Training directors to be on the vibrant boards of tomorrow

The Sri Lanka Institute of Directors (SLID) launched the first of its six modular series of its programme on 'Contemporary Views on Corporate Stewardship and Board Room Governance' at the Ivy Room of the Cinnamon Grand last week.

It was a full house that interacted enthusiastically with the panellists on the topic of 'A Dynamic Board of Directors'.

Vice President of SLID and Group Finance Director of JKH Ronnie Peiris was the challenger that evening, and he led his panel with style and panache, questioning and provoking thought and initiating discussions based on their experiences.
The powerful personalities that formed the panel were Sharmini Ratwatte, Non Executive Director MAS Investments; Harsha Amarasekera, Lawyer/Non Executive Director, CIC PLC; Trevine Jayasekera, Group Finance Director Brandix Lanka Ltd.; and Kavan Ratnayake, Group Chief Corporate Officer Dialog Axiata PLC.

Under scrutiny

Giving an overview to the topic, Peiris said that in the past there was little interest in the composition, duties and responsibilities of boards of directors, as long as the company produced results. Today, however, boards and the process of corporate governance are under scrutiny. Many people believe that just following the multitude of laws, rules, regulations, codes and best practices, is sufficient. The personal qualities of directors, their behaviour, their professional competence, moral standards, integrity and ethics, play a significant role to his contribution to corporate governance.

Peiris continued that in the early days, the interests of the company were synonymous with those of its shareholders. In the words of Milton Freidman "the business of business is that of business".
In today's complex social, economic and political environment, the concepts of social responsibility and sustainable development are important determinants of corporate behaviour. The board of directors must be aware of the wider responsibilities to shareholders, stakeholders and society.

Stakeholder perspective

Boards which had a shareholder perspective now take a stakeholder perspective. Boards must operate within a framework of rules which govern their actions, and they must reflect deeply and thoroughly on these rules on a continuing basis.

"The Chairman and CEO must play a defining role in this endeavour. In the past the role of the Chairman and CEO were combined, however, there is an increasing trend to separate the two roles. Often boards of directors will comprise of heavyweights who may tend to be opinionated. Therefore it is extremely important that board members treat each other with utmost respect in order that free discussion and debate on issues take place. A vibrant board with mutual respect for each other could contribute to better decision making and to good governance," continued Peiris.

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The next module of the programme – 'An Effective Audit and Risk Committee' – is scheduled to be held in the Ivy Room of the Cinnamon Grand on 11 November. Followed by the third module on 'An Efficient Nomination and Remuneration Committee' on 13 January 2011, 'Critical Issues of the Board of Directors' on 17 February, 'Contemporary Board Issues' on 17 March and the last module on 'Governance Issues of Specific Organisations' on 22 April.

"The board has an obligation to ensure the organisation is properly manned, has the right skills, that they are properly compensated, they have succession planning as well as all the HR principles such as talent nurturing, performance development training etc in place. Further, the board must have an overview and be involved in strategic planning, spanning not just one year, but for three to five years and in the longer term up to even 10 years. It may actively participate in mergers and acquisitions or advice and counsel on such matters. It must also ensure that the organisation has instituted proper internal control and risk management procedures, proper programmes to monitor and measure financial and non-financial information, and communication with the external world. Although the board may not be involved with detailed operations it is responsible for the overall performance of the organisation, the most important function being creating the tone at the top," upheld Peiris.

"Putting it in to context" he continued, "on the one hand the board is responsible for all above and on the other hand the company has employed senior skilled managers to perform." He then opened it to the panellists to come out with what they thought the right balance was to be struck by a board.

Champion team

Jayasekera in response agreed that setting the tone at the top was important and to do so one must have the right team, "not a team of champions but a champion team." In selecting a champion team experience, expertise, and requisite skills were important considerations. They should view the company from the risk, operational and strategic perspectives.

In respect of directors getting more involved in operations, he attributed it to the fear factor arising from the ultimate responsibility carried by the board. He thought "the drive and energy in a director was very important, starting with the chairman, which often is oriented towards strategy and less towards risk and operational spheres."

