

CHAIRPERSONS CONCLAVE

CHAIRPERSONS AND THE GOVERNANCE AGENDA

4TH MARCH, 2016 | MUMBAI

SUMMARY OF DISCUSSIONS

CORPORATE GOVERNANCE

Corporate Governance is important for the sustainability of business. It helps in delivering value to all stakeholders of a business. However, **in an over-prescriptive regime, Boards are increasingly becoming Boards of compliance** and not Boards that address issues of strategy. The focus is shifting from **adding value to ticking boxes** in the name of compliance. **A pragmatic approach to governance is overdue.**

LAWS ON GOVERNANCE

Post the coming into effect of the Companies Act, 2013, several representative bodies as well as individuals made representations to lawmakers. The Ministry of Corporate Affairs (MCA) Committee's views on these suggestions have fallen short of expectations. Securities and Exchange Board of India (SEBI) Regulations (LODR) are in parts more clumsily drafted than the Companies Act, 2013. **Regulators world over have become understandably hyperactive and regulations are often kneejerk episodic reactions to corporate scandals in their jurisdictions. Laws have become needlessly detailed,** with no focus on improving the quality of Board composition and in turn, Board productivity. **Discontinuity and ambiguity in law** is causing avoidable problems. The market too is not exerting as much valuation pressure as necessary for improving governance practices in companies.

CHAIRPERSONS AND GOVERNANCE

In the debate on Corporate Governance, **one of the many important stakeholders is the Chairperson** of the Board because the Chairperson is **expected to lead the Board, and extract value from each Board member.** The Chairperson is **first among equals,** and not a superior in the Boardroom. She is a **trustee,** and has to carry the Board with her. She has to **ensure** that **inclusive discussions** happen, which unfortunately is not the case at present in many companies.

There are essentially **three types of Chairpersons.** First, **non-executive Chairperson, with domain and business knowledge;** second, **non-executive Chairperson without domain knowledge;** and third, **Chairperson cum Managing Director (CMD).** It is felt that **domain knowledge is essential** for a Chairperson to effectively discharge her role and to carry conviction with the management. It is for this reason that a non-executive Chairperson without domain knowledge, will find it difficult to function effectively since she will constantly lean on the management for domain related help. At the same time, domain expertise may also be counterproductive because the Chairperson would then be tempted to second guess and step on the toes of the management. A CMD would often face another problem, which is not knowing where to draw the line as a Chairperson. **It is tough for a CMD to behave like a Director in the Boardroom, and not a person from the management.** Companies are now increasingly having **written roles and responsibilities for Chairperson and for Managing Director (MD)** for promoting role clarity.

BOARD COMPOSITION

The **effectiveness of a Board primarily depends on its composition.** It **should be dynamic** and should change with changing times. Many Indian **companies do not have a proper selection process for Board members,** since the controlling shareholder, whether in the public sector or the private sector, decides the composition of the Board. Board members are often not chosen on the basis of skill sets required in the Board. As a result, many **Boards are not intellectually capable** or equipped to effectively perform their role. A Chairperson has a major role in ensuring that the **composition of the Board is in line with the requirements of the company.** While some Chairpersons do not appreciate the contribution of Directors, others seek out Directors for their contribution.

Law of natural selection will play and ultimately, the Board will comprise the type of Directors that the Chairperson wants. **Many Nominations and Remuneration Committees (NRCs) are yet to take their role in effective Board composition seriously.** They should actively identify the skill set required, but currently missing, at the Board level and suggest names of probable Directors for their induction to the Board. While doing so, NRC should ensure that the Board does not become a Board of consultants. Emphasis should be laid on Directors having domain knowledge. Increasingly it is felt that the **Chairperson should be a member of the NRC** (this is optional now) since she would be able to help in determining the required skill sets and in identification of the right kind of Directors, thereby aiding in the Committee becoming more productive and result-oriented than it is at present. Also, even if the promoters, guided by good intentions, are seen as deciding the composition of the Board, IDs will lose faith in the Board and its functioning since the Board will be perceived as a rubber stamp Board. One of the major problem that some companies suffer from is the presence of a former Chief Executive Officer (CEO) (especially a predecessor CEO) on the Board as a Director. Ideally, there should be a **cooling off period before a former CEO is appointed to the Board.**

The **current laws have made many Directors apprehensive about joining company Boards.** Many Indian companies have checkered pasts. With very strict rules and regulations being imposed, Directors would shy away from joining the Boards of many Indian companies. Lawmakers should be mindful of the fact that companies which are facing problems are the companies that require better quality Directors. There are good Directors in India, but laws prevent such companies from getting good Directors to join their Boards.

