BUILDING A HIGH PERFORMANCE COMPANY BOARD IN INDIA

A DISSERTATION

by

ALEXANDER MOORE
CHIEF EXECUTIVE OFFICER – LJ HOOKER (INDIA)

Prepared for Review by :

INSTITUTE OF DIRECTORS - MFD COURSE PANEL

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1. INTRODUCTION

The most striking feature about company boards in India is their general lack of independence from the executive of the company and its promoter.

In essence, there is often little or no value added to the company through the board.

The structure of a company and the powers of its various parts (Shareholders, the executive, and its board of directors) have evolved over time with the boards role and responsibilities now clearly defined, both in common law and statute – the board should clearly be the dominant entity in the company management and structure, and at law it is assumed to be so.

The development of a separate board of directors to manage the company has occurred incrementally. Until the end of the 19th century, it was assumed that the general meeting of the shareholders was the supreme organ of the company, and the board of directors was merely an agent of the company, subject to the control of the shareholders in a general meeting

In 1906 the first common law judgement overruled this when the English Court of Appeal made it clear in the decision of *Automatic Self-Cleansing Filter Syndicate Co v Cunningham*, that the division of powers between the board and the shareholders depended on the construction of the articles of association and that, where the powers of management were vested in the board, the general meeting could not interfere with their lawful exercise. The articles were held to constitute a contract by which the members had agreed that "the directors and the directors alone shall manage".

This was endorsed by the House of Lords in *Quin & Axtens v Salmon (1909)*, and has since received general acceptance. Under English law, successive rulings have reinforced the norm that, unless the directors are acting contrary to the law or the provisions of the Articles, the powers of conducting the management and affairs of the company are vested in them.

The modern doctrine was expressed in *Shaw & Sons Ltd v Shaw (1935)* as follows:

"A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of shareholders can control the exercise of powers by the articles in the directors is by altering the articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders."

The clear direction at law is that the ultimate power, and as a consequence responsibility, for the good management and governance of a company rests with its board.

But in India are our boards (and more importantly company promoters) ready to accept this, and to fulfill their obligations ?

2. THE IMPORTANCE OF AN INDEPENDENT BOARD

2.1. SEPERATION OF POWERS – EXECUTIVE AND BOARD

Much as the state sees the need to separate the powers of the executive government from that of its judiciary, it is held that a company board should be independent and separate from the company executive.

If the board is not independent then it simply functions as an arm of the executive and offers little or no added value, and most importantly no risk assessment or governance control - "the handbrake is off"

Under current Indian Law a listed company board must have a minimum 50% non executive directors (as detailed in 2.3), but there only needs to be 50% independent directors where the chairman is the founder (or related thereto).

So in essence the regulations do not provide for independent boards as the founder always holds the casting vote, even at the 'best case' scenario, in the worst case the independent directors make up only 33% of board numbers.

2.2. FIDUCIARY AND PERSONAL RELATIONSHIPS

Here is an example of a fairly typical company in India that has morphed from a privately held company into one now publicly listed on the stock exchange ;

Chairman	MD & Founder
Additional Director	Founders brother
Director	Founders other brother, and Co MD
Director	Equity advisor and investor
Director	Independent (family friend)
Director	Independent (family friend)
Director	Independent (family friend)
Exec Director	Long term employee
Exec Director	Family member
Exec Director	Family member
Exec Director	Family member
Exec Director	Family member

Out of the 12 Directors, 7 are direct family, 1 has a fiduciary relationship, and at best 3 (or the 12) can be seen as "independent" – and these three all have long personal relationships to the promoter.

Until Indian company boards rid themselves of nepotism and 'friendly' placements they will never be seen as independent and the performance of the companies will suffer as a consequence – international funding will in the main be difficult and expensive to obtain, and the voice of articulate balanced dissent and reason will never be heard.

These sorts of boards are a recipe for disaster in the long term, as companies will invariably blindly follow the path of one man with little or no assessment of risk and consequence.

You have a sycophantic board rubber stamping decisions of the generally sycophantic management.

The composition of a board in India largely suits the interests of majority shareholders and/or the promoter. In light of the dominant position of promoters in India, corporate boards do not have enough powers under the current regulations.

The agenda is set by the controlling family or majority owners and most of the corporate boards are made up of family members or professionals who are devoted to the majority shareholder.

2.3. TRUE INDEPENDENCE BEYOND STATUTORY REQUIREMENTS

The relevant legislation that controls the composition of a company board in India is clause number 49 of the Listing Agreement between a company and the stock exchanges on which the company is listed (the Listing Agreement is identical for all Indian stock exchanges, including the NSE and BSE).

This clause (49) was inserted initially in 2000 consequent to the recommendations of the Birla Committee on Corporate Governance that was constituted by the Securities Exchange Board of India (SEBI) in 1999.

The (much) revised Clause 49 has pushed forward the original intent of protecting the interests of investors through enhanced governance practices and disclosures.

Five broad themes currently dominate ;

1. The independence criteria for directors have been clarified.
2. The roles and responsibilities of the board have been enhanced
3. Quality and quantity of disclosures improved
4. The roles and responsibilities of the audit committee in all matters relating to internal controls and financial reporting have been consolidated
5. The accountability of top management—specifically the CEO and CFO—has been enhanced.

By Circular in April 2008, the Securities and Exchange Board of India amended Clause 49 of the Listing Agreement with the 50% independent director's rule to all Boards of Directors where the Non-Executive Chairman is a promoter of the Company or related to the promoters of the company.

In relation to board composition and the definition of non executive directors, clause 49 in its current form requires the following ;

At least 50% of the board to comprise non executive directors.

If a non executive director is chairman then at least 1/3 of the Board is to comprise of independent directors, or if the chairman is an executive director or promoter then at least ½ of Board to comprise of independent directors.

An independent director is a non-executive director, who fulfils <u>all</u> the following conditions –

1. Shouldn't have (apart from receiving managerial remuneration) any other material pecuniary relationship/transaction with the co or its promoters. Management/Subsidiary which (in judgment of Board) may affect independence of judgment of Board.

2. Not related to promoters or persons occupying management positions at Board level or at one level below the Board.
3. Not been executive of the company in proceeding 3 F.Y.
4. Not partner/executive (this year or Pr. 3 F.Y) of ;
   (i) Statutory/internal audit firm and
   (ii) legal/consulting firm having material association with co.
5. Not a material supplier, service provider or customer or lesser / lessee of company.
6. Not a substantial shareholder of the company owning 2% or more of block of voting shares.

So, is it enough for a company to merely comply with the letter of clause 49, or should the company and its board strive for real independence by complying with the inherent spirit of clause 49 ?

The example used in 2.2 above clearly shows that;

Firstly the letter of the law is not enforced adequately (as in this case to pass the test the investor/advisor must have been counted as an independent director, and even then as the promoter is the MD and chairman the test should have been 50% independent directors - not 30%),

Secondly, even if a company complies with the letter of the regulations it does not necessarily comply with its real intent – to provide an independent board.

If only 1/3 of the board is independent, then of course the board as a whole has no real independence from the executive or majority shareholders.

The 50% rule assumes that there is 50% of the board unaligned, but of course you have 50% of the board as executive directors and a further 20% as non independent directors – so again, no practical independence.

It further allows the chairman's casting vote (as promoter and an executive officer), so even if the 50% rule gave independence, the executive/promoter would still control the board in any practical sense.

If Indian companies are to find a place in world markets they have to show governance standards that fit those world markets. Boards must be independent by design and function, and cannot be a rubber stamp for the promoter or the majority shareholders.