Continuing his observations Jayasekera felt that a proper balance may be achieved through appointing independent directors, although difficult, due to shareholder and other stakeholder interests also commanding attention.

"The board papers must be structured in such a way that you can get out of the operational issues and into more strategic discussions. Why we move more and more into operational issues is that the document itself says 'support operational discussions' and it doesn't take you into a strategic oversight. First, put the process right. Second get the structure and your people right. It cannot be said that you are not responsible for the operations, but only for the strategic oversight, because they are joined at the hip. If the process is not in place, the effectiveness of the board will be restricted to just 'board' and the 'vibrant' part of it will gradually disappear. The strategic oversight and the risk side are your primary responsibilities."

Peiris endorsed this as a vital point. An agenda for a board meeting should not be operationally heavy and the right balance could be struck with more strategic interests brought in.

Formulating strategy

Ratnayake on the other hand felt that the main role of the board is to pick the CEO, select a good management team, put in place a system of values and corporate culture, and most importantly, to formulate strategy. The board should concentrate on the 'big picture' guiding the team and ensuring the right people are in the right place.

His recent experience suggested that the board may get more directly involved on a hands on basis during times of crisis but withdraw to its main role of guidance and strategic decision making no sooner the crisis is under control. He made the additional point that a huge element of trust between members of the board must exist, but should not amount to being 'yes' men.

In his experience this was productive in times of crisis. He felt the need to interact with each other on a more human interface, rather than through e-mails, especially during a crisis which would lead to productivity and better decision making.

Agreeing with Jayasekera, Amarasekera observed that the primary responsibility of the board was to set strategic policy. He added that a pro-active board should go beyond that, and exert influence on management to adapt to changing environments. During the past seven to 15 years the private sector was resilient in striving to survive under onerous conditions which saw companies struggling with interest rates of up to 21%. The boards were pre-occupied with cost cutting, relegating future investment to concentrate on managing cash.

He thought the situation had changed over the past year, and that over the next couple of years, well managed companies, driven by able Chairmen or CEOs would be looking at new opportunities.

“In these circumstances the board needs to be more pro-active, dynamic and aggressive, to motivate and drive management teams to take up new challenges and opportunities that arise.”

He contended that the aggressive, proactive companies of today will be the giants of tomorrow. In this context he believed strategy was the key, with governance, meaning risk management, taking second place.

Interaction between board and management

Continuing on Ratnayake’s idea of interaction between board and management, Amarasekera thought that often the board was quite removed from management. In a rapidly evolving environment a closer interaction with management was important. Interaction helped the board to have a clearer view and exert pressure on management when necessary to move pro-actively. This, he believed, was the way boards should be structured for tomorrow’s challenges.

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A passion for the organisation and its goals must be instilled in the board as much as in the management team. It is the chairman's role to bring it together in terms of the operational vs. carrying the can. If the two are to work as a team, responsibilities need to be allocated, with the board playing a more strategic and futuristic role. That is when a company has a vibrant board that can evaluate itself at the end of the year – **Sharmini Ratwatte, Non Executive Director MAS Investments**

Sri Lanka is in a unique position, because the end of the war coincided with the global financial crisis, which, to an extent blunted the effects of the crisis. None of the boards on which I sat two years ago would have imagined the current scenario of low interest rates, or the current values of the dollar or rupee, which are the fundamental requirements of business today – **Harsha Amarasekera, Lawyer/Non Executive Director, CIC**

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Boards must be agile, available, and must be able to second guess management in areas such as "are we heading in the wrong direction? Is the business we are in now the correct business to be in within the context of the changing path of the country? Are we diversifying enough or perhaps too much?" These questions need to be answered and not always at the board level alone.
Ratwatte agreeing with all of the previous speakers took up the point mentioned by Jayasekera of the board and management being 'joined at the hip'. The board of directors in her company are appointed for periods of three to nine years, which she contended makes them effectively a team. Therefore, she thought, they needed to invest the kind of time such that they are joined at the hip to management.
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Mutual trust

