THE EXCHANGE

The Mind of the Board

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The Board's at work Discussing matters threadbare Rawpixel.com/shutterstock.com

Regulators have needlessly given boards a bad name. Well-functioning boards take decisions after assessing risks well

The Board of Directors ("board") has legal accountability to a corporate entity. It is their collective mind that drives and directs the company. They are legally obligated to exercise reasonable care, skill and diligence, and avoid/disclose any potential conflicts of interest.

Ideally, notwithstanding the category one belongs to (such as promoter, independent, nominee) each director is expected to exercise independent and good faith judgment in promoting the company's success.

It stands to reason that the underlying ethos uniting the board must be an implicit bond of mutual trust and confidence, surely not one of convenience or connivance.

In recent times due to a variety of reasons there has been a lot of negative commentary on board dynamics, leading to a typical reaction of revisiting regulations. But more is not always better.

Misconceptions galore

The law prescribes how there cannot be any central or disproportionate point of control in a board, and that key decision-moderating powers lean away from interested directors. But the Chairman is central in generating consensus from different constituencies so that decisions are balanced.

Even political parties resort to consensus decisions, but that does not put all parties ideologically in the same corner. Similarly a board decision arrived at by consensus cannot suggest any nexus.

Yet, audiences removed from real boards often rush to conclude that promoters sit on boards to evolve collateral agendas divergent from company interests, or that outside directors either find it easier to sleep on the job or collude in some form.

Of course, there will always be some bad eggs. But society, government and media would do well not to paint established configurations with a broad brush.

Take, for instance, a sample of opinion that typically emanates from regulators: "Some independent directors are appointed at the mercy of promoters, (with) no prescribed qualifications or procedures, many are from closed clubs, and have no commitment to any cause". Tough words; yet one point of view.

However, the respected M Damodaran (former SEBI chief) "warns against the assumption that all managements are scheming manipulators, and independent directors zealous guardians of the public good; things could be the other way round too". Tougher, but closer to the truth.

Career activists for governance develop volumes of remedies against failures of governance. Yet most of them remedies are merely procedural or rule-based. It's probably a no-brainer that both good and bad companies have adopted these, even if in tick-boxes. So, if such regulatory recipes do not always make a good board or lead to good decisions, what works?

Preoccupations of boards

We cannot underestimate the key – the human element – combining chemistry, respect, trust and frankness. There is a lot of effort that needs to be put in – even between people who know each other well for years (in itself this does not form a club) – to ensure that the collective chemistry and mutual trust is put to the company's best use.

While India is poised for rapid economic growth, the subject of lack of private investment recurs frequently. Investment is an act of both short-term and long-term faith and cannot occur without the board's mandate of investing own funds, borrowing money, and undertaking business risks. Therefore, it may serve to also analyse how the mind of the board is otherwise occupied.

Just like US boards spent disproportionate time on regulatory compliances after the Sarbanes-Oxley Act of 2002 came into being, Indian boards also invest considerable ink and sweat in compliance reporting and recording.

The proclivity of our system to provide cumbersome – and sometimes uncoordinated – workloads to various constituencies such as company secretaries, chartered and cost accountants multiplies the less-than-productive workload of the board.

After regulatory compliance is finished, the board spends time on (i) current business conditions (ii) monitoring/evaluating performance (iii) forming a view on expected performance in coming quarters/years (iv) understanding risks, and mitigation strategies of the management.

Risk assessment

Risk appreciation/management is a key task for all boards, yet is truly addressed by only the most evolved ones. A dispassionate understanding of risks can prevent/could have avoided the delicate spots that many companies find themselves in today.

It goes without saying that a continuous churn in what is already an extremely complex legal and administrative environment, or the possibility that businesses may be indirectly affected in the short term by potentially disruptive policies, is an added unforeseeable dimension.

Stretching too far

For most boards, the possibility of considering any new investment or major expansion comes up only after all the above elements have played out.

It must not be ruled out that promoters assuming risks or obligations beyond their core equity positions will at heart seek alteration of delicate balances.

I have at times argued that onerous obligations (including but not limited to guarantees) induce false complacency, including at the creditor end, leading to multiple complications when a structure crumbles. Outside directors may also get a false sense of inhibition, to the board’s detriment.

In tough situations, the chemistry and trust in a board plays a definitive part. Good governance balances the often-conflicting demands and helps reach good decisions (remember, sometimes even good decisions have poor outcomes); a good Chairman can steer the ship appropriately.

The quality of a Board’s decision-making is directly dependent on the quality and timeliness of information and analysis submitted by management. Regulations dictate the scope and type of information and disclosure, but cannot dictate quality. Evolved boards can direct ever improving disclosure and analysis standards, but many boards still have to work hard to catch up.

The job of the board is complex and ethically demanding. The penalties in law for infractions can be as severe as is seen around the globe. More than a century ago Louis Pasteur said, “Chance favours the prepared mind.” The typical board makes every effort towards a reasoned and prepared mind, even if outsiders don’t always agree.

The author is an entrepreneur and past president of FICCI. The views are personal.

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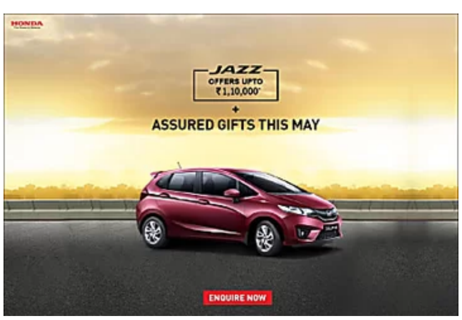

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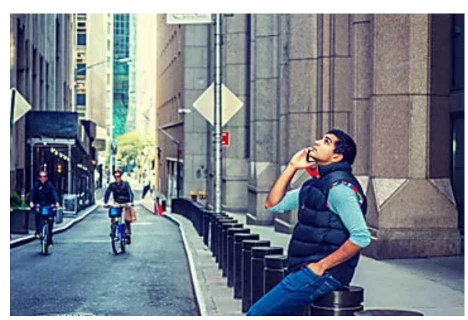
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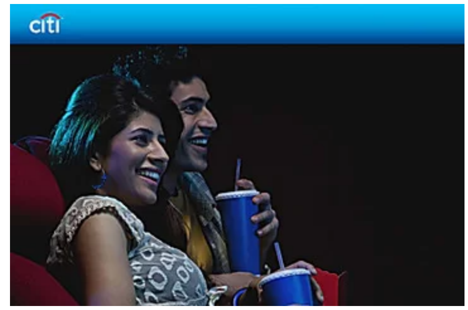

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