To attract significant investment from world capital markets companies need to demonstrate that they have a strong <u>independent and qualified</u> board that can ensure best practise corporate governance - they need transparent systems of operation.

At present this level of governance is the exception (driven in the main by large globally functioning Indian companies) rather than the rule – the broader cross section of those 'aspirational' companies need to now get on board if they truly aspire to global function.

3. SEARCH, SELECTION AND INVITATION OF DIRECTORS

3.1. IDENTIFYING THE RIGHT CANDIDATES – THE NOMINATION COMMITTEE

The board should form a Nomination Committee. The function of the Nomination Committee is to help the board achieve its objective of ensuring the Company has a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

The Nomination Committee should be responsible for:

1. Identifying and recommending to the board nominees for membership of the board, including the chief executive officer;
2. Identifying and assessing the necessary and desirable competencies and characteristics for board membership and regularly assessing the extent to which those competencies and characteristics are represented on the board;
3. Developing and implementing processes to identify and assess necessary and desirable competencies and characteristics for board members;
4. Ensuring succession plans are in place to maintain an appropriate balance of skills on the board and reviewing those plans; and
5. Recommending the removal of directors.

If any company in 2011 is still relying on the chairman's contacts at the golf club to make up the board numbers then the company will probably fail the test of having an effective and independent board.

The Nomination Committee's policy for appointing new directors should be to ensure the company has a board of sufficient size with the appropriate balance of skills and experience to meet the company's present and future needs.

Each and every appointment should be based on merit against set objectives.

The Nomination Committee must look beyond obvious candidates, and its procedure for selecting candidates must be transparent and objective.

3.2. PRE QUALIFY AND APPOINTMENT OF CANDIDATES

The procedure for appointing new directors should be designed to ensure maximum transparency and objectivity. Each appointment needs to be based on merit and suitably extensive enquiries must be made to find candidates from all areas, including non-traditional sources (ie not the promoters Golf Club or College reunion).

The steps involved include:

- Regularly assessing and identifying the necessary and desirable skills, experience and knowledge for board members;
- Regularly assessing and identifying the skills, experience and knowledge represented on the board and those desired;

- Regularly assessing and determining the time commitment needed from each board member to adequately perform their duties;
- Having a developed position specification for the role;
- Making suitable inquiries of professional executive search and recruitment consultants, and major shareholders for candidates;
- Interviewing each candidate and conducting background and reference checks;
- Ensuring that each candidate:
  1. Has the necessary skills, experience and knowledge to perform their duties and responsibilities as a director;
  2. Is able to devote the time necessary to perform their duties and responsibilities;
  3. Is sufficiently independent in accordance with the SEBI definition of independence; and
  4. Is able to work with the other members of the board;
- Assembling a short list of potential nominees for submission to the board; and
- Ensuring that any notice of general meeting at which the appointment of a director is to be considered is clearly and comprehensively written in accordance with the suggestions/rules of the regulatory body

In case of the appointment of a new director or re-appointment of an existing director, as per clause 49 (4) (g), the shareholders must be provided with the following information:

1. A brief resume of the director;
2. Nature of his expertise in specific functional areas;
3. Names of companies in which the person also holds the directorship and the membership of Committees of the Board; and
4. Shareholding of non-executive directors as stated in Clause 49 (IV) (E) (v)

In the interests of good corporate governance the nomination committee should endeavour to surpass this fairly low threshold by providing full and detailed information to both the board and the shareholders.

4. DIRECTORS INDUCTION & DEVELOPMENT

4.1. INDUCTION OF NEW BOARD MEMBERS

A number of surveys suggest that most new board members believe they had not received adequate induction (a survey by an Australian State Government of NFP company boards showed well over 50%).

Induction programs help individuals to settle into their roles, so improving the performance of the board. If induction is poor, new members may be slow to contribute effectively.

A comprehensive induction program should cover at least the following:

- Special features of the company and it's strategic goals
- Full current financial standing of the company including risk assessment
- Legal responsibilities and liabilities of individual members
- Introduction to the company, its services, and vision
- Explanation of the role and processes of the board and the responsibilities of the individual member.

It is essential that members are aware of their potential legal liabilities and take steps to remedy any weaknesses that would make it difficult for them to carry out their duties properly.

The risks to boards and individual members are real.

After a spectacular corporate collapse in Australia, the non executive Chairman of the company was found to be <u>personally liable</u> for $97 million of its debt.

He and other directors were judged not to have maintained adequate controls over the Chief Executive Officer.

The judgement stated: *"The stage has been reached when a director is expected to be capable of understanding his company's affairs to the extent of actually reaching a reasonably informed opinion of its financial capacity."* Courts are expecting higher standards when dealing with issues of acting with due diligence and in good faith.

4.2. SHOULD PERSONAL DEVELOPMENT BE MANDETORY

Clause 49 (5) of the Listing Agreement states ;

A company <u>*may*</u> train its Board members in the business model of the company as well as the risk profile of the business parameters of the company, their responsibilities as directors, and the best ways to discharge them.

Clearly, this is grossly inadequate.

The company should as a matter of course have a full and detailed orientation of all incoming directors in not only the business model of the company, but in all matters required to provide the director a full and clear understanding of the aims and current position of the company.

The Nomination Committee should be responsible for establishing induction programs for new directors, and developing continuing education programs for directors.

4.3. TEAM BUILDING

Great teamwork makes things happen more than anything else in organizations, and it is the job of the board to foster and incubate this, both within the board itself and for the greater span of the company.

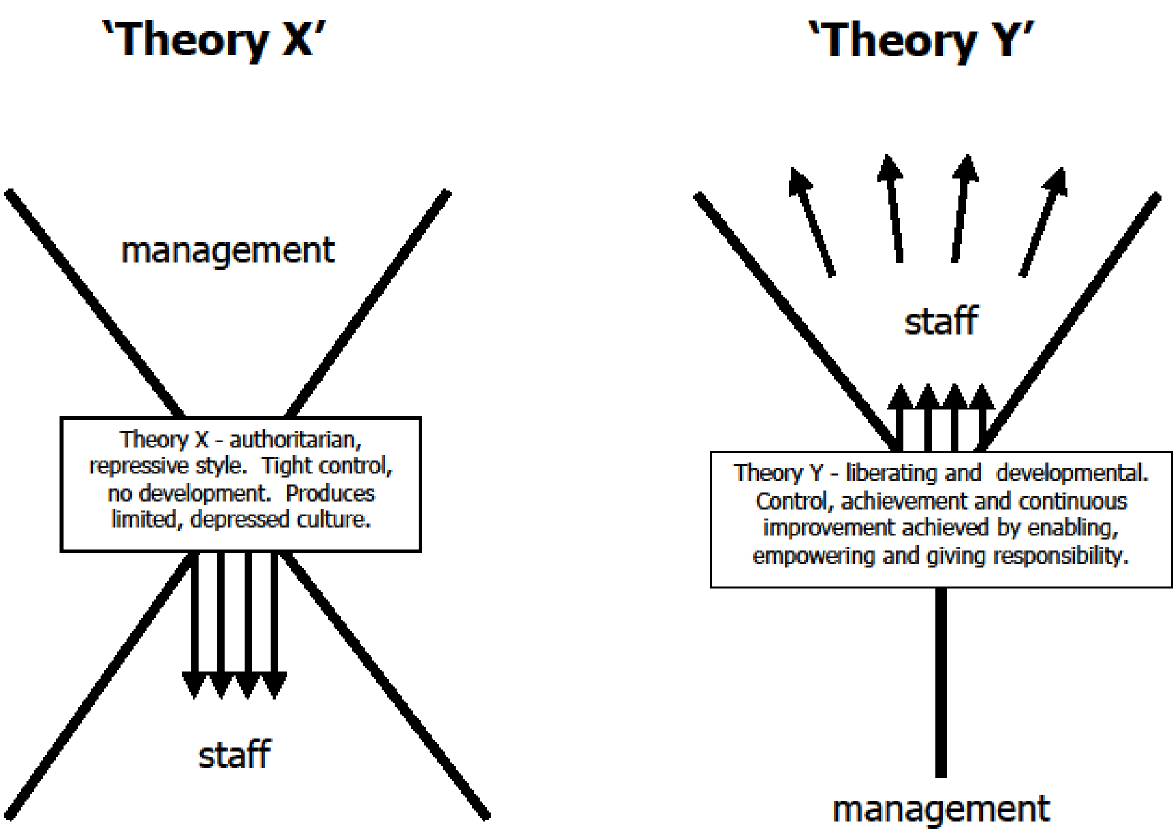
The diagram (below) representing McGregor's X-Y Theory helps illustrate how and why empowered teams get the best results. Empowering people is more about attitude and behaviour than processes and tools.

