Little boardroom dissent

EARLY last month, Bank Negara Malaysia mandated that boards of banks have a majority of independent directors who should not serve for more than nine years. At last count, only five of the 10 listed banking groups have a majority of independent directors, and three have equal numbers of independent and non-independent ones. Of the 83 directors, 43 or 52% were independent.


by Cheah Chor Sooi

So how do listed blue chips compare with the banking groups?

Research by *FocusM* shows that 20 of the 30 FBMCI companies have a majority of non-independent directors, and only 10 with more independent ones.

Overall, only 50%, or 137 of the 274 directors, are independent. Broadly, 51 (18.6%) are executive directors, mostly CEOs and managing directors, and 223 (81.4%) are non-executive directors who are either independent or non-independent.

Axiata Group Bhd and Genting Malaysia Bhd boast the highest percentage of independent directors with 66.7% (six independent directors in a nine-member board) among the blue chips.

The statistics appear to show that the 30 blue-chip stocks pass with "flying colours" with respect to Bursa Main Market's listing requirements that a listed issuer must ensure at least two directors or at least one-third (whichever is higher) of its board comprise independent directors.

A 10-year study (2005-15) by Mazmi Associates Sdn Bhd on listed companies shows a 7% increase in the number of independent directors, from 40% in 2005 to 47% in 2015, compared with a 7% decline in non-independent ones, from 60% to 53%.

That's not too bad considering that of the more than 900 listed companies on Bursa Malaysia, only 47% have independent directors. Like banks, should listed companies be required to have a majority of independent directors?

To be sure, there has been growing awareness and regulatory push for listed companies to be more independent. There has been some praiseworthy progress – albeit at snail's pace – as the number of independent directors has been rising.

However, how "independent" these independent directors really are, is a bone of contention. Sceptics say since they are usually appointed by controlling shareholders, they can't be truly independent.

Custodian role

Independent directors have long been seen as saviours of many corporate governance problems. According to the Webster's New World Finance and Investment Dictionary, "independence occurs when a board member has not been and is not currently employed by the company or its auditor and the board member's employer doesn't do a significant amount of business with the company".

Nevertheless, there is no one-size-fits-all definition of independence that can be applied to every company in all situations. After all, it's rare to have a perfectly-independent board – one with a majority of outside directors who are not affiliated with its top executives or have minimal or no business dealings with the company to avoid potential conflicts of interests.

Even if a board is truly independent, sceptics doubt its effectiveness in raising the bar in corporate governance standards and establishing public trust, especially in championing the cause of minority shareholders.

As observed, board independence alone does not guarantee corporate success as it is incapable of preventing some of the mismanagement and fraud that surfaced in recent corporate scandals.

Many promoters have brought in people whom they have known for a long time to their company boards. They are often expected to add value or toe the line without any constructive challenge.


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However, if a non-executive director engages in constructive challenges in the boardroom, that is real independence. In the long run, such constructive dissent will lead to more effective decision-making.

Finding the middle path

In today's competitive business environment, the role of independent directors has become more challenging due to intense scrutiny from stakeholders, greater demands imposed through regulatory requirements and an increase in overall complexity of the business environment.

An independent director is duty-bound to protect the interest of the company, and at the same time exercise independent judgment on issues which may lead to competing interests. When faced with issues where the interests of the management or promoters are in conflict with those of minority shareholders, an independent director's decision is sought to reach a judgment without fear or favour.

"At the end of the day, independence is a state of mind," Malaysian Directors Academy (Minda) executive director **Datuk Abdul Aziz Abu Bakar** tells *FocusM*. "We have to bear in mind that whatever that revolves around human relationships, one can rely only on the integrity of individuals who take on the role of directors to ensure they maintain clear separation and independent minds when performing their duties as directors."

In his view, an effective board comprises a group of people with an appropriate skill matrix, knowledge and experience that fit into the organisation's objectives and strategic goals.

"This should always be considered not only when looking for new appointments but also in the context of regular board evaluations. The minimum number of independent directors required should be one-third of the total board membership to ensure it continues to be properly constituted to perform its oversight role."

Putra Business School director (non-thesis programme) **Dr Ahmed Razman Abdul Latiff** believes an ideal executive director and independent director ratio should be 50-50. This is necessary to provide more clout for independent directors "to subdue a powerful" chairman or CEO who might be able to dominate fellow executive directors.

"Even so, these independent directors might not be that independent if they are somehow related to the executive directors, not necessarily by family linkages but through past business activities or went to the same education institution and other cases of close relationships," he tells *FocusM*. "Therefore they have to consider the personal ramifications if they decide to go against the CEO or the chairman's wishes."

