

## **NRCs – EXPECTATIONS AND EXPERIENCE**

### **Wednesday, June 10, 2020**

## **SUMMARY OF DISCUSSIONS**

### **Background**

*Covid-19 came with not much of advance notice, and wrought, and continues to wreak, untold havoc on the lives and health of humankind, across continents, and the economic health of most nations. In the corporate world, managements are waging continuing battles to ensure crisis management of a high order. There is increasing focus on the quality of top management and senior management as they attempt to keep the ship afloat so that it can sail, once normalcy sets in. Consequently, the role of the NRC has come in for increased attention. The selection of Directors, KMPs and SMPs, their compensation and the evaluation of their performance has never been more critical. This is a time when companies cannot afford to carry passengers. At the same time, recruiting and retaining the best in the business and compensating them appropriately will differentiate winning companies from those that will fall away in due course. The expectations from NRCs are high. Does the experience match?*

### **DISCUSSIONS**

- There are three types of Boards - pliant, compliant and effective Boards. In the pliant Boards, processes are driven by the Promoters. In the compliant Boards, tick-the-box approach is followed, with no thought given to the reason for having these processes in place. In the effective Boards, effectiveness of the processes is given a lot of importance.
- There are huge expectations riding on NRCs. However, in most companies, the effectiveness of NRCs is sub-optimal. The committee has not generally delivered as per expectations.
- The key responsibility of any NRC is to have good leadership in the company, both at executive level and Board level, and to look at the structure and compensation of executives and non-executives.
- While the role of the NRC has not changed during Covid times, it has assumed additional significance.
- NRC's job is not easy to perform since the committee deals with persons. Sometimes, dealing with Promoters and/or Directors is more difficult than dealing with management. The role of Chair of NRC is particularly important in this context.
- At the heart of good governance in a company is an effective NRC. All apparatus of governance should function properly, for the company to function properly.
- While the Companies Act, 2013 and SEBI LODR Regulations, 2015 contain some provisions regarding the role and responsibilities of the NRC, it is for the NRC to suitably expand and interpret its role, so that the company is benefitted from its interventions.
- The charter of NRC is seldom looked at or revisited.
- Large companies have a complex structure of subsidiaries, associates and joint ventures. Some of these subsidiary companies are themselves listed and/or may have their own Boards. NRCs of all these companies may not have clarity on whether they are expected to work together or whether the NRC of the holding company is expected to have exposure to the NRCs of the other companies.

### **NUMBER OF MEETINGS OF NRC**

- The remit of NRC has become broader. A number of companies that were satisfied with having the statutory minimum of one meeting of the NRC every year, are finding that more meetings are needed to discharge its responsibilities. Proactive NRCs should meet at least quarterly.

## **BOARD COMPOSITION**

- NRCs should assist in ensuring that the Board is rightly composed composition. This involves finding answers to questions such as who is best suited to be on the Board.
- The Chairperson of NRC should have a conversation with the Chairperson of the Board, to factor in the latter's assessment of the requirements of the Board.
- Domain familiarity is important, but an expert is not necessarily required on the Board. If expertise is required, it would be better to bring it in an advisory capacity.
- Most companies do not have a clear idea about their future. They believe that they would grow incrementally. As a result, they do not know what kind of Directors they would require in the future, should the company redefine its business.

## **SELECTION OF DIRECTORS**

- Role of NRCs in selection of Directors has been very limited. Most companies continue to choose IDs on the basis of their "celebrity status" or because they form a part of the "old boys club". The present role of NRC is generally limited to the balance on the Board, in terms of competence and capabilities.
- If a Board has to be evaluated for competencies or reconstructed completely, the role of NRC should not be limited.
- Most companies give each ID a term of 5 years. In case an ID is found not to add value, the possibility of letting her go, and getting a new ID is limited, since most Boards would shy away from telling the member that she is not adding value, or going back to the shareholders to say that a wrong choice was made.
- An Executive Director is inducted on the Board because of her managerial role. The role of NRC should be limited to one of oversight, to ensure that there are no biases influencing her selection, to the exclusion of more suitable candidates.

## **BOARD DIVERSITY**

- Board diversity is not merely gender diversity. Too much attention is given to gender, to the exclusion of other diversities.
- Knowledge, experience, competence, capability and skillsets should be considered while constituting a diverse Board.
- A number of companies are looking overseas for getting new Directors. This is a welcome development. There is merit in getting different perspectives arising out of cultural, functional or generational distinctions.
- Age diversity is increasingly becoming important. The younger generation is willing to take much more risks. However, the younger generation may not have adequate wisdom, which comes with a certain amount of experience. Experiential wisdom is required in the Board. Ideally, a balance between experienced persons and younger persons is required in the boardroom.
- The second line (below the CEO) as also the CEO, should be given Board-level exposure. This would help them learn new things and bring back good practices to their own Boards. There is also a view that some companies, with non-competing businesses, should come together and appoint each other's top management personnel as Independent Directors (IDs) on their Boards. This would bring freshness of views and diversity of experience to the Boards. This idea has found huge resistance in most companies, since it is felt that this would compromise on the time and bandwidth available with management persons for the company's work.