Teamwork is fostered by respecting, encouraging, enabling, and mentoring people and is equally relevant in the board dynamic as well as the executive and broader workforce. It is often absent in Indian corporate hierarchy's.

People working for each other in teams create a powerful force - more than skills, processes, policies. More than annual appraisals, management-by-objectives, more than anything.

Non executive and executive directors can provide a key role in enabling a team building culture throughout an organisation.

McGregor's X-Y Theory



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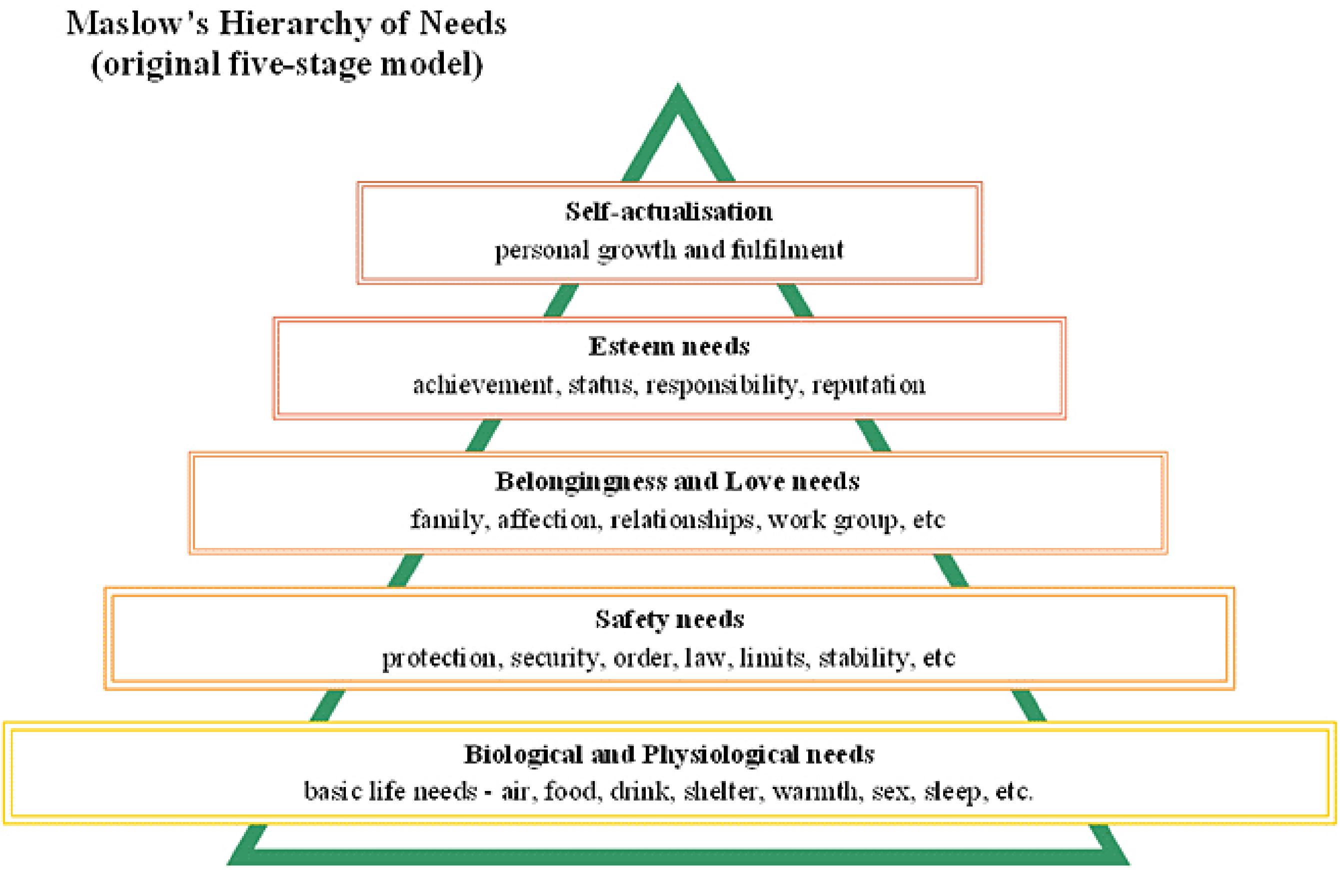
To build an effective team (be it the board or executive) you have to understand that all people have a basic set of needs that have to be addressed.

This was best encapsulated in Abraham Maslow's hierarchy of needs (first published in the 1940's). When you look at teambuilding through an organisation (from the board down) you need to base your teambuilding on the needs of the people you aim to work with – start at the base and work up.



In every company the chairman is ultimately responsible for building the board into a cohesive functioning team where the individuals participate in such a way that the board gains a synergy from their interaction.

As you rise up the corporate ladder so to do you rise up the pyramid of needs in regards the people you are dealing with – board members will need to find satisfaction of the issues in the top two tiers, whilst a shopfloor employee will be more concerned with the issues in the bottom two tiers.

5. INSTILLING A UNIFIED PURPOSE & VISION

5.1. A CLEAR MISSION

What is it that your company does, and what is our your business ?

Many companies have unravelled when they have moved too far from their core business. Non strategic and non core assets and strategy can take a company away from what it does best, and where it has traditionally made its profits. The result can be diminished profits, lost opportunities and in the worst case the destruction of the business itself.

The board needs to ensure that they, the senior executive, and ultimately the whole organisation have a very clear understanding of what the company mission is.

If companies driven by a strong shared purpose are more successful, then part of the board's mediating role must be defending such a purpose—and if there is none, fostering one. It must be satisfied that the purpose is consistent with advancing shareholders' interests, of course. But it must also support the company's leadership and protect it from short-term market pressures.

A clear Mission Statement that succinctly and precisely spells out the company mission is a necessary first step.

It is the boards responsibility to set, define and from time to time refine the mission of the company. Whilst it's important that the company doesn't move away from its core business it is also important that it adapts to the changing market and outside influences (such as technology).

This is one of the key functions of the board and goes to the core of its responsibilities.

A good example of a well defined Mission Statement is from the US company Applied Materials, it is one of the world's largest semiconductor equipment manufacturers.

Applied Materials' mission is to be the leading supplier of semiconductor fabrication solutions worldwide-through innovation and enhancement of customer productivity with systems and service solutions.

This statement tells you immediately that the company focus is on customer productivity through innovation and systems/service solutions – and they expect to be No 1 (which they now are). It is very clear and concise, and drives their core mission as a company to their people in the clearest terms.

