GALVANISING THE CORPORATE BOARD

"Things I Wish I had known Before Joining a Board," This is one of the thoughts that cross the minds of some of the directors serving on the board of companies.

The role of the members on the boards to-day is making a big impact on the confidence of the public; therefore to maintain the confidence, our corporate board members must do the right thing every day, individually and collectively.

THE BOARD:

The role and functions of a director has been laid out in different enactments over a period of time. The definition of "**Director"** under section 2(13) of the Companies Act, 1956 "includes any person occupying the position of director, by whatever name called. Clause 49 of the listing agreement lays down the criteria of how many directors would constitute an ideal board and who should it comprise of.

As regards the Board size section 252 deals with the numbers for minimum number of directors and states that every public company (other than a public company which has become such by virtue of section 43A) shall have at least three directors. Every other company there shall be two directors.

The maximum number of directors that a company shall have is 12 or such number as may be fixed in the Articles of Association.

Galvanise – the dictionary meaning is to stimulate action. The discussion then evolves around how to stimulate the Board to action. The emphasis is to analyze Boards, which existed in the nineties and the developments that have taken place over the last few years.

THE TREND:

What organizations are looking for is dependent on a variety of factors. It is fair to say that, most of the time, organizations are looking for individuals who can devote sufficient time to their board duties, can contribute meaningfully to board discussions on strategy and other issues, to bring their experience to bear in helping the direction of the organization and use their base of contacts to help promote the organization.

INVESTOR CONFIDENCE:

The needs can differ, however, depending on the type of organization and the stage of development of an organization. For example, companies that are already listed in major stock exchanges are generally looking for inducting independent directors who can add to the credibility of the board with investors. High-level independent directors are considered a vital part of good corporate governance by most institutional investors, and companies which are listed have more visibility and are well advised to make the transition from being a closely held company to a widely held public company by inducting the right independent directors, having exposure in growth oriented companies.

On the other hand, a lot of startups are concerned with a different type of board composition that a startup can benefit from; one of which is the funding activity which gets facilitated when the board is broad based and has the experience of running a growing company.

Some of the major changes that are taking place in constituting the Board are:

Outside Directors: The trend to appointing a majority of outside directors is of relatively recent vintage. Some of the software majors have an ideal strength of upto fifty per cent of its Board as independent directors. Where as the present level is to have only two to three inside officers on the Board, and the trend going forward maybe that many would like to see only the CEO on the board.

Smaller Boards: Presently the strength of the Board commonly varies from 10 to 15. The trend is towards downsizing of the Board to the 8 to 10 range and things should be stabilizing there. But there are statutory changes in the offing to increase the strength to fifteen.

Fewer Meetings: Companies are gravitating toward an average of 6 meetings a year, down from 8 to 10 meetings which is an indication, that boards are operating more efficiently than in years past. To the extent that smaller boards and fewer meetings lead to more focused board discussions and make a company more attractive to recruiting highly accomplished directors.

Compensation: The major trend is that very few companies in the past compensated their directors with some form of company stock. The one major form of compensation used to be the sitting fees alongwith out of pocket expenses. Today more and more companies are providing some form of stock arrangement to their directors, to compensate for the time spent.

Rise of the Nominating Committee: Infosys was one of the pioneer companies to create nominating committees of the board. Among the trends that have done the most to reshape boards over the past years has been the rise of the nominating committee, which mainly comprises of committees, which handle investor sensitive issues, an important factor in the shift from insiders to more independent outside directors.

Other Trends: These are future trends that directors themselves believe will become generally accepted practices in the next five years. Formal CEO performance reviews by the board will grow rapidly and be well established in most companies. Board performance reviews will increase but more slowly than CEO reviews, it will be the norm for a retiring CEO to leave the board. Committee chairs and committee members will be appointed by a board and not by the CEO.

The number of inside directors will continue to decline and the number of truly independent directors will continue to increase. Lastly, written statements of corporate governance policy will become more appropriate and meaningful.

You will note that many of these trends represent structural changes to boards. The structural changes are important because of how they can lead to process changes. A problem that we've had with our system of corporate governance is that the directors by law have always had all the power that they need to govern. What they have not had was the process.

INDEPENDENCE OF DIRECTORS – THE ULTIMATE BOARD TREND:

As these structural trends have impacted, and continue to impact, the process that allows boards to act with optimal effectiveness, are worth close attention, encouragement, and applause. That's what has changed. It is this ultimate board trend.

While there may be different types of directors, Corporate Boards can be broadly categorised as functional and non-functional. When I say functional it includes those directors who are actively involved in the day-to-day administration or by being member of committees and airing their views on issues which needs attention in the interest of the company. As regards non-functional members they would fall under the category of individuals who are part of the board to fill in the number for the quorum or provide requisite support for the functional member and who are friendly to their cause. To give an example a board member who is not technically qualified would find a place in the audit committee.

REMUNERATION:

The other issue is on the remuneration paid to Directors. In India it is not statutory to constitute a remuneration committee. It leaves one wondering as to who decides the basis of recommending payment of remuneration to directors. The remuneration fixed by directors is taken up at the General meeting for approval of shareholders. That leaves us with couple of unanswered questions on shareholder democracy.

The passage from one of the address of on independent directors begins:

"In the past few years I have perceived on the boards where I serve, and from conversations with other CEOs and directors, that some fundamental changes are taking place. Directors are re-examining their roles, their functions and their responsibilities. Directors are asking questions now before they accept membership on boards. Directors are thinking about their liabilities to stockholders and to beneficiaries of company pension plans...."

