Board Failures: If Winter Comes

BloombergQuintOpinion
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Published: Dec 21 2018, 11:15 AM
Last Updated: Dec 24 2018, 9:12 AM

If 2008 was the year of the global financial meltdown, 2018 will be remembered, at least in India, as the year when corporate governance came of age. With major

of a direct relationship between size and governance standards exploded.

Whistle blowers began to find their voice, and the commentariat found adequate opportunities to express informed and uninformed opinions on issues, real and imaginary. Those that lived in denial came up short, and the transgressors found that no longer could excuses masquerade as explanations. In the midst of the episodic excitement and entertainment that such events produced, the lessons were obvious and compelling.

> **Some of the cornerstones of corporate governance became no more than rebuttable presumptions in marquee companies.**

Independent directors and indeed whole boards moved up to the top spot in the merit list of non-performers, with auditors coming a close second. Those deemed the defenders of the faith got shown up as disbelievers.

Top Of The Demerit List

The board of directors deserves the highest place in the pecking order of those that let the side down.

This collection of individuals—presumably chosen for experience, maturity, wisdom, a sense of balance, and fair play—proved through action, and inaction, that they were no more than clapper boys or cheerleaders for chief executive officers who were considered infallible, invincible, indispensable and immortal.

> “ **The highly questionable performance of boards was best illustrated by the manner in which a chairman bolted out of a boardroom, at a pace which Usain Bolt would have envied, to mount a public defence o CEO whose conduct was in question.**

When The Music Stopped

Independent directors have for some time been the punching bag of those who seek to find villains on occasions of corporate misfeasance. Protestations of being part-time non-executive functionaries, and at the disadvantageous end of boardrooms.

Statutory stipulations regarding the role and responsibilities of independent directors were at best seen as read, but not absorbed and acted on. Part of the blame clearly lies at the doorstep of those who over prescribe in the mistaken belief that more laws and regulations necessarily lead to better conduct. The icing on the cake continues to be the attempt to define director independence in quantitative or monetary terms. We seem to be only one step away from seeking to define integrity in monetary terms.

> **The simplistic perception that compensation and independence have an inverse relationship is striking at the root of the institution of independent directors.**

Legislative and regulatory excess is worse than the perceived excess in compensation of independent directors.

The auditor community has also legitimately received a fair share of the blame attached to financial crimes and misdemeanours. With stakeholders placing complete faith in the observations of the auditors, and hoping to make investment decisions based thereon, auditors have sought refuge in increasing disclaimers and complexity of language to escape the responsibility of stating what subsequently has become obvious at least in a few cases. With an independent statutory disciplinary body, NFRA, now in place, there is reason to hope that auditing conduct will improve and that auditors who wrongly perceive management as their employers, will not pull their punches if irregularities, or worse, are noticed.

Many Challenges In The New Year

2019 is on everyone’s mind as the year in which India goes to the polls. At the same time corporate India is expected to witness a significant churn in the composition of the boards, with the first five year term of many directors, after the implementation of the Companies Act, 2013, coming to an end. Sensing the assessing the suitability of new appointees to board positions. There is no clarity yet on how attributes such as collegial behaviour (as distinct from collusive behaviour), independence and integrity will be determined by an institute through an assessment process. The outsourcing of the statutory responsibility of the Nomination and Remuneration Committee to a bunch of academics is a highly questionable move.

2019 will also see the position of chairman of the board being occupied by a number of new entrants to the board, especially with the position becoming non-executive in the near future.

> **The presumption that every chairman will hit the ground running and will need no orientation to provide leadership to the board deserves to be set aside.**

Programmes are required to be designed to handhold new chairmen to clearly understand their role as leaders of the board, and to help create an enabling environment for board members to contribute effectively in exercising superintendence, direction and control.

Breaking Up Unwieldy Boards

The size of the board is also a cause for concern. Unwieldy boards with a large number of executive members, many of whom do not express views other than on their functional areas, is a problem that needs to be addressed.

Simultaneously, the fear factor that drives independent directors out of boardrooms has to be taken cognizance of, so that the corporate sector is not denied the benefit of their wisdom.

> “The answer presumably lies in a two-tier board structure that has the independent directors on the supervisory board, and the executive directors on the fiduciary board.

board members. An abundance of executive directors on a unitary board also negates the board-management distinction.

An Evaluation Mechanism

If boards and their constituent directors are to add value on a continuing basis, it is necessary to have a robust no-holds-barred evaluation system put in place. The mutual admiration societies that come into being, as a result of what passes for peer evaluation within the boardroom, should be a thing of the past.

The salutary example of the United Kingdom which provides for evaluation by an external agency at least once in three years would be a good starting point. Due disclosure here: Excellence Enablers, with which I am associated with, functions as an external board evaluation consultant.

The Ideal Package

Boards that are right in size and content, and have role clarity, board committees that are correctly constituted and contribute meaningfully, constructive tension between boards and managements, auditors that seek and state the truth, retail shareholders that ask questions, institutional investors that practice activism—and do not stray into adventurism—and proxy advisory firms that distinguish the grain from the chaff, is the package that Santa should hopefully bring this month.

The lessons have hopefully been learnt. The solutions are in sight. What is needed is clarity, courage and conviction to put in place a meaningful pragmatic value-adding structure, supported by appropriate procedures, to ensure that 2019 will be the turning point in India's corporate governance history.

No longer must it be said that when the going got tough, the tough got going the boardrooms, and the stakeholders got burnt at the stake.

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