A less well defined (and as a consequence less effective) statement is this one from a southern US F&B chain, Maxie's ;

To sell delicious and remarkable food and drinks. That the food and drink we sell meets the highest standards of quality, freshness and seasonality and combines both modern-creative and traditional southern styles of cooking. To consistently provide our customers with impeccable service by demonstrating warmth, graciousness, efficiency, knowledge, professionalism and integrity in our work. To have every customer who comes through our doors leave impressed by Maxie's and excited to come back again. To create and maintain a restaurant that is comprehensive and exceptional in its attention to every detail of *operation. To provide all who work with us a friendly, cooperative and rewarding environment which encourages long- term, satisfying, growth employment. To keep our concept fresh, exciting and on the cutting edge of the hospitality and entertainment industry. To be a giving member of the Ithaca community and to use our restaurant to improve the quality of life in the Finger Lakes region*

Whilst the Maxie's statement covers everything the board might believe their business to be, it is far from focused, and far too long to impart the clear company mission to those in their employ.

5.2. COMMON VISION

What is it that our company *aspires to be* and to do ?

This is the aspirational statement of the company - formulating a Vision statement is only the beginning – even the best-crafted Vision statements are worthless if they are not used as a leadership tool, and are not a commonly shared vision with management.

This is an example from General Electric written in the 1980's (under Jack Welsh's Chairmanship)

Become the number one or number two in every market we serve and revolutionize this company to have the strength of a big company combined with the leanness and agility of a small company

This was a clear vision of the future from the board of GE that was transposed throughout the entre company. Welsh (as CEO and Chairman), was able to unite the entire company to achieve the realisation of this vision.

The board needs to set the company vision for its future, and once set it needs to have that vision become the common goal of all those in the company, the shareholders, the board and the employees.

The management plan adopted by the executive (and approved by the board) needs to at all times reflect the stated future vision of the company.

5.3. UNDERSTANDING THE COMPANIES STRATEGIC GOALS

The strategic goals of the company are the executive managements plan on how they are going to execute and achieve the mission and vision of the company.

The board needs to have a clear and in depth understanding of the strategic goals of management and how they plan to execute the strategies adopted.

They need to approve these strategies and believe that they are indeed the best path to achieving the company mission and vision.

The boards role is to provide oversight and risk assessment plus the required resources so that management have the opportunity to execute as per the approved strategy.

6. GOVERNANCE STANDARDS

6.1. IS COMPLIANCE WITH STATUTORY REGULATION ENOUGH ?

The simple answer is no.

Whilst the regulatory platform in India has been strengthened considerably in the last 10 years (clause 49 etc) it still has a long way to go.

In basic terms the directors look after the affairs of the company, and are in a position of trust. They might abuse their position in order to profit at the expense of their company, and, therefore, at the expense of the shareholders of the company.

Consequently, the law imposes a number of duties, burdens and responsibilities upon directors, to try and prevent such abuses.

Much of company law can be seen as a balance between allowing directors to manage the company's business so as to make a profit, and preventing them from abusing this freedom.

Directors are responsible for ensuring that proper books of account are kept. In some circumstances, a director can be required to help pay the debts of his company, even though it is a separate legal entity.

Directors of a company who try to 'trade out of difficulty' and fail may be found guilty of 'wrongful trading' and can be made personally liable. Directors are particularly vulnerable if they have acted in a way which benefits themselves, for example ;

- The directors must always exercise their powers for a 'proper purpose' – that is, in furtherance of the reason for which they were given those powers by the shareholders.
- Directors must act in good faith in what they honestly believe to be the best interests of the company, and not for any collateral purpose. This means that, particularly in the event of a conflict of interest between the company's interests and their own, the directors must always favour the company.
- Directors must act with due skill and care.
- Directors must consider the interests of employees of the company.

At present however you have the invidious position where some legislation holds non executives responsible for actions of the company, whilst other legislation and regulation allows the company to only partially disclose information to the board.

The general market consensus today is that non executive roles are dangerous and not for the fainthearted. An independent director in particular is viewed as having little detailed knowledge or control, but equal (and unlimited) liability.

In 2009, in the immediate aftermath of the Satyam scam. India's top legal experts, company board representatives, CAs and auditors start working with the government on a draft code on corporate governance.

It was released in November 2009 and the code dedicates five of its 25 sections to directors, including independent directors, who are heralded as future messiahs for good corporate behaviour. Though it makes a distinction between executive and non-executive directors, the code confirms that even the latter can be tried in court if it is established "prima facie" that they were liable for a failure on part of their company.

This was demonstrated in 2010 with the sentencing of non-executive chairman Keshub Mahindra in the Bhopal gas leak case.

Now, sections of industry want total 'immunity' for independent directors in non-executive roles. CII's Hari Bhartia says non-executive directors should be exempt from "vicarious criminal liability," otherwise "good" independent directors would be reluctant to join firms. This has sparked off much debate.

"Obviously, provisions of the Indian Penal Code can't be excluded for direct acts by company officials," says Karuna Nundy, a Supreme Court advocate representing Bhopal citizens in cases relating to the gas leak 26 years ago. She says the desire for immunity is partly a reaction to the trial court's judgement in the criminal case. But, in this case, there was no question of vicarious liability for criminal acts by Carbide's officials. "Each company official accused has been convicted for their individual rash and negligent acts that caused the deaths of thousands of people," she says.

Yet, sections in industry argue that Mahindra, a non-executive director at Union Carbide India, has been singled out for the two-year jail term (along with six others in management, executive and non-management posts at the plant). Many independent directors are threatening to quit their positions in other companies, saying they fear similar liability in future.

Since the Satyam fraud, around 1,000 independent directors have already quit.

Author and commentator Gurcharan Das, who is an independent director with several large companies, is among those protesting that imprisonment is too dire a risk—he wants to quit those positions. "No matter how brilliant you are, or how qualified, a company can pull the wool over you," Das says. "If a prison term is likely for the job, all I can say is life is short—it's better to stay away from independent director posts."

The issue does not seem to be one of qualifications or even of availability of directors, though it is often made out to be. It boils down to liability

Independent directors are often left holding the wrong end of the regulatory stick in the wake of management missteps they were not privy to. What can be done, says Rekhy, is to make independent directors "more independent and powerful". "Perhaps independent directors should be allowed to escalate a note of dissent to the level of a regulator," he says.

The more extreme solution, some say, is to do away altogether with independent directors—after all, how independent can someone selected by a proprietor or senior management be? Another solution, arising out of the Satyam case, is to appoint investors, such as insurers or FIIs, to boards—the assumption being, direct stakeholders would make better watchdogs than "independent" ones. Of late, companies have also started taking steps to mitigate the financial risks arising out of the liabilities of directors and officers. Market regulator SEBI is apparently considering compulsory liability cover for listed companies.

6.2. WHAT IS BEYOND STATUTORY REGULATION

It is almost a truism that the adequacy and the quality of corporate governance will shape the growth and the future of any capital market and economy

In essence each board has to make firm decisions on how they want their company to run and the level of governance they require.

If a board is to avoid the pitfalls describes in sect 5.1 the only way they can do so is in raising the governance and disclosure standards of the company to an acceptable level.

If a director is fully informed and acts in accordance with their obligations, they will be in no danger of adverse consequences from the position.

The real protection to a director is to be actively engaged in a company where the norms of governance and transparency are at a level much higher than that required at law.