Commenting on the matter of mutual trust discussed by one of the panellists, Peiris asserted that often boards had a matrix of decision rights where the board could permit management to go ahead with substantial expenditure (with a ceiling) without reference to the board for approval. The authorised limit would depend on the balance sheet of that particular company. However, there would be certain decisions irrespective of value that needed to be approved by the board. Such decisions on delegation could be done only in an environment where there exists a high level of trust between the board and management.
"The distinction of 'we' the board, and 'they' the management, or between executive and non-executive director is 'not within call'. When you do that you tend to look in the opposite direction and it's very detrimental to the strategic goals. The board oversees and challenges with the wider experience it has and not with a view to criticising or being negative. A while ago, we were looking at survival, cutting costs etc. Depending on the circumstances the aggressiveness will change forming the composition of the board," detailed Jayasekera.
"Boards must be flexible. There are times when survival is paramount, but in changing environments one must rise to challenges and opportunities" perceived Ratnayake. He agreed with Jayasekera on the unacceptability of the 'them' and 'us' perspective of management and the board and the adoption of the 'we' concept.

Independent director and executive director

However, he observed that there is a distinction between the independent director and an executive director who is 'hands on'. He saw a distinction between the board of a company that is controlled by one dominant shareholder who interacts daily with the CEO, and investment decisions made after due diligence studies, but, prior to submission to board for approval/ratification.
"In discussing boards, one needs to be mindful of different types of boards. For example companies which do not have controlling shareholders such as John Keells or companies which do have controlling shareholders. In these circumstances the distinction between 'they' and 'we' change. 'They' become the controlling shareholder and 'we' the management. Sometimes these

roles are reversed. The independent director needs to face fundamental issues arising in areas of possible conflict of interest, for example, where the company has entered a transaction with a major shareholder which may be detrimental to minority interests. In such situations the responsibility of the independent director is absolutely clear."

"Ultimately, an executive and non-executive director must accept the same responsibility," observed Jayasekera. "Independent directors have the right to consult independent advice, for example in relation to a project on which he has little knowledge."

Trust and confidence

Ratnayake thought that a key part of building trust and ensuring independent directors understand the business is the on-boarding process where a good scientific orientation is conducted to encourage them to interact with not only the CEO but also with personnel several levels down. "This deepens the level of trust," he noted.

"Trust and confidence is a two way street. The management team should also be able to look to the board and have confidence in the fact that it could inspire and guide the team," commented Ratwatte.

Peiris queried if the panellists thought that there was sufficient brainstorming between the board and management, which looked towards the future; formulating the vision, mission and strategy to position the company ten years from now.

Amarasekera thought not, because our boardroom culture is structured around the formal Board Meeting with its limited agenda. He advocated the board and the senior management adjourn casually for a weekend and brainstormed ideas. He felt that a throw away idea of one person would be picked up by another and could finally end up as an expansion or a new project. He has not seen this initiative from any board.

"In my experience the situation in private companies is different to that of public companies. In private companies the management is often represented on the boards and they will get involved in formulating strategy," observed Ratwatte. "If the board is concentrating on strategy and governance, they would have less focus on brainstorming and a vision of where they are heading."

"Does that mean that in family companies there is a preponderance of executives on boards in contrast to those of publicly listed companies?" queried Peiris.

Jayasekera replied: "There is much energy and drive in private companies, and things get done faster because one or two key people are the main drivers. These people would get the whole Board engaged in achieving their objectives. Sometimes it can be detrimental because it is shareholder driven and not stakeholder driven.

"The balance needs to come into play. In that context there is more money being spent to get expert advice, get the people together and closed door discussion, as opposed to a listed company that gets a little more structured and becomes more legalised because of the need to ensure that the governance side is being looked after."

