DIRECTOR SKILLS FOR EFFECTIVE GOVERNANCE
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For over 50 years, the Business and Industry Advisory Committee to the OECD (BIAC) has been the officially recognized representative of the OECD business community. An international business network with a global membership and a trusted partner to the OECD and other international institutions, BIAC advocates for open markets and private sector-led growth. Our leading engagement in OECD activities grants us privileged access to OECD discussions at the highest level and we regularly contribute position papers and expert views.
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INTRODUCTION

Good governance starts and is driven from the top. It is therefore of the highest importance that companies wishing to benefit from the revised OECD Principles of Corporate Governance have an effective board. The responsibilities of the board are diverse and require a balanced team of directors with the right skills sets.

As the OECD Corporate Governance Principles apply to a wider variety of ownership structures, including majority-controlled and state-owned firms across the world, expectations of directors and their skills are likely to increase as well. To meet these expectations, BIAC decided to organize an expert roundtable in February 2015 to emphasize the importance of obtaining and continually enhancing the optimal mix of director skills. The roundtable aimed to provide a platform for an exchange of views among corporate governance experts around the world, thus contributing to discussions taking place during the update of the OECD Corporate Governance Principles and the Guidelines on Corporate Governance of State-Owned Enterprises as well as to future OECD work on this topic.

The high-level roundtable brought together business leaders and corporate governance experts from North America, Europe, Asia and Africa, including from major non-member economies. Herein is a summary of the key points from the meeting as well as written contributions from panel discussants.
The composition of today’s boards of directors remains a pressing issue in corporate governance. Investors care who sits around the boardroom table because they see directors, rightly, as their advocates in ensuring that the business is well-run, and that management is accountable. Governments care about board composition, based on similar concerns, but also out of a sense that boards should reflect society in some fundamental ways; we have seen, therefore, great efforts made by governments over the last several years to require more women on boards of directors, and more diversity in general. And, of course, boards themselves care because they wish themselves to be stronger, more sustainable, and to have a greater ability to understand and respond to a fast-changing business environment.

What has surprised many observers, however, has been the recent push to discuss board skills and composition not only among large, listed companies but among private companies, state-owned companies, and companies controlled by families. Not only this, but there is growing interest in almost every part of the world in who, precisely, serves on boards in their country, and moreover, who should serve on boards. Call it a democratization of corporate governance; call it a revolution in awareness: whatever it is, the issue is not going away.

And it is precisely this renewed attention to board skills and composition that we see reflected in this year’s revision to the OECD Principles of Corporate Governance. For the first time, the Principles make direct reference to the diversity of skills on boards.

We also see this renewed attention in the diversity of speakers and participants at BIAC’s Roundtable on Director Skills, which this paper reviews and highlights. It is my sincere hope that readers of this paper obtain a sense of the kaleidoscopic views on this issue among the business community and corporate governance experts. And while there is a long way to go still in achieving the right boards for all our companies, I have a strong feeling that this report offers a few additional steps in the right direction.

Dan Konigsburg
Chair, BIAC Corporate Governance Committee
SUMMARY OF KEY POINTS RAISED AT THE SKILLS ROUNDTABLE
Paris, 17 February 2015

Good governance starts and is driven from the top. Therefore, it is of utmost importance that companies have an effective board. The following key points were raised during the BIAC roundtable:

• The responsibilities of the board are diverse and require a balanced team of directors with the right skills sets. While criteria, such as term or age limits are important, a key priority for boards should be to have a close look at both the collective and individual set of skills.

• It is important to ensure that there is not just one person on the board who has all the needed skills for the respective company. Therefore, in addition to considering the overall skills set, the skills of individual board members are instrumental for the overall efficiency of the board and need to be carefully considered and evaluated.

• It is essential to have a good understanding of the overall business characteristics and strategy in order to ensure strong alignment with the qualifications, skills and experience of directors. In addition to strong basic skills, overarching qualifications need to include technical expertise and good knowledge of the respective sector, financial literacy, the ability to assume risk strategy leadership, and knowing how to ask the right questions.

• In addition, it is important to have a clear understanding of institutional and cultural issues, in particular in markets where the company invests or considers growth opportunities. International experience of board members, a geographical mix that reflects the consumer base, as well as a good understanding of the concerns of minority shareholders are becoming increasingly important.

• Regular self-evaluation as well as outside evaluation where appropriate are essential. A clear strategy of how to evaluate skills and assess overall board performance needs to be in place, starting with objectively assessing the profile and background of directors and then assessing how he/she fits with the strategy of the company. In addition to evaluating the skills of new board members, there needs to be a clear understanding of the skills of the directors that already have a position on the board.

