

‘Corporate Governance Must Come from the Heart’



The-Panelists-from-left-to-right,-Ms.-Minette-Perera,-Messrs.-Sanjiva-Senanayake,-Hiran-Cooray,Dr.-Harsha-Cabral,-Desh.-Charitha-De-Silva,-Mr.-Faizal-Salieh-&-Mr.-Rajendra-Theagarajah.

A panel discussion on organization-specific governance issues was organised by the Sri Lanka Institute of Directors at the Ivy Room of the Cinnamon Grand recently, in the interest of fostering wider knowledge and appreciation of the need for better practices in corporate governance. Titled “Governance Issues of Specific Organisations,” the discussion was the final part of a six module series on Corporate Stewardship & Board Room Governance.

The Challenger that evening was the erudite lawyer, President’s Counsel Dr. Harsha Cabraal who led his team of distinguished senior corporate directors comprising Deshamanya Chari de Silva former Chairman of Aitken Spence and the Ceylon Chamber of Commerce, Messers Hiran Cooray Chairman of Jetwing Sri Lanka, Rajendra Theagarajah MD & CEO of Hatton National Bank PLC, Faizal Salieh MD Amana Investments Limited, Sanjiva Senanayake Director, Hemas Power Limited and Ms. Minette Perera Group Finance Director of the MJF Group.

Launching in to the topic of Governance Issues of Specific Organizations, Dr. Cabraal invited each of the panelists to comment on the topic. Ms. Minette Perera initiating the discussion said that corporate governance at the MJF Group is a way of life. “In our organization, we don’t see corporate governance as basically adhering to a set of rules,” she said. “We have been following good governance for a number of years even before the governance rules came into play. We look at it as the way of operating our business which is a bit unique because we are a combination of private companies and public companies. From Chairman downwards we make it a way of life, a way of operating our business.”

Mr. Sanjiv Senanayake raised the point that in all the boards that he has served and/or currently serve on, he had been told that a director must always act in the best interest of the company irrespective of whether he is a nominee of the shareholder or another stakeholder. “You may be nominated by a share holder or you may be an independent director; but it is very important to understand what is meant by the ‘best interest of the company.’ In the case of banks, which do more than running a business, in that it makes other businesses possible, a director is not only responsible for the institution but also for the system of banks; the payment system and the other transactions that go inside the financial system. You are also responsible for the depositors, who are an important stakeholder in a bank. That I think is a distinctive feature. As such when you are on a Board, the most important as well as the most difficult thing is to find the right balance between the stakeholders and company interests. The key is that you are not there to represent someone else’s interest but to represent what is best for the company.”

Speaking of his experiences of corporate governance in the tourism industry, Mr. Hiran Cooray stressed that it is the spirit that really matters. “In the tourism sector, it is a good practice to involve the local communities and safeguard the environment in which the entity operates. Actually these practices cannot be recorded on the balance sheet, or in the annual report. I think, to us, those governance principles are more important than just purely stating something at the end of the financial year merely to keep everyone happy. As Jetwing, we are proud to be in the heart of such social practices. I think we really go into the core of it. Looking at the legal side of it, we find it very easy to meet the requirements on reporting etc. What you believe and what you practice is to us more important. I think we’ve practiced these from the time my father started this business over thirty years ago. To us that matters a lot more than meeting the legal requirements.”

Mr. Theagarajah from HNB referring to what Mr. Cooray noted “some of those things on governance are beyond rules. In terms of culture and values, as a listed company, we enshrine that as a part of the sustainable business model, but as a banking institution which is regulated by the Central Bank, I think we are a bit different from most other businesses, in that we have a mandatory set of operating regulations that govern us. Exceptionally, we have gone away from the principles driven framework to one where there are a set of rules for every principle. In life, rules demand a minimum and very often these are worked around, although we, as HNB, have tried to do more. We trace our origins over 122 years and have been governed by a set of self governance rules and principles of values which have evolved over time. Over time, there have been a set of voluntary guidelines introduced by the ICASL as well as the SEC which have brought in a flavor of best practices. As you are aware, the Central Bank has brought in mandatory regulations and these have not posed undue challenges, as we have always believed that we must have a set of internal guidelines which go beyond the minimum. From an operational perspective there are still some grey areas that need to be ironed out. These are causing extra work: perhaps the most significant of which is getting a set of internal controls to prepare a set of accounts and disclose them. They have not only to be certified by the directors, the CEO & the CFO as in many companies, but in banks there is an added burden now for the external auditors to certify these declarations. This is causing an issue in the industry because the audit faculty of the institute has yet not decided on the most appropriate auditing methodology to adopt in effecting this certification. Right now, there is a dialog between the three stakeholders and I am sure it will be resolved between now and December. The most important thing from HNB and the quoted bank’s perspective is the view that the benefit of good governance will flow in positively to the share price. When one upholds a set of values and discloses the practice, transparency is accentuated, resulting in value addition and we have seen the value to our own share price over a 4-5 year period. Secondly, even though there might be an argument about independent directors coming into boards, their input is valuable and welcome, provided they do not remain as mere ornaments. On our board 5 out of the 9 directors are independent. We actually bring in a diverse mix of people who bring different perspectives and help to raise our internal bars of expectations. If at the end of the day, you add value to the organization, that’s the testimony” he concluded.