In *Crisis Prevention*, the author (Salmon) has enunciated 22 good questions that assist a director (or chairman) in understanding if the board adequately covers these issues and provides a safe engagement for them;

1. Are there 3 or more outside directors for every insider on the board ?
2. Are the insiders limited to the CEO, CFO and COO ?
3. Do the directors routinely speak to senior managers who are not represented on the board ?
4. Is the board the right size (8-15 members) ?
5. Does the audit committee, not management, have the authority to approve the partner in charge of auditing the company ?
6. Does the audit committee routinely review high exposure areas ?
7. Do compensation consultants report to the compensation committee rather than the company's HR staff ?
8. Has the compensation committee shown the courage to establish formula's for the CEO compensation based on the long-term results, even if the formula differs from industry norms ?
9. Are the activities of the executive committee sufficiently contained to prevent the emergence of a 'two tier' board ?
10. Do independent directors annually review succession plans for the senior management ?
11. Do independent directors formally evaluate the CEO's strengths, weaknesses, objectives, personal plans, and performance each year ?
12. Does the nominating committee rather than the CEO direct the search for new board members and invite candidates to stand for election ?
13. Is there a way for independent directors to alter the meeting agenda set by the CEO ?

14. Does the company help directors to prepare for meetings by sending relevant routine information, as well as analysis of key agenda items, ahead of time ?
15. Is there sufficient time allocated for thoughtful discussion in addition to the management dialogue ?
16. Do the independent directors meet without management on a regular basis ?
17. Is the board actively involved in formulating long term business strategy from the start of the planning cycle ?
18. Does the board, rather than the incumbent CEO, select the new CEO - in fact as well as in theory ?
19. Is at least some of the directors pay linked to corporate performance ?
20. Is the performance of each of the directors periodically reviewed ?
21. Are directors who are no longer pulling their weight discouraged from standing for re election ?
22. Does the board (and particularly the chairman) take the right measures to build trust among directors ?

The answers to these questions will tell you how well your board currently functions.

If you have more than 20% ‘no’ answers then you need to look at your current processes and implement change.

If you were looking to join a board where 30% or more of the questions were answered in the negative then you may well want to reconsider your decision given the liability and risk.

7. EFFECTIVE COMMITTEES & BOARD MEETINGS

7.1. WHAT COMMITTEEES SHOULD A BOARD HAVE & STRUCTURE

The following are the primary committees that every listed company should establish;

- Audit Committee (mandatory)
- Nomination Committee
- Remuneration Committee
- Governance Committee
- Risk Committee (sometimes looked at as part of the audit committee)

In addition to these a board may establish a committee to work in any area and on terms of reference of the boards choice.

To maximise the value in establishing and operating a board committee structure, the board of directors of a company should be able to answer 'yes' to the following basic questions:-

Rationale for having Board Committees

- Is the use of board committees maximising Board time, alleviating Board workload and increasing the scrutiny of individual Board agenda items?
- Does the board committee structure in operation summarise complex issues, sort through excessive detail and present a definitive framework, analysis and recommendation in writing from a Directors' viewpoint?
- Is the board committee structure producing informed feedback and analysis which is a product of a deeper understanding of the subject area to which the committee's Terms of Reference relate?
- Is the board committee structure being used to consider, develop and groom potential succession candidates for other Board and Committee roles?
- Is the board committee structure being used to help highlight individual Director performance and capability?
- Does the board committee(s) consider overall Board Policy and organisational strategy as part of its decision making process?
- Does the committee's delegation support the role of the board and the CEO?

When to use a Committee Structure

- Are the relevant issues for consideration by the board too complex and/or numerous to be properly considered by the entire board?
- Has the need for a board committee structure been appropriately considered?

Terms of Reference

- Have appropriate Terms of Reference been established for all board committees addressing all relevant matters including but not limited to roles and responsibilities, power and authority delegated, composition and quorum

- If board committee Terms of Reference have been established, do they clearly record that significant issues will be reported back to the board for the board to discuss and decide upon?

Matching Talent to Task and Committee Composition

- Is the board committee comprised of members with appropriate talent for its task and who have diverse skills, knowledge and experience?
- Is the service of board members limited to a maximum of 2 board Committees?
- Is the board committee comprised of a majority of non-executive directors?
- Does the board committee have an odd number of members?

Committee Dynamics

- Are there appropriate committee dynamics for it to be able to perform its function?

Appropriate Practices and Procedures

- Does the board committee's agenda provide ample opportunity for discussion time and consideration of matters before the board committee?
- Do board committee papers supply all necessary information in the format required by the board committee?
- Are the papers for board committee meetings circulated well in advance of the board committee meeting by secure and convenient means?
- Are the board committee meetings part of a schedule of meetings agreed at or prior to the beginning of a calendar year?
- Does the board and board committee have an agreed annual task and responsibilities Matrix for the board committee setting out the recurring tasks and responsibilities and specific annual objectives of the board committee for a calendar year including when the same are to be performed?

Committee Culture

- Does the board committee culture require members to come to meetings well prepared and to actively participate at meetings?
- Is the culture of the board committee that its members recognise that they owe their duty to the organisation of which the board committee is part and not to the organisation or person which appointed them?

Committee Tenure

- Is there an appropriate balance of rotation of directors on board committee positions and formulation of new ideas versus retaining corporate knowledge and the benefits from specialisation?

Committee Chair

Is the board committee chaired by a Board member who is a Non-Executive director and not chairman of the board?

Performance Assessment and Regular Structural Review

- Are the board committees considered as part of an ongoing board performance assessment every year?
- Does a review process consider whether the board committee is serving its function and adding value to the Board's decision making?
- Does a review process result in committees being abandoned, committee members being changed and Terms of Reference being amended where appropriate?

Frequency of Meetings

- Are the board committee meetings at least every three months?

Reporting to the Board

- Does the board committee clearly communicate to the board its assumptions, material issues, analysis and recommendations in a format agreed with the board in sufficient time for the board to properly consider the same?
- Are minutes of the board committee meetings taken and provided with the board papers for the next board meeting after the committee meeting?
- Does the board committee establish, maintain and update after each committee meeting a schedule of task and action items recording its outstanding task and actions from its previous meeting(s) ?

Involvement of the CEO

- Is the CEO invited to participate in each committee meeting?

7.2. MANDATORY COMMITTEE STRUCTURE

The primary committee and the only mandatory committee as per the current regulations is the **Audit Committee**. As per clause 49, the role of the audit committee includes the following ;

- Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
- Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
- Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
- Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:
    - Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (2AA) of section 217 of the Companies Act, 1956

  - Changes, if any, in accounting policies and practices and reasons for the same
  - Major accounting entries involving estimates based on the exercise of judgment by management
  - Significant adjustments made in the financial statements arising out of audit findings
  - Compliance with listing and other legal requirements relating to financial statements
  - Disclosure of any related party transactions
  - Qualifications in the draft audit report.

- Reviewing, with the management, the quarterly financial statements before submission to the board for approval
- Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
- Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
- Discussion with internal auditors any significant findings and follow up there on.
- Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
- Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
- To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
- To review the functioning of the Whistle Blower mechanism, in case the same is existing.
- Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

The committee also has a number of statutory requirements in regards disclosure to the board, the shareholders and public.

SEBI regulations state the make up and function of the committee shall be as follows:

- The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.

- All members of audit committee shall be *financially literate* and at least one member shall have accounting or related financial management expertise.

Explanation 1: The term "financially literate" means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation 2: A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

- The Chairman of the Audit Committee shall be an independent director;
- The Chairman of the Audit Committee shall be present at the Annual General Meeting to answer shareholder queries;
- The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;
- The Company Secretary shall act as the secretary to the committee.

