BOARD EVALUATION: A TOOL FOR GOOD CORPORATE GOVERNANCE

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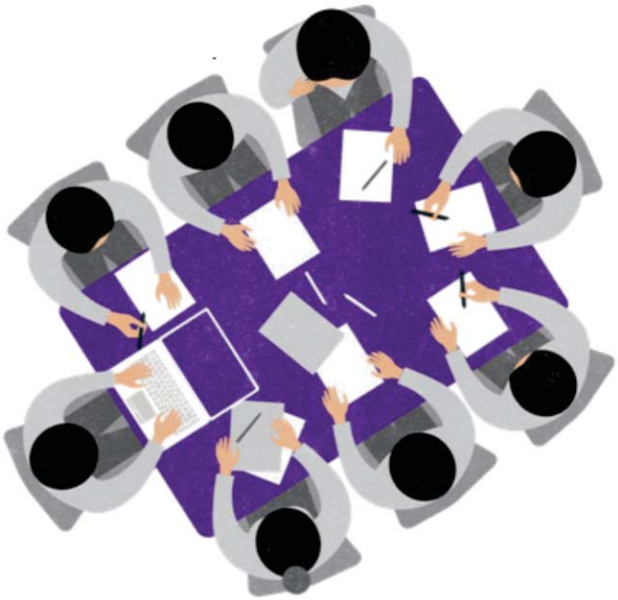
Governance is a key theme for corporates these days as they get bigger and instances of proven misdeeds increase. Like Caesar's wife, it is not only necessary to have good governance, but also be seen practicing it relentlessly. Post some mis-governance actions by well-known names in India Inc, the Government of India (GoI), Securities & Exchange Board of India (SEBI), among others are pushing the agenda of corporate governance aggressively through regulations and guidelines.

One of the requirements under the The Companies Act, 2013 is that boards need to be evaluated regularly which is a welcome and necessary requirement. In our opinion, everyone needs evaluation and boards are not above this. However, till the guidelines came in, we hardly saw any serious efforts (barring few) to evaluate the boards of companies in India. The Companies Act 2013 requires companies to conduct board evaluation on an annual basis, but does not specify any mechanisms or approach, leaving the matter to the judgement of the boards.



In early 2017, SEBI issued a set of guidelines to provide some more guidance on board evaluation (see box for summary) covering methodology, scope, parameters for evaluation, among other things. At the moment, these guidelines are not mandatory. Soon SEBI could make some of these mandatory if it sees that boards are not being appropriately evaluated.

We review some aspects of the areas suggested for evaluation in terms of what is desirable and ask some questions later on what boards need to do to ensure appropriate evaluation. Interesting facts on some of these areas have also emerged in the global survey conducted by Grant Thornton covering 2500 respondents.

SEBI's guidelines seek an evaluation of whether the board has sufficient diversity on gender/background / competence / experience:

SEBI has not given recommendations on the nature and extent of desired diversity. It is our belief that diversity is beneficial everywhere and more so in boards to ensure a healthy board culture of challenging rather than groupthink.

A University of Singapore[1] study has concluded that a company with diversity (gender, ethnicity, age) gave an average return on assets of 5.1 per cent versus 1.1 per cent of the ones without diversity. While most of the boards agree that diversity is important, 88 per cent of the 2500 respondents to the Grant Thornton International survey had mentioned that boards need to do more to encourage diversity.

One crucial dimension of this debate in the current environment is: Are boards having adequate digital diversity? With technology playing an overwhelming role in the business world by disrupting all traditional businesses, it is critical that all boards include individuals who can infuse digital-preparedness and guide companies on strategies for the Digital Future.

Whether the board has set corporate culture and values that executives shall follow:

Culture is clearly the bedrock of good corporate governance. A combination of best in class compliance and a purpose-driven culture

SUMMARY OF THE GUIDELINES

Coverage

a. Evaluation of board as a whole, committees of the board, individual directors and chairperson.

b. Process of evaluation including laying down of objectives and criteria to be adopted for evaluation of different persons.

c. Feedback to the persons being evaluated.

d. Action plan based on the results of the evaluation process.

e. Disclosure to stakeholders on various aspects.

f. Frequency of board evaluation.

g. Responsibility of board evaluation including role of Chairperson, Independent Directors and the Nomination and Remuneration Committee.

h. Periodic review of the entire evaluation process.

Criteria of evaluation

a. Board to be evaluated as a whole on competency, diversity, qualifications and experience.

b. Quality of board meetings in terms of frequency, notice, agenda circulation, time available, and quality of discussions.

c. Evaluation of performance of the management.

d. Delineation and clarity in the functions of the boards and its committees.

e. Is there adequate focus on strategy, risk management, governance, company culture, succession plan etc?

f. Are there appropriate board processes covering conflict of interest, board appointment and retirement, remuneration of board members, grievance redressal of investors, etc.?

g. Committee's composition, effectiveness, independence from the boards.

h. Individual directors to be evaluated on qualification, experience, competency, people skills, contribution, commitment, integrity, and independence.

will help separate the best from the rest. Boards need to think through whether their actions and initiatives are in line with what they seek from the company's personnel.