Deshamanya Chari De Silva confined his remarks to an aspect of governance that concerned him. He observed that boards of directors as a rule tended to pay smaller dividends than they should and they could. “Particularly, in private companies the shareholders cannot sell their shares freely and this is the difference between private companies and listed companies. They are entirely dependent on the benefits of dividends. For various reasons, boards of directors minimise their dividends. The law has a very little to say about dividends and does not insist that dividends of a particular level should be paid. Now the Inland Revenue Department has stepped in and has a say about what they will do to companies who do not declare reasonable dividends. More recently a Deemed Dividend Tax concept was introduced to address such situations. I don’t think that there are even 1% of companies which are subject to the forced deemed dividend. If you behave ethically, you are not affected by the deemed dividend tax. The point I want to make is that even if you are not the ones who call the shots in your companies, with regard to the level of dividends,

you should use your influence if you are on the board of directors to see that the company behaves ethically and in a manner reasonable to its shareholders.”

Mr. Faizal Salieh speaking of Amana Investments said “This group of companies is in to financial services, insurance, financing, investments, stock broking, asset management, funds management etc and the model which we operate on is unconventional. It is very different from the traditional, conventional banking model, because we work on the principles of Shari’ah, and this is a model on alternative financing which is seeing tremendous global growth”. “Being in the financial sector, governance is a very important factor in the operation of the business. Particularly when you are taking money from the public, governance becomes very critical and has to be observed very strictly and has to be driven from the highest level. Following the global financial crisis, everyone is looking at governance very closely; regulators are playing a key role in ensuring that the operators in the financial market observe governance. Rules with regard to governance have been established and regulators have introduced specific directions and guidelines to ensure that governance is more transparent. Governance cannot be sustained only through legislation or regulatory direction. It is best sustained by good ethical values to which individual directors must subscribe. I know of boards where they look for loopholes in the regulations. They talk to lawyers to find out whether they can maneuver within the law. The lawyers will obviously advise you on such areas and having, personally, read the governance directions from the regulators, word to word, line to line; I can see room to do things that do not add value to the governance process. It ultimately boils down to what extent the individual directors on the board are committed to ethics. Governance is all about ethics. It has little to do with legislation.” “Regulators will bring in the legislation. If the individual directors are not committed to a set of personal ethics, governance begins to fail. We are a non banking financial institution, we are being asking to get regulated, we want to get regulated, and we are on the threshold of being regulated, if all goes well. We have managed because we work on the principle of self governance. We have been observing rules without being forced to observe them. This attitude has come from the inner hearts, souls and minds of every individual director who sits on the board and has therefore become a collective stance. So my point of view and my recommendation to those who are aspiring to be on boards is; if you can’t get personally committed to a set of ethical values, then don’t get onto the board”.



The-Challenger,-Dr.-Harsha-Cabral.

Dr Cabraal shared his views on this particular issue of corporate governance, based on his research and his knowledge of actual practice. “What we see here as corporate governance officially is the bare minimal. What you get in the SEC regulations with regard to corporate governance is primarily on independent directors and on the specialised committees such as the

audit committee, the remuneration committee and the nominations committee. That is only for listed companies. As Rajendra said, we have yet another kind of a governance regime under the banking law, and the insurance law where the regulators come in and have introduced specific governance measures to those different trades.”

“Although this has been introduced through legislation; - what have we achieved? Are the companies following this? The Annual Reports are full of niceties with audit committee, remuneration committee and nominations committee reports from the committee chairmen. Unfortunately, in certain cases these are not practiced, because these reports are often drafted by the advertising agencies who are marketing experts. There is a lot marketing “puffery” which boils down to mere words. A company’s annual report is looked at by all their stakeholders. It happens all over the world. Many play around with words, but how best do we follow what we say? For example, most of the companies who got in to trouble also had lovely annual reports. I look at the corporate governance codes like the Ten Commandments. Good if you can follow them. I agree with Faizal Salieh. It has to come from within your own system.”