• It is important to have the right balance of skills to ensure that the board can effectively oversee the company’s current and future strategy. A key challenge remains how to identify the right soft skills. Furthermore, it is important that board members with the right skills have the necessary time to invest.

• There needs to be a clear understanding of the rationale of how board members are selected, underlining the importance of a well-functioning nominating committee. A number of companies have developed skills checklists reflecting the experience and diversity of the skills they require. Succession planning and oversight of the succession process have to be considered an integral part of the process.

• Leadership of the chairman is particularly important. The balance of skills varies and needs to be carefully considered based on, among other things, ownership structure. Evaluating board performance is not only important for private companies, but also for state-owned enterprises to ensure that they are not just regulator-driven.
• It is important for directors to discuss the obligations of whom they are representing. Ownership structures vary widely and must be taken into consideration. The role of independent directors, which is considered not only important for large listed companies, can vary depending on whether he/she works in a controlled company or a company with dispersed ownership. Independence of thought and “courage,” i.e. the ability to challenge in a constructive manner, were underlined as important director qualities.

• In addition to the board, it is important to carefully consider the skills of committee members. Due to the fundamental importance of the audit committee, it is essential that committee members have a clear understanding of complex financial matters. In the case of remuneration committees, boards need assurance that there is no influence due to strong personal relationships. Members of risk committees need to demonstrate the ability to manage instability.

• In the nominating process, which can face the challenge of a small pool or lack of qualified candidates, a formal, robust and transparent process, including clear criteria determining the kind of candidates they look for should be in place.

• With a great number of middle-sized companies transitioning from informal to formal practices, from unlisted to listed status, and in light of the growing need for both strategic skills and risk management skills, some developing and emerging countries are experiencing difficulties in finding skilled directors. In some countries, a new generation of directors will need to be created. The importance of corporate governance centers and/or institutes of directors to cultivate and steer talent pools was highlighted at the Roundtable as critical to corporate governance success at the national level. The importance of the OECD Corporate Governance Principles for overarching guidance based on a principles-based approach was also underlined.

• The involvement of the investment community was considered important as skills and experience of the board matter for investor confidence. Board effectiveness and board assessment are essential from an investor point of view among others to mitigate interpersonal risks. Having the right people in place can enhance the quality of oversight and quality of management.

• Board assessment as well as board refreshment (including how to ease under-performing directors from the board) should be given continued attention. The chair needs to apply particular skills for the management of this process. Quality of oversight and quality of management are related to having directors with the right skills in place. Investors also see a particularly important role for auditors in this process.

• Governments have an important role in providing general guidance and laying out checks and balances, including in the OECD Principles. With regard to the composition and precise skills set of the board, the private sector should address these issues in a proactive, dynamic and flexible manner.
Jesus Estanislao, Ph.D., FICD
Chairman, Institute of Corporate Directors
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Going Beyond Conformance

Introduction

Over the years, there has been an almost exclusive stress on conformance to the new corporate governance rules and regulations being issued everywhere. The idea has been that the more you conform, the more robust your corporate governance practices will be, and the more trustworthy you are.

These past few years, as the rules and regulations of a conformance-oriented corporate governance regime have become more specific (and therefore somewhat rigid), more and more people are suggesting that there should be much more to corporate governance than mere conformance. The focus has to shift more towards performance: i.e. the delivery of “from good to great” outcomes.

Of late, there has also been greater interest in the sustainability of good performance over time. This is referred to as “sustenance” of performance gains from good and proper corporate governance practices.

Working as a corporate governance advocate in an emerging market, we at the Institute of Corporate Directors have come to appreciate the three different facets of conformance, performance, and sustenance, not only in the Philippines but also in the ASEAN region (where we are launching the ASEAN Corporate Governance Scorecard initiative).

Conformance: Where We Began

In our advocacy, we have adopted a conceptual framework behind conformance, as gleaned from the OECD Corporate Governance Principles and globally observed accounting principles. The framework, in our view, is based on the concept of “stewardship”, i.e. that the corporation draws resources for its operations from providers of equity (shareholders) and of credit and other debt arrangements (other stakeholders such as creditors, suppliers). These resources the corporation puts to use following its own business model for creating value to consumers or customers, with various other stakeholders involving themselves in the value-creation process, e.g. employees, officers, and regulators (with responsibility for the wider economic interest). Thus, the first concern of conformance is the equitable and fair treatment of all shareholders and of all the other stakeholders.