CHAIRPERSONS AND THE BOARD

To the outside world, the **Chairperson is often the face of the company.** An individual **Chairperson's personal attributes and personality determine whether or not she is able to extract value from the Board** and get individual Directors to contribute effectively to Boardroom deliberations. This becomes especially important when the current laws seem to be extending the role of the Board beyond superintendence, direction and control. Also, some Directors are seen as representing only the interests of their parent organization in the Boardroom. It is important for the Chairperson to convince all the Board members that in the Boardroom they represent only one stakeholder, the company, and the interest of the company should be of paramount importance to them. Some of the more **important attributes** that companies and other Directors look for in a Chairperson are her **charisma, humility, ability to get other Board members to participate and contribute effectively, ability to generate trust in all stakeholders, ability to embody and represent the culture that she wants the company to have, inspire confidence in management, and ability to take everyone with her.**

While domain knowledge is known to be helpful, it would be incorrect to assume that the effectiveness of a Chairperson would depend only on their domain knowledge. There have been several examples of good Chairpersons, even in the absence of domain knowledge, leading from the front. In Indian Boardrooms, many Independent Directors (IDs) do not perform their role effectively. They are not mindful of the fact that their role is to look after the interests of all stakeholders. Hence, the role of a Chairperson in extracting value from them assumes greater importance. The Chairperson also has the responsibility of ensuring that Director interventions are not in the form of motherhood statements. The **suggestions from Directors should be direct and implementable by the management.** The **effectiveness of Board deliberations is also the responsibility of the Chairperson.** Equally, the Chairperson is also responsible if a Board fails to perform its role.

CHAIRPERSON, BOARD AND THE MANAGEMENT

It is important for the Chairperson to **extract maximum value from the management.** She should understand her role and consciously not step on the toes of the management, especially since an equally important person for the success of a company is the CEO. An increasing number of companies have started documenting the roles of their Chairperson and their CEO/ MD for greater role clarity. This helps them in working towards a healthy and productive relationship.

A Chairperson should be able to **create a culture of two-way communication between the Board and the management** so that the management can communicate freely and frankly with the Board, especially in case of a problem. **The Chairperson and the Board in turn should be shock absorbers.** Their reactions, especially those of the Chairperson, will help decide whether the management would be comfortable in discussing matters transparently with them.

The role of a Board is to realize the full potential of a business. As a result, Board members would need to understand some operational details. A **Board has to help the management finalise strategy**, such that the management co-owns it with the Board. This is essential to get a buy-in from the management since it has to ultimately implement the strategy. Further, the Board should empower management, while holding it accountable for its actions. At the same time, **Board members have to be cautious about over-optimistic ideas of the management.**

CHAIRPERSON AND ANNUAL GENERAL MEETINGS (AGMS)

The Chairperson also has an **important role to play in AGMs.** Currently in India, **shareholders do not utilize AGMs effectively.** More informed shareholders usually do not attend AGMs, and the shareholders who attend do not usually ask the right questions. As a result, no pressure is exerted on the Board or management to offer detailed responses to legitimate concerns of various stakeholders of the business. **Institutional investors also do not play their role effectively**, with many of them being absent from AGMs. Only **proxy advisory firms in India seem to bring Boards under some scrutiny.**

GOOD PRACTICES IN CORPORATE GOVERNANCE

Good practices in Corporate Governance propagate **separation of the role of Chairperson and MD.** In companies in United Kingdom, the separation between the two roles is complete. In many US companies there is no separation in the two roles, and power resides with one person. In India, as per SEBI Regulations, the separation of the two roles is non-mandatory, which will not encourage or force companies to separate the two roles.

At the beginning of a year, the **Board should broadly decide the agenda/ strategic items that it would deliberate in its meetings throughout the year.** More importantly, it should decide the matters/ agenda/ items which should not come to the Board. Finalisation of agenda items for Board meetings should not be left to the management, which is the practice in many companies at present. Active involvement of Board members in agenda setting can help make Board meetings more effective, given the time constraints. This would also help in assessing the contribution of the IDs. Tabling of items should also be discouraged by Board members.

Companies should **move beyond the statutory number of meetings for the Board and its Committees.** Well intentioned NEDs would be happy to accommodate this. Further, even though law states that only the **IDs should have at least one separate meeting every year, it is a good practice to have more than one such meeting.** If the agenda for such meetings is designed properly, they can be extremely effective and can help IDs perform their role better. However, a number of Chairpersons feel threatened by these meetings since they feel that this might result in the creation of another power centre in the company.