Family-controlled boards

Malaysian Alliance of Corporate Directors (MACD) **Paul W Chan** says itemising a list of what could possibly compromise the state of independence as laid down by Bursa and Bank Negara Malaysia is a good beginning to ensure a tangible framework.

"But it is far from perfect. A person could fulfil all the stated exclusions of independence, but if the appointee is easily coerced, submitted to, or is grossly influenced by certain obligations in the appointment, the status of 'independence of mind' could be compromised.

"That does not mean an independent director should always be a reflexive disruptor on every issue but have a healthy and constructive scepticism on significant issues that are being deliberated."

In family-controlled boards, Chan observes that the role of independent directors to remain totally independent can be quite challenging.

"If taken positively, input from a company outsider can be of strategic importance; taken with reservation, negatively or worse, with suspicion, the harmony of the board dynamics could be impaired," says Chan, who is also executive member of the Global Network of Director Institutes – an organisation with a global membership of over 100,000 directors and governance professionals.

An independent director is expected to exercise healthy scepticism and objectivity in board deliberations over management's operations. However, in cases where unresolved discords emerge between the management and independent directors, who should take the lead to decide?

"Obviously, the board as a whole," argues Chan. "If, however, the management has the support of the majority of the board or significant family shareholders, the independent director may not survive in the next re-election."

Malaysian Institute of Corporate Governance (MICG) **Datuk Yusli Mohammed Yusof** feels it is a misconception among some quarters that the role of an independent director is to be a voice of dissent to second guess the management.

"That's wrong. To be a rubber stamp is not desirable, of course, but challenging management, requesting details and questioning assumptions are about facilitating a full and well-informed debate at the board," he tells *FocusM*. "If done well, it is a role which can support the management and validate the strategies pursued by the company."

In a situation where the majority vote is against the independent director, Yusli urges the latter to request his position be recorded in the board minutes. "Board decisions, even if by majority, are collective," he justifies. "If it's a question of failure in fiduciary duty and the independent director took a different position from the rest of the board, then the minutes recording his position will be taken into account."

Preserving ethical standards

Hence, leaders who serve on boards of listed companies should understand their roles in discharging their fiduciary duties, says Securities Industry Development Corporation (SIDC) director (personal development) **Salleh Hassan**.

He says behavioural skills such as communication and negotiation are important. Independent directors should be mindful that if they fail to voice their concerns and/or fail to put on record their dissenting voices, they may be seen or be accused of failing to discharge their duties.

"There are serious consequences for these failures which invariably could affect their own reputation and standing,"

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Board of directors of listed companies

Executive – *active management*

Non-executive – *oversight role*

Independent

- One who is not an executive director of a company or its subsidiaries;
- One who has not been an officer of the company within the last two years but it is all right if one has been a non-executive director;
- One who is not a major shareholder of the company;
- One who has not been engaged by the company to advise it;
- One should also not be a partner, director or major shareholder of a company or firm which provides the company with professional advisory services;
- However, one may be an independent director of the company or firm providing the professional advisory services; and
- One who has not been engaged in any transaction with the company under such circumstances as prescribed by Bursa.

Non-independent

- One who is either the founder or co-founder of the company, but has taken a back seat after actively running the company and its subsidiaries for years;
- One who is related to the founder, controlling shareholder or managing director of the company; and
- One who is a representative of the substantial shareholder.

Source: **KPMG & Bursa Malaysia**


Abdul Aziz says independent directors are expected to exercise independent judgment on issues which may bring upon competing interests

What makes an effective independent director

FOR an independent director (ID) to be effective, certain elements are important, says Malaysian Directors Academy executive director Datuk Abdul Aziz Abu Bakar. They are:

- Perception about independence of directors among the promoters, including family-owned businesses, public sector corporations and multi-national companies;
- The importance of understanding the concept of true independence and what it entails;
- Always seek measures to diversify the pool of IDs rather than lament on their non-availability;
- Empowering IDs to develop the ability to proactively assist management to make the right decisions;
- Ensure that IDs enhance their skills and competence through ongoing training and induction;
- Ensure that IDs' remunerations are competitive; and
- Exercise supervisory oversight over the statutory compliances which are to be made by the organisation.