7.3. RUNNING AN EFFECTIVE BOARD MEETING

What is the purpose of the Board Meeting and what do you want/need to achieve ? In general terms most meetings need to ;

- Inform, convince, and inspire the directors
- Resolve conflicts between persons and factions and lead to appropriate decisions
- Allow debate on significant issues and strategic directions
- Coordinate people and activities
- Create common understanding and common purpose

Some Do's and Don'ts for the Board Chairman ;

- Do ask yourself before every meeting "what do we need to accomplish at this meeting?" Refer to the previous meeting's minutes. Construct the agenda and conduct the meeting accordingly.
- Do develop an agenda with the executive director. The agenda should have times and a person responsible for each agenda item. Also each agenda item should be marked to indicate whether its purpose is informational, for discussion, or for a decision/action.

- Do Not clutter the agenda with minor issues or committee or staff reports that are unrelated to significant topics for discussion or decision.
- Do make sure the agenda and supporting documentation is distributed by mail or fax at least three days before the meeting.
- Do make sure directors have the information in advance that they will need to make decisions.
- Do Not make decisions based on information distributed at a meeting. If the information is not available until the day of the meeting, reschedule consideration of the agenda item for a subsequent meeting.
- Do make sure the board packet (information backing up the agenda) contains information that is concise, accurate, and timely. Where a decision will be made, a summary of the relevant information should be provided highlighting the key points and the recommendations of the executive director and/or the committee.
- Do make sure the room is comfortable and well lit and that water and coffee or tea are provided.
- Do make sure the seating plan facilitates interaction among directors. A broad rectangle, with all directors facing in, is preferred.
- Do make sure the Executive Director is sitting next to you.
- Do make sure someone is taking minutes.
- Do start on time.
- Do review the agenda briefly and point out what needs to be accomplished at this meeting.
- Do stick to the time schedule, but be flexible enough to deviate if circumstances dictate.
- Do take a minute to acknowledge special events or special individual accomplishments that have occurred since the last meeting.
- Do Not talk too much. Your role is to be a neutral presider over the meeting process, to encourage full participation and teamwork, to prevent domination by a few, to make sure everyone understands the issues at hand, to help frame issues and bring them to resolution, to help crystallize consensus, to determine when it's time to bring an issue to vote or refer it to committee or seek additional information, to deflect tangents and stay on focus, to pay attention to the agenda and the clock.
- Do practice using the following techniques for encouraging discussion:
- How do you feel about that? Let me see if I understand your position, you are saying... Can you clarify that? Can you give an example? Let's give Tim a chance to explain... Sally, you haven't said so, but I think you agree... I'm concerned that we are not hearing from everybody on the committee. How do you feel, Lisa? If this doesn't work, what will we lose?

- Do make sure that decisions or assignments made are reflected in the minutes. Confirm with the recorder that he/she has written down the appropriate information.
- Do Not schedule a meeting to last more than two hours.
- Do summarize at the end of the meeting what has been accomplished and what assignments have been made. Also, thank directors for their participation.
- Do ask directors to evaluate each meeting, in writing and anonymously. The key question is: "Was this board meeting a good use of your time"

While board meetings will have a different tempo and requirement at different stages of the life of a company, there is a strong belief that the vast majority of the board meeting time should be "forward looking."

Many times, especially in the more regimented, and often larger companies (and those that are VC-based) boards are "backward looking".

Most board meetings are ;

- 80% status updates
- 10% strategy / issues
- 10% administration.

The 80% / 10% split on status vs. strategy should be reversed to give ;

- 80% strategy
- 10% status updates
- 10% administration

There are plenty of different ways to organize the "strategy" ("strategy" as shorthand for "forward looking discussion") and strategy includes a blend of short, medium, and long term issues, as well as plenty of tactical discussion.

8. DIRECTOR REMUNERATION

8.1. REGULATORY MANDATES

Schedule XIII to the Companies Act, 1956 was put in place with the primary objective of obviating the need for seeking Central Government approval by Companies to pay remuneration to their managing or whole-time directors if they satisfied the parameters set out therein.

Sweeping changes have been made by the Department of Company Affairs (DCA) to Schedule XIII to the Companies Act with a view to give greater freedom for the companies to acquire better managerial skills by relaxing the rules for appointing and fixing their remuneration. A balancing act was also achieved with the introduction of the concept of corporate governance.

The responsibilities expected of the accounting professionals as statutory auditors have also increased considerably in the area of managerial remuneration.

Circular No. 1/CL.VII of 2000 dated 23.06.2000 requires the Auditors and Company Secretary of the company to ensure that the remuneration to the managerial personnel is not paid in excess of the limit under Schedule XIII, without Central Government approval.

The aim of this article is to make a practical approach of the Companies Act, 1956 relating to the appointment and remuneration of managerial persons, with special reference to the recent amendments to Schedule XIII

Schedule XIII is divided into three parts ;

- Part I- deals with the qualifications and appointment of managerial person
- Part II- deals with the remuneration payable; and
- Part III- deals with requirements like share holders' approval and compliance certificate to be obtained from the auditor or company secretary.

Remuneration Committee - Under the amended rules it is mandatory to constitute a remuneration committee consisting of at least three non-executive independent directors, including nominee director or nominee directors, if any.

Managerial Remuneration to Non Whole Time Directors - As per section 198 of the Companies Act, the maximum managerial remuneration permissible is 11% of the net profits. If we practically analyse that 11%, first 5% percent is for the managing or whole-time directors, next 5% is for the second managing director, if there is any and only the balance 1% is left for the non whole-time directors.

SEBI's requirement for listed companies to have independent directors in the Board imposes much more obligation on the non whole-time directors. Adequate compensation is absolutely essential to motivate the independent directors and to ensure their greater involvement in the company. The limits fixed under schedule XIII may require further revision in respect of the non whole-time directors.

Sitting fees (which are regulated) are so small that a number of directors choose to waive the entitlement as a matter of principle.

8.2. EFFECTIVE PACKAGING THAT REWARDS PERFORMANCE

Remuneration for both full time and non executive directors should be geared to the performance of the company.

It is important to attract the right candidates, as well as for a harmonious relationship between the shareholders and the executive, that the remuneration basis is win/win.

However one of the most important debates of recent times has been about the relationship of performance bonuses to short term market value of the companies stock, rather than the long term strategic and sustainable growth of the company.

Smart boards and executives had worked out that there are many way to artificially drive up the short term price of the companies stock in the market, with ultimately a negative impact on the business.

So how does a company find the right balance and get a package that works for everyone ?

By adopting effective packaging that includes;

- Fixed component that is within market demands
- Short term performance reward
- Long term performance reward (that will claw back any short term factoring)

8.3. SHOULD THERE BE A DOWNSIDE & HOW

One of the most important lessons learned from the GFC (Global Financial Crisis) was that you must have all levels of your business feel the pain of downside, so they properly evaluate and consider risk.

The sub prime financing scenario was a perfect example of what will occur if everyone takes the upside without ever having to face the downside risk of a deal.

In a traditional financing market a home loan was written by a bank that had a long term history with the customer. The bank undertook rigorous due diligence over the application because if the customer ever defaulted, then the loan would be on the banks loan book, and the bank would realise the loss from that loan.

The people who wrote the loan and approved the loan worked at that company and were also not being paid on a deal/commission, but on their long term input into the business by building a strong and profitable loan book.

Look at this against the system that developed in the market and eventually led to the sub prime collapse ;

Brokers went into the market and sold product to people they knew had limited long term prospects of repayment, they were paid commission by the deal and had no link to the deal once written.

The bank who made the loan simply bundled it with others and on sold the package as a securitised instrument.

The ratings company that rated the bundled package as triple 'A' security, took a success fee for their opinion, and they too had no interest once the rating was given.