Regulators in developed countries like the United Kingdom (UK) and Australia have recognised these aspects and mandated boards to review and reinforce the right corporate culture. There is no clear measure of evaluating this, but SEBI has rightly pointed out that this is one parameter that boards need to think through and provide appropriate messaging. Currently, most boards don't spend enough time on this aspect. Nine in ten business leaders surveyed in the Grant Thornton Global Governance Study believe culture is important to a robust governance framework and directors generally agree that it is the board which needs to build and foster this culture. The tone has to be set from the top. However, one in five business leaders said their boards do not spend enough time focusing on culture.

Whether an appropriate and adequate succession plan is in place and is being reviewed and overseen regularly by the board:

History has witnessed that lack of adequate succession planning can impact growth and sustenance of organisations. Boards should identify the skills required for future and mentor the identified executives. Boards should cast

their net wide to identify potential candidates early both, within and outside the organisation. India Inc. could emulate Institute of Directors in New Zealand's Mentoring for Diversity scheme model of mandatory mentoring programme, encouraging cross-fertilisation of ideas across industries and borders.

https://bschool.nus.edu/Portals/0/images/CGIO/Report/diversity-report-2014.pdf

Whether significant time of the board is being devoted to manage strategic issues and whether the board reviews strategy, action plans, risk, and annual budget performance objectives:

It is generally seen that boards are tied up in routine administrative and regulatory issues, spending less time on strategic issues. SEBI is clearly asking boards to spend time on strategic issues. The Grant Thornton international survey highlighted that almost three-quarters of businesses globally operate under a planning cycle of three years or less. In recent digital times, however, businesses which operate in three-month cycles exist. Most board members agree that three years is a right planning term. Some would also like to see CEO compensation linked to longer-term performance which will prevent operational decisions being driven solely by quarterly reporting.

The SEBI guidelines offer a useful guide for boards which seek to conduct evaluation not just in letter, but also in spirit. While developing board evaluation framework, there are certain key aspects which boards must contemplate as the end objective is not limited to performing the evaluation exercise, but take actions. Whilst SEBI has not covered these in detail, we believe these are critical issues to ensure that benefits of the evaluation translate into good governance and performance. Boards should introspect on these and arrive at their own solutions. Clearly, boards don't want imposed evaluation criteria and hence it is best that they think and deliver on the expectations for proper evaluation. Here are some questions for boards to think through, come up with solutions and make the solutions a part of practice while undertaking board evaluation

a. What is the ultimate impact of the evaluation? Will it be used to add or remove directors? Do directors have the power to add or remove directors or is it the right of shareholders? Our view is that those who are not performing their roles within the board need to leave and those delivering should be rewarded appropriately. Boards should therefore make such recommendations to the shareholders on removal and rewards.

b. What is the extent of documentation and disclosure on the subject since such evaluations are usually expected to be confidential? Can or should the history of past evaluation be shared with boards? Our view is that the entire evaluation history should be maintained confidentially and be shared with board members so that the evaluation should take into account past performance and not a limited one-year view.

c. What is an appropriate level of disclosure on evaluation to the shareholders so they can use it to make decisions on appointment of directors? Given the broad nature of Indian public company shareholding where a promoter group controls majority or significant shareholding, this may seem irrelevant but as we move to become companies with wider shareholding these issues become critical. Can a summary of this be provided to shareholders so that they can benefit while evaluating appointment of independent directors? Our view is that a summary of the key evaluation should be shared with shareholders to empower them in making decisions related to re appointment of directors.

d. When the chairman or managing director is from the promoter group or a significant shareholder, how do we evaluate her or his performance? Also, who is the right person to provide feedback and in what manner? Can the rewards or remuneration of such individuals be linked to performance evaluation?

e. The role and rewards for independent directors is something that should be of concern and interest to Boards. In our current thinking on independent directors, along with the responsibilities and liabilities we have imposed on them, have we ended up in making them drive corporates to succeed or only to make them risk averse? Our view is that directors should be independent of the key shareholders, but not independent of the company and should benefit or loose based on the performance of the company on whose boards they sit.

Currently, more often, board evaluation is largely carried out meet to compliance requirements. With wider shareholding, growing importance of corporate governance, professionalisation of boards, improved activism of institutional investors, and corporates going global, we expect that board evaluation will evolve to be a robust process.

We believe it is more appropriate for boards to be evaluated by external experts compared to internal evaluation as it will ensure independence and objectivity. Unlike SEBI in India, the Financial Reporting Council (FRC) in the UK has mandated external party evaluation at least once in three years. It is equally important to understand how evaluation impacts directors in terms of their tenure, rewards and roles on different committees. A good evaluation will ensure that boards will seize to function as cosy clubs of people who know each other, becoming more professional and focussed on performance.

We believe companies that adopt robust corporate governance practices will see significant long-term benefits. ■

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