Chan says it's quite challenging for independent directors of family-controlled boards to remain totally independent


Yusli says independent directors must have their opposing views minuted

KLCI constituents: Number of independent directors

#	Company	Total number of directors	Number of executive directors	Number of non-executive directors *(Non-independent directors in brackets)*	Number of independent directors
1	Telekom Malaysia	14	2	12 (5)	7
2	Petronas Gas	8	1	7 (4)	3
3	Axiata Group	9	1	8 (2)	6
4	KLCCP Stapled	8	1	7 (3)	4
5	Petronas Dagangan	8	1	7 (3)	4
6	Tenaga Nasional	13	1	12 (4)	8
7	British American Tobacco (Malaysia)	8*	3*	5 (2)	3
8	MISC	9	1	8 (3)	5
9	Petronas Chemicals Group	8	1	7 (3)	4
10	DiGi.com	7	–	7 (4)	3
11	Maxis	8	1	7 (3)	4
12	Astro Malaysia Holdings	9	1	8 (4)	4
13	Westport Holdings	12	2	10 (4)	6
14	Sime Darby	13	1	12 (5)	7
15	Kuala Lumpur Kepong	8	2	6 (1)	5
16	Hap Seng Consolidated	9	3	6 (2)	4
17	PPB Group	7	1	6 (3)	3
18	IHH Healthcare	12	3	9 (5)	4
19	IOI Corporation	8	3	5 (2)	3
20	SapuraKencana Petroleum	8	2	6 (2)	4
21	Genting	7	2	5 (1)	4
22	Genting Malaysia	9	2	7 (3)	6
23	YTL Corporation	13	9	4 (0)	4
24	Malayan Banking	10	1	9 (3)	6
25	Public Bank	7	1	6 (2)	4
26	RHB Bank	6	1	5 (2)	3
27	CIMB Group Holdings	11	1	10 (4)	6
28	AMMB Holdings	11	1	10 (5)	5
29	Hong Leong Bank	8	1	7 (2)	5
30	Hong Leong Financial Group	6	1	5 (2)	3
TOTAL		**274**	**51**	**223**	**137**

* A new executive director, Ricardo Martin Guardo, will be appointed on Sept 1

Source: **Companies' annual reports & Bursa Malaysia**

Listed banks: Number of independent directors

#	Company	Total number of directors	Number of executive directors	Number of non-executive directors *(Non-independent directors in brackets)*	Number of independent directors
1	Malayan Banking	10	1	9 (3)	6
2	Public Bank	7	1	6 (2)	4
3	RHB Bank	6	1	5 (2)	3
4	CIMB Group Holdings	11	1	10 (4)	6
5	AMMB Holdings	11	1	10 (5)	5
6	Hong Leong Bank	8	1	7 (2)	5
7	Hong Leong Financial Group	6	1	5 (2)	3
8	BIMB Holdings	8	–	8 (4)	4
9	Alliance Financial Group	5	–	5 (2)	3
10	Affin Holdings	11	–	11 (7)	4
TOTAL		**83**	**7**	**76**	**43**

Research by **Mathenny K** and **Johnny Loh** | Source: **Companies' annual reports & Bursa Malaysia**

Define clearly criteria and attributes of candidates

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he cautions. "In light of the above, it is equally important to have a strong and competent company secretary to serve as the conscience of the board."

Salleh feels it is therefore crucial to decide only after careful consideration of facts and views that are followed by robust deliberation. "Everyone in position of leadership and decision-making will always be in a difficult predicament," he says. "In fact, every decision could turn out to be good or bad."

In the past, Bursa had taken action against independent directors for failing to discharge their duties. For instance, it fined Golden Plus Holdings Bhd RM3.25 mil this year for numerous financial reporting breaches and other breaches of the exchange's listing rules. Among others, the company failed to issue its financial statements for the financial years ended Dec 31, 2010 to 2014 and quarterly reports for financial years 2011 to 2014, within the stipulated timeframes.

Universiti Malaysia Pahang's Post-graduate Studies Institute dean **Prof Datuk Hasnah Haron** calls on every board to formulate its own set of ethical standards and system of compliance centred on the company's code of conduct.

"These ethical standards must be endorsed by the board. Independent directors must ensure compliance by issuing a reminder at the beginning of each meeting that all decisions must comply with such ethical standards."

Selecting right board members

To preserve board independence and safeguard independent directors from "the Sword of Damocles that hangs above their heads", Minda's Abdul Aziz proposes that independent directors be provided with liability insurance which indemnifies them from losses resulting from claims made against them in the course of discharging their duties on behalf of companies.

"Faced with heavier responsibilities and stringent regulatory requirements,

Hasnah calls on every board to formulate its own set of ethical standards and system of compliance

Ahmed Razman says an ideal executive director and independent director ratio should be 50-50

they need the assurance of cover to help protect them against the financial burden of litigation, damage to their reputation and loss of personal assets," he says. "It is recommended that independent directors seek to be provided with this assurance prior to agreeing to serve – or continuing to serve – on the board."

While some organisations offer their qualified independent director candidates to public-listed companies (PLCs), the latter must do their due diligence based on their industries' unique requirements, says MACD's Chan.