The second concern is closely related to the fair manner in which shareholders and other stakeholders are treated. Indeed, one of the mantras of a conformance-oriented corporate governance regime is: “disclosure; disclosure, and disclosure”. The mantra extends to this: the more you disclose, the higher the chance all stakeholders (and in particular, shareholders) will get to know how fairly you are treating them.

The third concern is also related to how shareholders’ and other stakeholders’ interests are promoted and protected. Someone has to take on the responsibility for doing this. That “someone” is a collegial body, which is the Board of Directors. The call of modern corporate governance has been for the Board of Directors to step up the plate; take their fiduciary duties seriously; and be fully accountable for the governance and the management of the affairs of the corporation. A good portion of what has been pushed for adoption over the past decade and a half has centered on the Board of Directors becoming
a more professional and hands-on overseer on behalf of all stakeholders (starting with shareholders).

The work of OECD and of the global economic community concerning corporate governance these past few years has been focused on articulating these broad principles, using the framework described above, and on drawing from them “good and proper” practices. Rules and guidelines have been formulated and issued; and best practices have been broadly shared and spread. The up-side to all this is that conformance to these rules and guidelines is an indicator of the trust-worthiness of the corporation as a creator of positive economic value, and therefore as worthy of a premium in capital markets (1).

There is a down-side to rules and guidelines, however. They can become rigid and inflexible. They multiply. In the hands of lawyers, they expand the area for litigation. In the hands of accountants, they get to be more detailed, more specific, and more concrete, even to the point that rules have to be complied with, oftentimes forgetting the spirit and the principles behind them. In the hands of regulators, they may also become an excuse for more bureaucratic meddling. Moreover, rules are not cost-free; and they may deaden the spirit that should enliven and animate governance.

**A Greater Focus on Performance**

Precisely because the underbrush of rules and best practice guidelines have produced a thicket of almost endless and often unnecessary controversy and disaffection about corporate governance, for the past few years there has been an increasingly louder call for a return to basics, with their focus on long-term performance. There had been far too much “short-termism” and obsession with financial results (2); this needs to be offset by a longer perspective, which takes on a more comprehensive perspective of the strength of the corporation. This “offset” demands that:

A. Boards play a leading role in the formulation and final adoption of strategy. Strategy is necessarily long-term, and should at best be of a transformative character. Thus, strategy should deliver at least a few breakthrough results.

B. Boards therefore put in place an accountability system for breakthrough results - associated with strategy - to be actually delivered. This accountability starts with the Board: a professionally undertaken performance evaluation (both of the Board and of individual directors) is increasingly considered a “must”; it extends to performance standards for the CEO and the top management team (pay for performance); and it ends with performance scorecards down to the last unit and individual within the corporation.

The over-emphasis on financial returns and maximization of ROI, and on meeting targets in earnings guidance as well as analysts’ expectations, has led to a demand for an “offset”, which asks for a more comprehensive coverage of performance. This must include how all the other stakeholders are treated; and how well their interests have been promoted in a balanced and fair manner. Instead of maximizing only shareholder value, other stakeholders’ interests need to be reckoned, using pre-agreed performance metrics.

**Sustaining Performance Gains**

Going beyond maximizing shareholder value alone, the Board of Directors is called upon to take responsibility for securing the long-term sustainability of the corporation. To live up to this responsibility, the Board should serve not only as the mind of the corporation; it should be its heart and conscience as well.
A. It formulates and puts forward a “shared vision” for the corporation, which is fully consistent with its core purpose and mission as well as its core values (which are at the very core or ethical foundation of the corporation). It reaches out not only to all those working within the corporation, but also to all other stakeholders, most of whom are outside its immediate ambit. Not only an “investor relations office” is called for; this is expanded to become a “stakeholder relations office”. Through it, other stakeholders are given a “voice” that can speak to the Board of Directors.

B. It encourages and fosters a spirit of enterprise that leads to team work and cohesion within the corporation; it also orients the corporation towards the external environment: what opportunities the corporation can seize to be of value and service by meeting certain critical needs in the environment (3). This is how social responsibility is embedded in corporate strategy and business plans.

It is by observing the “shared value” precepts - drawn from ethics, spirit of enterprise, and social responsibility - that the corporation finds itself more firmly grounded, more cohesive internally, and more aligned with the changing external circumstances (with problems that can then be turned into business opportunities) - that a corporation can keep sustaining itself: it can keep going from peak to peak. Moreover, by doing so, it attracts the best quality people, both in the Boardroom and in executive suites as well as ordinary offices. Quality people, after all, are the ultimate guarantees of corporate sustenance.