Corporate Governance should be **taken beyond quarterly Board meetings** with the aid of several tools available these days. Based on the need of the company, more Board and/or Committee meetings should be planned. Also, the Chairperson/ management should stay connected with Directors through calls in between meetings.

For a company with an executive Chairperson, it is a good idea to **appoint a lead ID**, who could be the Chairperson of NRC.

The ecosystem in which business functions, as also the structure of business, is changing rapidly. Business structures too are undergoing rapid changes. **Some company managements are finding it an uphill task to extract value from Boards** since Board members are either unwilling to accept the changes in structures or do

not understand changing requirements of the business. This problem gets compounded if Board members do not have domain knowledge. Companies too do not sensitise Boards to where they are found lacking, and/or do not communicate their expectations to them. Some companies have now started **appointing an Advisory Board, comprising experts of their industry**, in addition to the Board of Directors. Unlike the Board, an Advisory Board is not a statutory body. It does not report to the Board. It is constituted to help the management strategise on important business matters. However, the Board of Directors may not be comfortable with this arrangement since there could be a disconnect between the two Boards. Further, the Board of Directors will not appreciate the possibility of the Advisory Board overriding it since the Board of Directors is a statutory body. A related concern is that the management might end up spending too much time servicing the two Boards. Merging the two bodies might seem to be the only viable option in the long run.

BOARD COMMITTEES

Meetings of the Board Committees **should be more productive**, especially since detailed discussions happen in each of the Committee meetings. Composition of Committees should also be given due attention. **Each ID should not be expected to be a Chairperson/ member of more than 2 Committees for her to perform effectively.** Further, **members of each of the Committees should be rotated periodically** to ensure that the Committees benefit from a newer perspective.

CHAIRPERSON'S EVALUATION

Directors are not comfortable with the idea of evaluating the Chairperson. This gets compounded in case the Chairperson had, in the past, invited them to join the Board. Many companies engage external consultants who summarise the views of all the Directors and present it to the Chairperson. Ideally, evaluation exercise of the Chairperson should consist of open ended questions to ensure that the focus is on improving the effectiveness of the Chairperson.

SEPARATION OF CHAIRMAN AND MD IN PSU BANKS

Recently, the government has mandated separation of the post of Chairman and MD in Public Sector Banks (PSBs) banks. However, in the **absence of role clarity** for the post of Chairman and the post of MD, different persons, especially Chairmen, are reported to have interpreted their role differently **leading to a lot of avoidable confusion and resultant inefficiency.** This has resulted in **two power centres** within the bank. Further, some Chairmen also feel that the responsibilities given to them and the **compensation offered** are **not balanced** or fair.

STOCK OPTION PLANS (SOPS)

It is a **good idea** to give SOPs to Directors as part of their compensation. However, the Director should be able to **sell these stocks only after she ceases to be a Director** on the Board and a sufficiently long time period (such as a year) has elapsed since her ceasing to be a Director.

WAY FORWARD

Peer pressure exerted by better governed companies will hopefully persuade other companies to improve their standards of Governance.

ABOUT CHAIRPERSONS CONCLAVE

The objective of conducting closed door roundtables for Chairpersons is to pool the suggestions from those who practice Corporate Governance and to make appropriate recommendations to the lawmakers and regulators, as well as to share good practices.

EXCELLENCE ENABLERS CORPORATE GOVERNANCE SPECIALISTS

ADDING VALUE, NOT TICKING BOXES

EXCELLENCE ENABLERS PRIVATE LIMITED

Excellence Enablers Private Limited (EEPL) is an initiative that focuses on implementation of better corporate governance practices, improvement of Board performance, including audit and evaluation, training of directors and engagement with stakeholders of governance. It is founded on the firm belief that the gap between performance and potential can, and must, be bridged. Consistent with that belief, all our offerings are tailor-made to the specific needs of the organisation or the individuals concerned.

Given that our founder, Mr. M. Damodaran, introduced Clause 49 of the Listing Agreement, dealing with corporate governance in India, and has been a part of both public sector and private sector Boards, as well as performing and underperforming Boards, we offer experience based consultancy and courses on the journey from compliance through governance to performance. Further, given his success in turning around organisations that had been written off, we are uniquely positioned to offer courses on leadership, organisational transformation, and building winning teams.

EEPL has a number of highly experienced and renowned consultants and faculty members who have, and continue to, help us deliver programmes that have been well received.

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