The passage continues:

"An increasing number of CEOs as well have concluded that the passive roles of boards are not enough, that boards are responsible to the owners, the stockholders, that the old pattern of board practice must be changed, and that boards can be important involved elements in the top management process for setting policy and monitoring performance."

A Deloitte & Touche survey presented during the seminar noted that 58 percent of the directors at 209 Fortune 1000 companies agreed that a diverse corporate board is important.

BUILDING A BETTER CORPORATE BOARD:

Board of directors is a legal structure that represents and protects the interests of a company's shareholders. Choosing a good corporate board takes time and energy, and is crucial to the company's success: Picking the right team will increase the prospects for the company at the same time mitigate problems. The board helps to set strategic direction, infusing it with valuable expertise that makes the company attractive to investors.

1. **Choose People with Experience:** Any Company will want people who are well connected and who make themselves available when needed. But experience counts. One should take adequate care to recruit directors with expertise in the issues likely to confront the company.

2. **Choose People with Diverse Skills:** It is ideal to balance the composition of Board with directors with diverse skills in the field of finance, marketing and technology that is relevant to the company. However there are new areas like e-governance, which should be represented in the Board for success of companies. Board representations may have to be given to major investors acquiring stake in the Company.

3. **Choose People Who Know Your Industry:** The Company will want professionals who can speak from experience and provide perspective on industry trends. These are not people who work for your competitors, but rather work in complementary or related fields.

4. **Choose Independent-Minded Directors:** A common mistake that entrepreneurs make is to choose board members who are friendly to their cause. While it may be comforting to know these people are likely to side with them no matter how faulty their decision-making, they deprive themselves of the opportunity for an honest, independent performance appraisal. An independent board that includes people who aren't insiders, major investors, company advisers or golf buddies is in the best position to take an unbiased view of the company's performance and that of the CEO. This is exactly what entrepreneurs need if they have to succeed.

5. **Choose Outsiders:** Boards sometimes need to deal with such sensitive internal issues as the performance of key executives, including the CEO. Other issues they face may be directly related to the future of the company, such as succession, funding or merger/acquisitions. These issues are best handled when the board is able to speak freely. A board with too many representatives from management has to contend with leaks to the staff, politicking and people who have a vested interest in outcomes which may not necessarily be good for the company.

6. **Choose People Who Are Local:** The Company should look at picking board members who are easily accessible. There can be too many logistical problems if the directors have to get on a plane to attend board meetings: One may have to worry about weather in other parts of the country and they may have to allocate more time for travel.

7. **Involve Your Board Actively:** Although CEOs sometimes view their directors as a nuisance; the board is a strategic asset that plays a key role in corporate governance. Outside board members can be effective in evaluating the company's strategy, as no one else is in a better position to freely interact with the CEO. Invariably the board members are invariably well connected and the CEO can tap this wealth for potential gains for the company. The true ones do their homework before quarterly meetings, talk to managers and employees between meetings, and those having a financial stake in the business truly represent shareholders' interests too.

8. **Communicate Frequently With Your Board:** A board functions best when it is prepared; ill-informed directors don't take the best decisions. Before any board meeting, call all directors and give them a brief overview of the major topics to be covered. If possible, provide all of them with necessary materials for review.

There should be no surprises at a board meeting - especially bad news. Surprise force members to react on the spot, without adequate time to reflect upon appropriate alternatives. Directors need to know both the current state of company and any major pending issues, so that they have time to think them thoroughly.

9. **Listen to Your Board:** Sometimes an entrepreneur is so close to an issue, at times he mixes the forest for the trees. If the board disagrees with you, remember that they are not after your job. They are simply doing what is, in their opinion, best for the company and its shareholders. If you treat your board of directors as an adversary, you miss out on the value they can provide. But if you see them as an ally, you'll be able to tap into a significant resource that offers a tremendous payoff to you and your company.

10. **Fire Bad Board Members:** Board members must be willing and able to spend the time necessary to help the company; otherwise, they shouldn't be on the board. If you realize you’ve made a bad choice, you'd better be prepared to fix the problem. You guessed it: fire him or her

GLOBAL TRENDS:

This ultimate board trend has been playing out on a long and winding road. There will always be some potholes and barriers on this road, and there will be some off ramps that don't lead anywhere, and there may be no final destination on this road. But to think we can be confident that we're on the right road, going in the right direction, and that the destination is worth traveling to.

A growing number of investors are demanding that shareowners be given the right to nominate candidates for board of director elections. Most informed investors agree that independent directors on corporate boards should be part of the cure for U.S. type corporate-governance ills. The Sarbanes-Oxley Act has taken a step toward solving this problem by requiring all publicly traded companies to have a majority of independent directors within the year.

The height of irony is that a candidate nominated by management needs only one vote to secure a place on the board of directors, even if an overwhelming majority of shareowners oppose the nominee.

While it is heartening to note that India is also taking steps and thinking of bringing in amendments like the one on induction of woman director and doing away with the provision on sitting fees it may be far from satisfactory to note that there may not be enough directors who qualify for the position of independent director leave alone woman directors.

CONCLUSION:

Let me conclude with saying board of directors is one with the intelligence, integrity and courage to exercise dutiful overview of management and contribute meaningfully to the strategic affairs of the corporation. The lawmakers have come a long way in identifying and recognising the importance of Boards and their roles in protecting the interest of the stakeholders. In the years to come we will not be left with the Board thinking, “I wish I had known this before”.

References: websites of stegensolutions / Deloitte & Touche/ socialfunds