Current Challenges in our Advocacy

Taking all three concerns associated with conformance, performance, and sustenance of performance gains, our corporate governance advocacy ordinarily brings up the first area for attention and asks: where do you as a corporation stand in the conformance area? We offer one quick check: how well do you score, using the ASEAN Corporate Governance Scorecard questionnaire?

The second area we invite corporations to consider is associated with a performance governance system (PGS). This, in effect, adapts strategy formulation and strategy execution to local circumstances. It asks for strategy maps, performance scorecards, and a formal performance evaluation mechanism. It opens up a pathway to being certified as an “Island of Good Governance”. Such certification demands external audit of performance gains, and to keep the certification, the full institutionalization of a performance-focused corporate governance regime.

The third and final area is one that will require continuing commitment and interest. This asks for the installation and sustenance of a governance culture, which embeds ethics, the spirit of enterprise, and social responsibility in the corporate DNA. Such a culture may ask for an institutionalized governance outreach that will spread governance values in the broader community, starting with schools and families, the main instruments for values propagation and observance.

References:


There is a strong recognition of the need of qualified and knowledgeable expertise on boards across the Middle Eastern region. This is a key development in a region where business and family are commonly intersected. A recent survey by the Gulf Cooperation Council (GCC) Board Directors Institute reflects that on average 66% of the surveyed companies see the need for both functional knowledge and industry/sector knowledge.¹

Understanding Corporate Governance Principles

Board members require various skills to effectively contribute to the rest of the board and to the companies’ performance and sustainable growth. The key is the full understanding of good corporate governance practices, in which the nominations committee should confirm the nominees’ comprehension of this skill. The director should have a full understanding of his/her responsibilities and obligations towards whom he/she represents on the company’s board and his/her willingness to be active and engaged in board meetings and the decision making process.

Policy makers and regulators worldwide have worked progressively to introduce independent directors as a fundamental constituent of the board of directors in enhancing corporate governance mechanisms and practices². Recently in the MENA region, boards that include independent directors are an increasing feature of the landscape of publicly listed companies as these have been required by the listing rules in a number of markets, for example Egypt and the UAE: that at least 2 independent members should be on a board. For example, out of the Egypt’s prime index EGX 30 companies, only 2 company boards are dominated by independent directors. One third of the remaining 28 companies have boards with between 1 and 3 independent directors.

Similarly, in Morocco, 2 out of 42 listed companies’ boards are dominated by independent directors, while the remaining companies indicated that they have at least one independent director on their boards. However, the majority of directors deemed to be “independent” by listed companies are in reality non-executive board members appointed by institutional investors.³

Selection Challenges

Effective boards of directors have nomination committees that should disclose their selection mechanism, often based on board recommendations for the skills needed to fill the gap. However, in reality the process is not that straightforward, as selection is based on personal relations, which in some cases might compromise a skills factor or effective engagement in board discussions and decisions.

One of the challenges here is that the pool from which directors are selected in the region is not as big as many expect. Thus, most of the directors sit on too many boards and they are not giving much time to discuss

² Based on an article titled “How Far should we rely on Independent Directors”, by Maged S. Sourial, 2015, unpublished.
and study issues. This is confirmed by GCC Board Directors Institute survey, which shows one-third of respondents sitting on 3-5 boards, while 13 per cent of those surveyed sit on more than five boards, and several sit on up to nine boards. Though unconfirmed by the survey, this is also quite common in the case of Egypt.

Culture and Country Specifics Do Matter

Experience reveals that corporate governance principles are often influenced by a country’s political, economic & cultural ideology. For example, in social-democratic countries like those in Scandinavia and other European countries, the concept of corporate governance seems to come naturally as it is based on inclusion of all stakeholders, including employees. Cultures where capitalism is at the core of strategic management like the U.S. and the U.K., the role of the firm in the society is to create wealth for shareholders, as individuals pursue their own interests. As a result, allocation of resources is more efficient, in a sense based on Adam Smith’s notion of the invisible hand of the market from his seminal book The Wealth of Nations.  

In the MENA region, despite cultural distinctions among countries, when it comes to business, corporate cultures are often skewed toward a capitalistic culture, one that is aligned with Sharia Law, and with a dimension of corporate social responsibility. Executive management and directors are influenced by western education and/or international expertise. For instance, in the GCC it is very common to see executive management positions occupied by expatriates, while directors remain local.

