businesses. Some SMEs do not have NEDs because they are concerned about breaches of privacy or have not been able to arrange for some yet. Other reasons are: the cost involved in engaging NEDs, ignorance, lack of expertise, lack of inside knowledge, and disruption of the direction of the firm.

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