## **COMMITTEE COMPOSITION**

- Hardly any NRC has a decisive say in the composition of the committees of the Board. This is a grey area since most Boards feel that this role should be performed by the Chairperson/ the Board, as committees are the eyes and ears of the Board.

### **SELECTION OF TOP MANAGEMENT**

- The role of NRCs in selection of Key Managerial Personnel (KMPs) has been limited.
- NRC should ensure that the role of KMPs is clearly defined, to avoid any overlaps.
- The effectiveness of an NRC depends on the leadership team that it can build. Ideally, the NRC should have a role in appointing the entire leadership team.
- NRC should handle the selection of top management, especially the CEO, because the committee would know the requirements of the company and can do a deep dive into the process.

### **TALENT MANAGEMENT AND CAREER PROGRESSION / APPRAISAL**

- NRCs in some bigger companies have played a role in helping with talent management at senior levels.
- A number of companies do not look at talent plans.
- Appraisal of second line executives/ personnel (the level below the CEO) is not easy since most NRCs do not have adequate visibility to them.
- The best possible way is for the Board to encourage them to make presentations, so that the Board can interact with them. This is not a substitute for appraisal, but would at least ensure some visibility.

### **SKILLSETS REQUIRED FROM NRC MEMBERS**

- Diplomatic skills are important because the NRC has to deal/work with people, especially Promoters.
- Different Promoters are different. Some of them are receptive to ideas and changes, but others want to play safe. However, this does not mean that the latter types are bad Promoters or that the company is bad. Different approaches are required for dealing with different Promoters, and each Promoter would want a say in how the company/ Board processes are run.
- The Chairperson of the NRC has to be strong, and not succumb to the demands of the Promoter. In such cases, the role of an NRC is also to strengthen the Chairperson, so that the company and the Board can function well. This also requires diplomacy.
- How does diplomacy work? NRC should gauge freedom / boundaries within which it should operate, and then play along. NRC should be originating ideas, and not just be responding to them. They should push the envelope. NRC, especially its Chair, should communicate what needs to be communicated. The recipient should understand that the member of the NRC have no axe to grind, and that no member is married to the Board position.
- The role of the NRC sometimes seems to be second-guessing the CEO. As per law, the compensation to be paid to the direct reports of the CEO has to be approved by the NRC. This could be perceived as the NRC hindering the CEO, and tying her hands, and making her weak. In such situations, if the NRC works diplomatically with the CEO, the best resolution can be achieved. In Promoter companies, the Promoter too has to be brought into this equation. That can bring its own complications, but they must be dealt with.
- In many companies, irrespective of their type, NRCs are ex-officio arbiters between the true power that runs the company, and the management. This role has to be played diplomatically, interpreting signals from both sides. If the NRC does not play this role fairly, it would be a poor arbiter.

### **SUCCESSION PLANNING**

- Sustainability of any company depends on succession planning. NRC should obtain regular status updates on succession planning.
- Traditionally, succession planning has been mostly for the post of CEO/ MD. However, in Covid times, it has been extended to the position of Chairperson too, whether Executive or Non-Executive.
- Some NRCs have played a role in succession planning for the posts of KMPs too. They have vetted the profiles and recommended the right candidates.

## **BOARD EVALUATION**

- A number of NRCs have a limited role in determining the process of Board evaluation. Not all the NRCs are upto the task of efficiently managing the evaluation exercise. However, if done properly, this exercise can add value.
- If done as an exercise of ticking boxes, it is a waste of time. If done seriously, it reflects the confidence that the Board has in the Chair of NRC. It should be a free and transparent process.
- Blindly adopting a questionnaire approach to Board evaluation, does not help in adding value. The focus should be on assessing the contribution of each Director, and in turn that of the Board.
- The exercise should focus on improvement of Board performance. The process should focus on the qualitative aspects such as what the Board should be doing and what it should not be doing, and on this basis, provide feedback to the Chairperson, so that she can influence the agenda setting accordingly.
- NRC can play an important role in providing feedback to Board members, especially to the Chairperson of the Board, both formally and informally. Notwithstanding a formal Board evaluation process, NRCs can pick up signals and communicate them to the concerned Director.
- Feedback should be given to each Director, on a one-on-one basis. This feedback should be on the basis of self-evaluation of the Director, as compared to, and contrasted with, what other Directors think and what the management thinks of her. Equally important is to identify changes in the contribution of the Director, over the years, since feedback is given each year.
- If the manner in which the Chairperson's feedback is given is constructive, the receptivity of the Chairperson to feedback would also be high.
- The role of a separate meeting of IDs seems to have been envisaged by law for the purpose of Board evaluation. This requires companies to have at least 1 meeting of IDs, without the presence of management, for evaluating other Directors and the Board. This meeting has been not been given enough importance. This is a critical meeting which gives a lot of insights about the Board, its functioning and about the Directors. Additionally, if this meeting is used for seeking inputs to give feedback to the Chair, it can be very helpful.