The financial institution that ended up with the product simply re packaged it and then resold it as an investment product and again took huge fees.

The person that ended up owning the downside was generally a retail investor (be it an individual or a large institution) that thought they were buying long term secure bonds - plus of course those institutions that were caught holding large unsold portfolios when the music finally stopped….

All those who made 'performance' fees were never linked to any downside of the product so they of course did nothing to minimise the downside risk, leading to the near catastrophic events of 3 years ago.

So the lesson is that yes, you need to have a payment package to executive and non executive board members that rewards them for real long term performance (growth) of the company.

You must be careful that you do not have a package that rewards short term manipulation of the business.

One of the best ways to achieve this in a listed company is to have a long term lock in period on share options. Large cash incentives on short term market fluctuations are also potentially very dangerous.

If there are bonuses related to profitability the investment and capex should be clearly defined and isolated.

9. MONITORING & APPRAISING BOARD PERFORMANCE

9.1. PROCESSES

The prime organ for setting the processes in regards the monitoring and appraising of board performance is the Nomination Committee.

Some of the key areas that they are responsible to review include ;

- Leadership
- Management (including initiative and follow-through)
- Planning (mission and vision, assessing needs)
- Implementation " Fiscal reporting & budgeting"
- Contribution to committees and general governance
- Communication with board and executive
- Professionalism

For evaluation of an individual director the committee should seek feedback from both the director and the wider board and executive, the comments should be summarized by the committee, which then meets with the director.

During the evaluation meeting with the executive/non executive director, review the board's comments with him or her--and allow the director to respond.

The committee and the director together should set new annual goals. An additional meeting to iron out any differences may be necessary, and final approval of the new goals should be made by the entire board.

When the evaluation process is complete, board members should review its success. What worked? What procedures could be improved next time?

9.2. INDIVIDUAL CAPABILITIES & CONTRIBUTION

A board is a group of individuals, hopefully cohesively working together with a common purpose, all of whom bring different backgrounds and skill sets to their position.

It is important that the reviewing organ within the company (normally the nomination committee) regularly reviews the contribution of each director and how they fit the overall board composition and the company objectives.

There is no point in having one of the world's best accountants on the team when you have desperate need of marketing skills.

10. ACCOUNTABILITY

10.1. REGULATORY REQUIREMENTS

Some of the general areas covered in Clause 49 regarding accountability include the following ;

Accountability to the Shareholders:

- *In case of Appointment or re-appointment of a director(s), shareholders must be provided with a brief resume, nature of expertise & names of companies in which he holds directorship.*
- *Information like quarterly results to be put on companies web-site or on S.E's site.*
- *Board committee under chairmanship of non-E.D to look into redressing of shareholders & investors complaints.*
- *To expedite the process of share transfer this work to be delegated to an officer or share transfer agent.*

Subsidiary Company:

- *At least one independent director of holding company shall be a director in material non-listed Indian subsidiary company.*
- *AC of holding shall review the financial statement (particularly investment) by unlisted subsidiary company.*
- *Minutes of Board meeting of unlisted subsidiary company to be placed at board meeting of holding co.*

Disclosures:

- *Statement on transaction with related parties in ordinary course of business/not in ordinary course of business to be placed before A.C.*
- *Details of transaction with related parties or other not on arms length to be placed before A.C. with management justification.*
- *Financial Statement to disclose (with management explanation) A/C treatment difference from A/C standard.*
- *Procedure to inform Board risk assessment & its minimization procedures.*
- *Company to disclose Audit Committee (quarterly) use of funds raised through issue.*
- *Criteria for making payment to non-ED.*

CEO / CFO Certification :

The CEO and the CFO or any other person heading the finance function discharging that function shall certify to the Board that :

- *They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :*

  i) these statements do not contain any materially untrue statement or omit any material fact.

ii) These statements together present a true and fair view of the company's affairs.

- *There are no transactions entered that are fraudulent, illegal and violative of the company's code of conduct.*
- *They accept responsibility for establishing and maintaining internal controls.*
- *They have indicated to the auditors and the Audit committee*
  - *i. Significant changes in internal control during the year;*
  - *ii. Significant changes in accounting policies during the year.*
  - *iii. Instances of significant fraud.*

Report on Corporate Governance :
There shall be separate section on Corporate Governance in the Annual Reports of company with a detailed compliance report on Corporate Governance.

Compliance :

The company shall obtain a certificate either from the auditors or practicing company secretaries regarding compliance of conditions of corporate governance

But the question remains, are the directors being held properly accountable for their performance and the performance of the company (under their direction), and supervision ?

Do the regulations provide adequate transparency and accountability ? the answer is probably not, certainly not to best practise standards.

Whilst the CEO/CFO must certify the company financials and the Audit Committee oversee the financial affairs of the company, the regulatory control (as per clause 49) simply says that "All members (of the AC) should be financially literate with one member having accounting or financial expertise"

Clearly having only one member (and that not necessarily the chairman) who is qualified and certified to a basic level in regards accountancy means that the expertise test is both vague and a very low bar to cross.

The disclosure regulations are likewise an improvement on what they were, but not really up to the standard required. The loose framing of the regulations allows boards to interpret the fulfilment of their obligations in a myriad of different ways – some will comply with the spirit and intent and others just the low point of minimum legal delivery.

10.2. EFFECTIVE INTERACTION – BOARD - EXECUTIVE - SHAREHOLDERS

Building and sustaining a high performance board requires an investment of time, the right leadership and a thoughtful strategy. It is important to align the board's role and its members' expectations with the executive execution of the company's vision and goals and communicate this to shareholders.

In many countries, corporate boards and shareholders are unhappy about the way they communicate with each other. Companies complain that investors tend to tick boxes and that it is an uphill struggle to convince them to accept any deviation from the country's corporate governance framework. For their part, investors retort that they are too often denied an open and candid dialogue with the senior people at companies and, lacking the requisite trust, they have no option but to insist on strict adherence to form.

Shareholders have recently expressed their wider frustrations by voting in unusually large numbers against the remuneration report at a number of recent annual general meetings in Australia, the Netherlands and the UK, and by demanding annual elections of the Chairman and board committee chairs.

To some extent the economic and financial crisis has made things worse but the discontent over poor communication has been simmering for years. If it persists, it could threaten the continuing viability of self-regulation on corporate governance in those regions where engagement between boards and shareholders is integral to the effective functioning of the system.

Directors who respond with openness and understanding can realize substantial benefits, including greater flexibility in structuring their boards, less angst about remuneration, and greater acceptance of other governance-related arrangements (including deviation from established best practices). Better communication will also underpin investor support in turbulent times, not least when activist shareholders agitate for change.

To gain these advantages boards should venture beyond conveying factual information and projecting a positive image of the company, and strive to build a long-term, trust-based relationship with their most significant investors. In doing so they need to conduct meetings in a spirit of candour, providing time for concerns to be addressed and not being afraid to admit to mistakes and differences of opinion.

Building long-term trust

Boards should view (and project) themselves as shareholder stewards. According to a major UK asset manager, "We engage with boards as much to get a sense of whether the board will promote and further our interests as we do to gain information on companies."

Direct interaction between boards and shareholders is commonplace in the UK, US and other mature markets, where various board members – in particular, the chairman, senior independent director, and remuneration committee chair – routinely meet with key shareholders. But in other markets (especially developing markets such as India) many boards continue to delegate shareholder engagement activities to the investor relations (IR) function.