Sharing his views, Dr Cabraal continued that one of the crucial things in corporate governance was to have proper independent directors. “Most of the developed companies have recognized this and they insist that their chairman must be independent. Unfortunately in Sri Lanka, there is a scarcity of independent directors. When the new code was introduced, a very valid point raised, was whether the so called ‘independent’ directors were actually independent because they too are voted in by the majority shareholders and very often they are a part of the “buddy club”. Was it possible to have a method which could prevent this? My answer was that it was not possible as it would then cut across the entire company law. What is important to note is that independent directors must not be appointed just to run the club. In practice though, if the shareholders don’t like an independent director they can easily get rid of him and find another independent director who will say “yes” to everything. Another important thing to follow is that whatever the independent director says has to be taken seriously because they are there to pinpoint issues which may not have been spotted by the executives. Independent directors should be people who are not dependent on the company. Their bread and butter should not come from that particular company. He must be independent and has been brought in for those reasons. He must be prepared to dissent and voice his own views. To find truly independent directors is very difficult. Even a good man who was independent when he joined the board may not be so after 6 months, because he gets used to that comfort zone. He will not meet the shareholders regularly – only at an AGM or EGM, whereas he will meet his board colleagues quite frequently. These are issues we have to look at.”

He further asserted that after the Enron issue, the Sarbanes-Oxley Act came in to force in the US. And that most say it was too harsh because too much regulation is bad for a company. Corporate governance is something that must come from the heart. It is also a culture that needs to be created. Whilst I acknowledge that in various fields the cultures may be different, at a board the culture should ideally be one of self regulation and a code of ethics founded on integrity, transparency and morality.

“If you have a good board, one that follows these principles, even if you can’t reach 100%... but you are somewhere there; - then you have achieved a great deal. It is not just a matter of bringing in statutory regulations. It is said that our corporate governance code is very minimal and that we should improve on it. Earlier we had ‘voluntary’ provisions but now we have ‘mandatory’ provisions, and most of the companies follow them. The question is how best can you follow them? That is a voluntary thing. We are in a stage of evolution. In certain jurisdictions such as Singapore, everything is regulated. So depending on the society and depending on the cultures, some forms of regulation are easier to enforce. I suppose in Asia regulations are a must. However, aspects such as ethics and values are things that boards must follow as a moral obligation and not just as a legal obligation. There are two schools of thought. Some say that it ought to be statutorily brought in and the others say you got to voluntarily follow it. Corporate

Governance must come from the heart and is a culture that needs to be created and entrenched” he said.

Dr Cabraal questioned his panelists and the participants on how best corporate governance or the code ought to be regulated. “Are you happy with what happens in your organization or do you do you personally feel there ought to be some improvement?” As Faizal said, very often you find directors coming to the lawyers to find out if there was any way in which they could work around these words. How effectively are your organizations meeting the challenges of governance?”

Deshamanya Chari De Silva noted that many companies did not practice what they preached through, and described in, their annual reports. Awards for corporate governance and corporate behavior, based on these reports along could be very flawed. “I think these accolades, and awards, are sometimes totally misleading because the recipients are not compliant with the governance codes and are possibly engaged in negative behaviour. We are talking about ethics. The top advertising firms create these annual reports and much of what is said in them merely conceals other things which go below the surface. At the end of the day governance has to come from the heart and therefore must be based on a mix of self regulation and enforcement. It requires honest people. It requires people of total integrity, at the top. Because you can be 100% sure that if the people at the top are dishonest then the entire organization will gradually begin to bend the rules and think of ways to enrich themselves in various ways. Much of it must come from the top. With regard to independent directors, I totally agree that the most important quality he should have is courage. He must have the courage sometimes to risk his position on that board by very courteously pointing out that certain things are not right and that he does not think he can support it. Without that I don’t think this whole concept of independent directors is of any value” he concluded.