## **REMUNERATION**

- The Company's policy on remuneration should be rational, and defensible.
- NRCs have a very important role in helping design compensation structures since the structure could be complicated. Equity plays a significant role in the compensation structure. NRCs have to help create the right incentive mechanism, and the performance management exercise has to be suitably designed. This is especially true for smaller companies/ start-ups.
- The compensation of the Board and the promoter has to be discussed and finalised by the NRC and the Board.

## **ROLE OF CHAIRPERSON OF BOARD**

- The receptivity of Promoters/ founders makes a difference to the effectiveness of the Chair of the NRC. Attitude of the Promoter is very important.
- A lot depends on the working relationship between the Chairperson of the Board and the Chairperson of NRC. This has a huge bearing on the role and effectiveness of the NRC.
- Some companies have paid the price for the Chair of the Board and the Chair of the NRC not being on the same page.

## **COMMUNICATION**

- Communication lines between the Board and the management needs to be clear and transparent.
- NRC should have the ability to convey the views of the committee constructively, without bending it to suit the Chair of the Board.
- If the NRC tries to implement newer ideas, there could be some resistance, but if the NRC approaches this constructively, over time, the Board, the Promoter and the management would appreciate it.

## **MENTORING ROLE**

- Independent Directors can undertake the role of mentoring the CEO and the top management persons.
- NRC Chair can have conversations with the CEO every 6 months on matters such as the organisational structure, talent pool, her struggles etc. This is very important. This should be on the basis of the CEO reaching out to the Director, and not vice versa.

## **FUTURISTIC NRCs**

- NRCs need to think about the organisations of the future, the structure and the talent pool required. For this, the NRC will have to work with the CEO. The Board and the CEO have to be receptive to the possibility of looking at the organisation of the future. Accordingly, organisational design and talent plan have to be thought of.
- NRCs should also look at businesses of the future, and not just organisations of the future. They should accordingly look at the talent pipeline required. NRCs should look at future readiness of the business.
- During Covid times, NRCs/ companies have looked at the possibility of delayering and flattening of organisational structures. Also, they have discovered that this does not adversely impact productivity in a work-from-home situation. CEOs and Boards have begun to examine the need for so many persons at the top in a work-from-home situation.
- However, some companies believe that the future strategy of a company has to be decided by the Board, and not by the NRC, and once this is decided, the NRC will come in to help create the organisational structure and talent required for it, on the basis of the business of the company.
- In Covid times, there is understandably some thought on simplifying organisations. NRCs and managements have to think about what the company can do differently to manage talent, especially with work-from-home, and no personal touch. How should the company create a common culture, especially when a large part of the workforce may not come to office for a long period of time? How do you create a bond with your workforce?

## **ADDITIONAL ROLES THAT NRC SHOULD FOCUS IN THE NEXT 12-24 MONTHS**

- Much depends on the proactivity of the Chair of NRC.
- Be forward looking. Building up talent pool depending on the businesses that the company wants to enter into. This would involve onboarding a good Chief of Human Resources and giving her the necessary powers. This idea has to be socialised, and should come from the CEO.
- There should be reflection as well as conversation at the Board, to make the Board more effective.
- It must be ensured that the right kind of leadership and governance processes are present in the company.
- Rotation of Board committee membership can facilitate more information and knowledge sharing.
- Board evaluation process is evolving and improving. Stronger feedback mechanism will help.
- NRC should help in boosting the morale of top management, especially in times when increments cannot happen. One-on-one meetings between NRC members and top management can go a longer way in keeping their spirits high.
- Virtual meetings for Boards are not sustainable in the long term. A new Director, with no proper induction, and without any in-person meetings with other Directors, would find it difficult to function as a team member.
- Inculcating a culture, and the building of a muscle of learning agility, should be ingrained in the organisation. Learning agility is majorly missing in most companies.

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