"It is critically important the nomination committee (NomCom) of the board has an effective due process to source and evaluate potential candidates to join the board," stresses Chan. "Quite commonly, potential candidates are referred through informal networks of corporate, professional, civil service, family or friendly connections."

While some PLCs adopt the process of mapping out the skill set matrix of their boards to assess gaps to be filled, others may engage search firms and their methodologies of selection, including psychometric assessments.

"That said, the NomCom is still responsible to clearly define the criteria and desirable attributes of potential candidates and justifies its recommendations to the board," Chan points out.

MICG's Yusli says every company and candidate must answer two vital questions: the ability to fit in and how to add value. "Good companies value independence as it enriches boardroom debate…this doesn't come from being a stranger, rather it comes from an attitude of mind," adds the former Bursa CEO.

Heavy responsibilities

For now, the roles and responsibilities of independent directors are quite well defined in the regulatory frameworks of the Securities Commission, Bursa, Bank Negara and the Companies Commission Malaysia. The Malaysian Code on Corporate Governance 2012 (MCCG 2012) and the updates to MCCG 2016 is poised to enhance the code on independent non-executive directors, among others.

The Whistleblower Protection Act 2010 (WPA 2010) is another legislation that the boards of PLCs can incorporate into their corporate governance frameworks. Under the WPA 2010, a director may make a disclosure of improper conduct to any enforcement agency based on his reasonable belief that any person has engaged, is engaging or is preparing to engage in improper conduct, provided that such disclosure is not specifically prohibited by any written law.

"A disclosure of improper conduct can also be made although the person making the disclosure is not able to identify a particular person to which the disclosure relates, and even when the improper conduct has occurred before the commencement of the WPA 2010," explains Putra Business School's Dr Ahmed Razman.

Additionally, the proposed Corporate Liability Act – when passed – will pile more responsibilities on boards to include ensuring, among others, appropriate systems and processes are in place to check and deter unethical practices of corruption and bribery across the boards and companies.

Thrown into the mix is the required disclosure of Sustainability Statement in the Annual Report of PLCs with market capitalisation of over RM2 bil effective Dec 31, in addition to the proposed implementation of Integrated Reporting which demands both increasing responsibilities and personal liabilities on the part of independent directors.

"If the existing regulations are not challenging enough, there are very few avenues for independent non-executive directors (INEDs) who uphold their independence with integrity to be protected," reminds MACD's Chan.

"If an INED feels being coerced against his/her better judgment, integrity, objectivity or independence, the consideration to resign from the board is clearly not an unreasonable option given the heavy legal and personal liabilities."

FocusM

Time to step down

IT'S common to hear about underperforming employees being counselled out of companies, but how does one approach the more delicate situation involving a director?

A study by KPMG's Audit Committee Institute entitled *Non-Executive Directors 2013: Profile and Pay* suggests a director could be considered underperforming when he:

- Has overcommitted himself to other directorships, his personal affairs and business, or both (thus, he is unable to devote the time required to serve effectively on the board and usually turns up for board meetings underprepared);
- Cannot or does not want to keep up with current issues confronting the company; and
- Is painfully unaware of his roles, duties, rights and obligations; and/or is literally a silent attendee at board meetings.

While some companies impose term limits to ease directors out of office, there are two disadvantages – this can either be an extremely slow way to remove directors or increase the likelihood of removing high-performing ones.

Hence, boards may want to consider the following options:

- Agree on minimum performance standards required of each director (namely, roles and responsibilities which could be written in the director's appointment letter/service contract);
- Agree on a process to handle situations when a director may be required to leave on the basis of non-performance; and
- Have a succession plan in place not only for chairman and committee chairmen, but also for all directors (this would signal that a director's position is not permanent).

Overstaying one's welcome

KPMG'S findings also reveal that non-executive directors on average served about seven years – 7.5 years for independent non-executive directors (INEDs) and 6.5 years for non-independent non-executive directors.

An interesting finding is that about one third (33%) of independent directors, or close to 390, had served more than nine years.

An INED's tenure can be a controversial topic indeed. Why is there so much fuss to limit the tenure? Clearly, if regulators are seeking to bolster the independent element of company boards, something must have been lacking in the first place. This could be indicative of a lingering feeling that non-executive directors (NEDs) – both independent and non-independent – may not be carrying their weight and see their board positions as "just a reward" at the end of a long career.

On the other hand, empirical evidence gleaned from interactions with high-performing NEDs over the years indicates that tenure isn't necessarily the best indicator of an NED's independence and behaviour. After all, an NED could be non-performing from the first day of his appointment!

Salleh says decisions must be based on careful consideration followed by robust deliberation