Mr. Salieh commenting further stated;-“The challenge for all of us is to create the due process at the board level and then it will cascade down to the rest of the company. Take for example-“whistle blowing” which the Companies Act facilitates. How many of us actually create the processes and the mechanisms to facilitate whistle blowing? The general tendency is from CEOs, Directors downwards to say “no”. The general view is that the little fellow is now going to put a spanner in the works and make our lives miserable. That sadly has been the general attitude, whereas if the proper process and the mechanism are created a lot of good can come from it. What if an unsigned letter comes to the CEO or the Chairman; - do you put it into the wastepaper basket? Or do you read and see if there is some truth in it? I know some CEOs and chairmen saying that if it is unsigned then I am not going to waste my time; - but if it is signed I will look at it. Now how many of our employees have the courage to sign something and send it to the CEO or Chairman? Not many. Perhaps, none at all! Why should they sign it? But if they flag something, I think you need to look into it. I think a due board process to see what is going wrong in the corners of the companies if somebody raises a flag is critically important. I have been challenging the boards that I sit on to create this process. Of course you need to weed out the people who create problems but you need to have a process.” Continuing on his observations, he raised the point of how we view debate at the board level. “Do we encourage debate? Do we go into analysis? There must be sufficient analysis and debate on important issues. That is where the independent directors come into play, because share holder directors might be inclined to push things through because they have thought it over in their mind and they might use a system by which you take a quick vote and you have around you the board people who would agree and then you are through. But the independent directors would offer sufficient challenge to question that process and encourage discussion and debate. How many of our board encourage analysis and debate and how many of them allow dissent? The general tendency is to look at dissent as a factor of disloyalty. If somebody dissents, then he is not with us. In my view, dissent must be encouraged and there must be a due board process to facilitate dissent, as that is a critical element to ensure good governance” he stated. “The other element that strikes my mind is age being a bar to board appointments. My view is that whilst we must allow the infusion of new blood into boards and so on, we must let people over 70, and who are capable of contributing positively,

continue to be on boards. I have come across very good independent directors over 70 who contribute tremendously. Does legislation actually kill opportunities and board processes? So there are a lot of challenges that come from governance via legislation and governance based on principles.”

Salieh further believed that it is a challenge for those sitting on boards to call and demand for good board processes, particularly at times when there is strong shareholders interest. “You may have a number of executive and non executive directors who are too familiar with each other and there make it extremely difficult to bring about effective board governance. CEOs who are also on boards must call for transparent board processes. Whilst it is natural for the CEO to be profit oriented and focus on bottom-line delivery, if you are an Executive Director CEO he is also expected to contribute to the board process and he must ensure that the proper mechanism and facilitations are there. At the end of the day you have to hit that right mix and I think that is what is required to make good boards great and good boards become better boards”.

Mr. Theagarajah commenting on boardroom dissent and debate was of the view that the role of the chair is critically important. The Chairman must take control in facilitating discussion through the allocating of reasonable time and encouraging active participation of all. Commenting on the negatives highlighted before on shareholder intimidation, Mr. Theagarajah noted that it was reasonable of any shareholder to get the best return on his money. The trick, however, was in recognizing that discussion, debate and dissent may lead to fine-tuning the magnitude of the return. Talking about the CEOs involvement in driving the governance processes, he stated that having been in the CEO seat for five years, he has experienced the enormous potential of good board-room governance when balanced correctly with the profit motivation.

Reverting to Dr Cabraal’s question on how the panelists were faring in each of their organizations in driving governance, Mr. Cooray stated that very often non executive directors would be reliant on what the CEO says and may not have the desired knowledge and industry skill to challenge a CEO’s views, He was of the opinion that 1 to 2 hours a month, or sometimes a quarter, is not enough if you to have a board meeting which encouraged discussion, debate and dissent. However, how many independent directors are willing to devote say 3 to 4 hours for a board meeting, he asked. On top of that one has to prepare himself adequately for the meeting. So all in all, it was not easy to be an effective independent director and these issues must be recognized by them when they take up directorships

Ms Perera held that every member of the board must have the courage to agree or disagree. “Even if you are an executive director you must be able to stand up for what you think is right and communicate it; not just bow down to what someone else may say. I may sound a bit naïve but I think it comes from the individuals believing in their own ability. In our company we don’t have many independent directors but though we have a majority executive director, we have a healthy debate and the debate stops in the board room. It is not a personal debate. If you disagree with someone it doesn’t mean that you don’t like that person. As a professional you should be able to stand up for what you think is right” she declared.



A-participant-in-discussion.

Dr Cabraal got the participants actively involved in the discussion, and judging by the questions asked and the feed back given, this was yet another very successful session of the Corporate Stewardship and Board Room governance series conducted by the Sri Lanka Institute of Directors.

This was the last of the series of a six modular programme conducted by the Sri Lanka Institute of Directors (SLID) who had with them the top most rung of the senior corporate directors sharing their own experiences, views, opinions and beliefs very openly on 6 essential elements on corporate governance. These programs were tailored to help directors and other senior manager understand the “living” complexities of governance and corporate stewardship. SLID provides continuing education programmes on Corporate and Board Room Stewardship with a view to strengthening the corporate governance practices of boards of directors. These programmes give the participants the opportunity of interacting with the highest level of experts and practitioners in the field of business and regulation. The next of this series will commence in October 2010. Look out for details.