IR personnel will often not be able to provide the same level of comfort and assurance on governance-related matters as senior board leaders. At one continental European industrial company, the IR officer insisted that a major institutional shareholder meet him first, even though the investor was seeking personal assurances from the CEO that remedial measures undertaken in response to the findings of an internal investigation were progressing well. This lack of access to the CEO contributed to the decision by the institutional shareholder not to support the discharge of the board at the AGM.

In the United States, some companies wheel out legal counsel whenever investors seek to speak to non-management board members. By contrast, the Chairman of one European insurer flew directly to London to meet the company's largest shareholder when the latter expressed interest in learning more about the company's atypical corporate governance arrangements.

Perceptions of arrogance or disdain for shareholders can haunt a company a long time. Many companies face heightened suspicion and scrutiny from their shareholders due to real and perceived slights that occurred years earlier. Humility is advisable even for highly successful companies – as we have witnessed in the financial, mineral extraction, and other sectors over the past 18 months, fortunes can change quickly.

A meeting of minds

The focus on building a long-term, trust-based relationship means that regular meetings are important, as relationships and goodwill are built through repeated encounters. Some company chairmen will strive to meet their largest 20-25 shareholders at least once a year, wherever they are located.

Meetings with shareholders do not have to be especially formal. In most situations, casual conversation often works better. The Chairman of a UK retailer, for instance, arranges 30-45 minute "coffee chats" with the company's largest shareholders and will make impromptu calls to them whenever issues arise of which they should be made aware.

The style of meetings is typically influenced by cultural and legal considerations. In Asia, they are often much more formal, including prepared speeches. In the US, due to fears of infringing "fair disclosure" regulations, meetings between boards and shareholders are sometimes highly scripted, with the specific agenda items agreed in advance and legal counsel in attendance to ensure that the discussion does not venture beyond permitted boundaries. Some boards adopt a one-way "listening mode" that involves hearing what shareholders have to say but not offering their own thoughts in return.

Some boards consciously ignore passive shareholders, even when the latter are eager for a dialogue, because they know that their investment approach precludes them from selling the stock. However, the support of passive investors can matter greatly when contentious issues arise, whether on corporate governance or relating to a hostile bid. With the resurgence of interest in passive investing among pension funds – attributed in part to the underperformance of active investment strategies and in part to the low fees of passive funds – companies that continue to neglect this type of investor do so to their potential detriment.

One industrial company only recently met with a passive investor who had, for years, been one of its top five shareholders. With the company now "in play" and amidst calls for the CEO's ouster, the board's earlier failure to develop a relationship with this investor may prove costly.

Boards should always strive to be as candid as possible, bearing in mind insider trading laws and the trustworthiness of the individual shareholder (not always assured given leaks of sensitive information on some high-profile matters in recent years). While boards may be concerned about appearing less than perfect, shareholders do not expect them to be infallible. In fact, owning up to mistakes can help disarm even the angriest investors. At one contentious company meeting with a group of institutional shareholders, the Chairman of a mining firm started the meeting by uttering "I am sorry, I have let you down." His willingness to accept responsibility altered the course of the meeting. Expected to be a confrontation about the company's various problems, the tone became more constructive and discussion focused on measures that would put things right.

By contrast, Chairmen and CEOs seeking to demonstrate their infallibility – believing this will win over investors – are likely to arouse suspicions and intensify existing concerns. One institutional investor I know always asks "What worries you?" at the end of a meeting in order to calibrate the degree of candour of the discussion. When the response is the equivalent of "everything is great" or "only unforeseen external developments," that investor will substantially discount the preceding dialogue.

Ideally boards should propose remedial action when they acknowledge any deficiencies. At one technology services firm, the senior independent director told a leading shareholder that the non-executive directors possessed insufficient understanding of the company's business and that, consequently, the board was looking to appoint additional outside directors with international business and telecommunications experience.

Effective board – shareholder communication also requires that shareholders have adequate time to respond. The Chairman of one European retailer called the company's largest shareholders over a weekend to inform them that, on Monday morning, the board would announce that it was combining the Chairman and CEO roles. Unsurprisingly, this tactic provoked a furious response and the board was subsequently forced to engage in extensive consultations over several months to placate angry shareholders.

Quality of discussion, particularly when sensitive topics are on the agenda, is often inversely proportional to the number of people in the room. As a principle, both sides should strive to minimize the number of attendees. Consistency in communication is important because institutional shareholders increasingly speak with each other in informal shareholder groups, including across national boundaries. That said, divergent viewpoints are not necessarily problematic, as long as they do not reflect a dysfunctional board, and they can even provide comfort to investors that the board is rigorous and serious. At one company, investors actually felt reassured when the SID told them there was a healthy debate among board members about how to rebuild the capital base.

In some countries, companies are engaging shareholders in groups. Such meetings require some degree of orchestration – for example, discussing only issues of concern to all investors – and it is therefore important for boards to follow up with individuals to ensure that their key concerns have been disclosed. These include "outlier" issues that might have been omitted from group discussion but could still influence voting decisions.

Linguistic and cultural barriers, meanwhile, need to be addressed when communication takes place across national borders. Where possible, boards should strive to adapt their communication styles to match those of their investors. Similarly, shareholders need to play their part to bridge this gap. One London-based asset manager, for instance, fields an engagement team with fluency in more than 15 languages. In addition, foreign investors can join local shareholder associations to better understand local business and governance practices and collaborate on certain matters.

This dissertation is primarily addressed at companies and their boards of directors. But as the last example illustrates, shareholders must also play their part by gaining a good understanding of the company, acknowledging the challenges involved in running a listed company, adopting a principled but pragmatic approach to corporate governance, and, most importantly, demonstrating an ability to keep confidences.

It has been quoted in the financial press that when one investor told a CEO that he appreciated how difficult it must be to turn around a conglomerate with an entrenched culture, the previously guarded CEO quickly opened up and admitted that "it has been extremely frustrating how few people understand the enormity of the task."

In addition, shareholders should be forthcoming with their own views and be willing to ask direct, contentious questions.

It is in the interest of companies to improve this two-way flow. Those that strive to build relationships based on trust and follow a pragmatic approach to meetings will likely be rewarded in the long term.

11. SUMMARY & CONCLUSIONS

Building a high performance board in India is a process that will take you beyond existing legislation and require a commitment to world best practise.

Some of the key areas that need to be addressed are ;

- Having an independent board that will assist the promoter in realising the company vision, but also be strong enough to stand up for the interests of the company and its broader shareholders.
- Having quality independent directors who can contribute in a meaningful way to the growth of the company.
- Having disclosure and accountability norms that are totally transparent and allow for global institutional investment.

India is seen as one of the powerhouses of the business world in coming years.

We have a massive population, that is being driven to consume on an unprecedented scale by what I recently described to a property industry group seminar as a 'demographic tsunami' - a young population pyramid with an extremely broad base.

Many in this country predict that India will surpass both the Chinese and US markets in coming years.

The reality is that there are many problems that need to be addressed before this can happen.

The wider debate at present in regards corruption is an example of the types of practises that stifle the Indian economy and its business houses.

A joint venture UK/Indian based mining company was recently quoted as saying it had a proud tradition of never paying a bribe – but it took over 10 years to get their first operational permit, and today after over 20 years they are still waiting for all the permits required to be fully operational.

For companies in India to partner with international corporations they are being driven by legislation in those other domains to adopt a zero tolerance policy in regards corrupt conduct and disclosure norms. Both the UK and the US have introduced legislation that targets those partaking in corrupt conduct in offshore markets.

Transparent practises lead to efficiency at every level – opaque and bureaucratic practises lead to stagnation, corruption and ultimately failure.

It is up to the corporate boards of India to set the agenda for the future.

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