Vibrant boards

Peiris questioned the participants as to whether they would like to make observations on the discussion on the linkages between the board and management. "At one extreme there may be a situation where all decisions are made by the board, thereby delaying every decision; on the other extreme, a 'hands off' board, which is happy to let the management run the company whilst concerning themselves with a bit of strategy."

Responding to this a participant remarked that a board was as vibrant as its directors are fearless in contributing to discussions. However, few have the courage to speak out. He observed that where the chairman and CEO are separate, the board is more vibrant.

In the light of making decisions in the best interests of the company and the need for unanimity in decision making, appointments to the nominations committee is of utmost importance. How are directors brought in? Are some names proposed and the majority say "aye"?

Challenger Peiris agreed with the sentiments, adding it was important to have dissension and managed discomfort. At times it was annoying when people asked questions but eventually it was valued.

Global financial crisis

A further question was addressed to Ratnayake by yet another participant, to share his experiences of how his boards reacted to the global financial crisis, and how they realised when it was over and the decision was made to get back to business as usual.

Ratnayake replied that he viewed the global financial crisis from the executive side and not from a board perspective. During this period he experienced absolute trust and support with none saying "you messed up, now go home". Instead their response was "yes we know you messed up, now fix it".

"They grilled us a lot more down the line. The role of the finance director came into the fore and we had to work out how to survive. We had to consider what areas of the business were facing danger."

"It all depended on how hard you were hit," added Jayasekera "and what decisions you took because it was hard to send people home, salary cuts or to tell the staff that there will be no bonus. It was all about survival. Communication was vital. It was not just the finance director but HR also played a huge role in communicating. The board's role was more on the financial issues of getting into survival mode and preparing the company to come out of the doldrums."

Peiris from his experience recalled that it was the management which evolved strategies to cope with the effects of the financial crisis. Management prepared plans encompassing several disciplines such as financial, HR, and right sizing. HR issues were sent to the remuneration committee, and structure related issues to the board. The non-executive directors provided guidance to management.

Learning experience

"The global financial crisis was a huge learning experience for both board and management. Those boards and management teams who asked themselves what they learnt from it, what actions they took, and what they could have done differently, would have learnt strategic lessons from the process. When the questions are answered, they will know that they have come out of it and that may be the point at which they disengage," added Ratwatte.

Amarasekera felt that Sri Lanka was in a unique position, because the end of the war coincided with the global financial crisis, which, to an extent blunted the effects of the crisis. "None of the boards on which I sat two years ago would have imagined the current scenario of low interest rates, or the current values of the dollar or rupee, which are the fundamental requirements of business today.”

Role of the independent director

“Taking together the balance between the roles of executive and non executive directors along with the concept of the role the independent directors play, are boards comprising of people who have independent thought who have a voice, opinion of their own?” queried Peiris.

Amarasekera replied: “There is a misconception in Sri Lanka that the role of the independent director is akin to that of a watchdog, ensuring the company has conformed to all legal and statutory obligations. There are some directors who for the most part remain somewhat silent. There are also directors sitting on strong boards where nothing goes past without them having their say. In the better managed companies plans are so well thought out and prepared that at board level a mere nod was all that was necessary.

“Yet in other companies many of the decision making processes are put to the board before the actual decision process is taken. This is the point at which one can judge the vibrancy and independence of the board, and also whether the board is willing to go with the management. In order to contribute, one needs to have the information, to have got engaged in the business of the company and not be afraid of appearing ignorant.”

Peiris recalled the international board of a mining company that he worked for. “None of the directors knew mining and had their skills in areas not even related to mining. In Sri Lanka we hear it said that boards must consist of those who know the business, but I disagree. You should have people with common sense who ask the questions you had not thought of, which make you look deeper and become better at what you are doing.”

Ratwatte defined a non executive director as someone who will bring in diversified skills, fearless, investigate and ask the right questions, not afraid of appearing ignorant and having a passion for the business.

“Do we all agree that there should be more independent directors as opposed to executive directors on Sri Lankan boards?” queried Peiris.

Jayasekera in disagreement said that the executive part together with a stronger independence was necessary. “You need to bring them in, groom and give them a good roundup of the business and they will bring in a different value to the board for sure.”

Ratwatte thought a number of start-up companies who could not afford full time professionals could benefit from having non executive directors on a consultative basis.

Bottom line

Expressing his view point Amarasekera said: “The bottom line is the quality of the independent director. It is increasingly difficult in the Sri Lankan context to pick them because there are prohibitions. Limitations are set on the number of boards they can sit on. It is no longer prestigious. Now it is a task, and an obligation. A seat on the board carries with it certain legal obligations and the level of experience and expertise requires to be properly remunerated.

Peiris for the benefit of the younger participants that evening gave some insights to the rules for listed companies in respect of appointing directors. “A listed company must have at least two non-executive directors, or one third of the total number of directors must be non executive. To ensure independence, he should not have been employed by the company for two years prior to the appointment, nor a material business relationship with the company for the preceding two years, nor should he have a family member who has been a director or the CEO, etc. These are the listing rules which are mandatory regulations but ultimately it is the ethics, the spirit of independence the person brings with him that matters."

Lack of people or confidence?

Peiris raising yet another question asked whether in Sri Lanka "we don't have enough people to serve as directors or is it that we do not have the confidence to take in new members on to the board?"

Ratnayake responded that this could have arisen in the context of the accountants.

Amarasekera continuing on the issue "most of the audit committees have now taken the position that none of their members can serve on boards. In the past the partners were serving on a number of boards. That takes a whole spectrum of people out. With all the audit firms out, you are left with partners who have retired. And then if you are serving on one bank you can't serve on another. When you bring in that whole breadth of conflicting restrictions, it becomes an issue. I think most of the companies do have a huge problem in finding independent directors.

"Do we have enough potential directors on a list or do we start identifying people who could be potential directors? I don't think this is happening as we feel comfortable with the known people and we find it very difficult to go out and bring someone with different views. That may be one of the issues for not finding the right person," added Peiris.

Amarasekera added that many of the boards are also looking at names that bring prestige to their organisation and they tend to look at the field that is known. "The nominations committee has to actively spend time sourcing these persons and bring in those who are not going to be lackeys. Apart from the nominations committee how many of us are really training the next level? We sit on as many as 20 subsidiary boards. Surely there must be at least five to six younger guys who can be exposed, groomed and developed?"

Training younger directors

Ratwatte observed that awareness of the job had not been created. "People with 20-25 years of experience should have gathered enough knowledge to contribute to a company. We should have a list of people who have been taught well and available as board directors. I advise the younger folks that they should be looking at stepping out of their organisation and serving on another, enriching themselves and also their organisation. The 30-40 age group are rarely found as independent directors. The filtering system and proactively looking for them is not there. I think that the SLID can play a large part in training younger directors."

Peiris concluded: "This was exactly what we are trying to do at SLID. We are creating this pool of young people who will know what it is to be a director, what types of situations are encountered by directors in everyday life and the type of behaviour that needs to be adopted in each situation."

'A Vibrant Board of Directors' was steered with competence by the able challenger Peiris, who involved the participants in a lively interactive session with the panellists. The skill and overall knowledge the challenger had of the topic was exemplary.

Next modules

Going by the proceedings at this discussion, the next module of the programme being 'An Effective Audit and Risk Committee' scheduled to be held in the Ivy Room of the Cinnamon Grand on 11 November is an event not to missed. Again on 13 January 2011 the third module on 'An Efficient Nomination and Remuneration Committee,' on 17 February 'Critical Issues of the Board of Directors,' on 17 March 'Contemporary Board Issues' and the last module on 22 April on 'Governance Issues of Specific Organisations'.

The calibre of professionals having contemporary views on these topics will add value through their knowledge and experience and will also act as inspirational role models to participants to become fearless and courageous directors, demonstrating independence, accountability, and transparency.

The number of participants for this programme was restricted, creating a scramble for registration for all six modules.