Influence of Ownership Structure

There are great distinctions between a family-owned company and a publicly listed company, or between a listed company and a government-owned enterprise. For example, in the GCC, where ownership is mostly through sovereign wealth funds, things look very different where there is direct ownership by the government, which is the example of Egypt and a number of MENA countries that have undergone privatization programs. As a result, in the later case, boards of these companies can lack independence; they mainly represent the interest of the government and do so at the expense of the company’s competitiveness versus its peers in the private sector. There are also cases where employees are represented on the board, a situation often seen at companies that have been privatized under a government program. The experience here is often that the employees’ board representatives are actively engaged when it comes to decisions related to the employees and sometimes this is at the expense of the company’s performance.

These distinctions in ownership structures should be clearly understood by the director as it requires in some cases a diplomatic approach in engaging in boardroom discussions and influencing decisions. For example, this is certainly the case for directors on a board chaired by a member of a royal family, or by a political figure in the government. This requires extra soft skills in

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4 valuelink.com/2013/01/corporate-governance-usa-versus-europe/


engaging in the board and being effective, especially when it comes to remuneration, evaluation of senior management, and director performance and nomination.

**The Role of the OECD Principles of Corporate Governance, and National Instruments such as Governance Codes**

Adoption of the OECD Principles of Corporate Governance relies mainly on establishing an institutional setup for issuing and promoting a national code, as well as training and entrenchment of the concept of corporate governance within the business and governmental communities. The MENA region has experienced success on this front. Mainly, this has been achieved by promoting, training and enhancing the corporate governance principles through issuing the local Code of Corporate Governance, establishing local institutes of directors or their equivalent, and enforcement through the local stock exchanges and central banks.

In Egypt, a Code of Corporate Governance was issued in 2005\(^7\). The Code is the primary source for the continuous revisions of the Egyptian Exchange’s listing and disclosure rules, allowing efficient mechanisms for the enforcement of corporate governance principles through the Exchange. With respect to enforcement, this has been significant evidence of EGX’s commitment to upgrade corporate governance practices among listed companies. As a result, the number of listed companies declined from 795 companies at the end of 2004 to 212 at the end of 2010. These measures have been reflected on main market indicators, specifically, market capitalization has grown exponentially from LE 234 billion (about US$ 42 billion) to hover around LE 500 billion (about US$ 90 billion).

| The number of traded companies as a percentage of listed companies increased from around 60% in 2004 to 95% in 2010. The value of trading increased ten-fold from about LE 36 billion in 2004 to an average of LE 430 billion during the period 2008-2010. Thus, the turnover ratio increased from 14% in 2004 to more than 40% on average during the period 2008-2010. Moreover, it set the foundation for the Code of Corporate Governance for State-Owned Enterprises (SOE) issued in 2006, the Code of corporate governance for financial intermediaries issued in 2007, and the Banks’ Governance Directive issued in 2011. The Code is the essence of a number of family constitutions adopted family owned companies. Moreover, The Egyptian Institute of Directors has been established to promote, train and enhances corporate governance culture.

We see a similar story in the UAE, where the Hawkama Institute and GCC Board Directors Institute are playing a significant role in enhancing corporate governance practices, and the UAE Exchanges play a progressive role in enforcement of corporate governance principles.

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\(^7\) The Egyptian Code of Corporate Governance was drafted in collaboration with the Egyptian Corporate Governance Task Force and has been authored by Dr. Zeyad Bahaa El Din (Chairman, General Authority for Investment, then) and co-authored by Maged Shawky Sourial (Chairman of the Cairo And Alexandria Stock Exchange, then) in 2005 through a project supported by The Center for International Private Enterprise (CIPE).
Standard Life Investments is an asset manager domiciled in Edinburgh, UK, with approximately £240bn of assets under management and these assets are invested in markets around the world. We believe that it is mutually beneficial for companies and long-term investors such as Standard Life Investments and its clients to have a relationship based on accountability, engagement and trust. Such a relationship helps to ensure that each has a good understanding of the other’s views and expectations, and enables us to exercise constructive influence as and when appropriate. We believe that this serves to enhance the long-term value of our clients’ investments and to protect their interests when necessary.

When making investment decisions we see the governance of the companies in which we invest as a key part of the analysis that we undertake. Standards of governance can introduce additional risks to the portfolios which we manage on behalf of our clients. These risks are often generated by the effectiveness of company boards and the individual directors. In order to assist in mitigating these risks, we see significant importance in governance and stewardship activities including:

- Voting at company meetings
- Engagement with board members at investee companies
- Reporting transparently to our clients

Our investment analysis and decision making is designed to identify those companies that will be successful and sustainable over the long term. We believe that such companies are headed by an effective board which has ultimate responsibility for a company’s affairs and is primarily accountable to shareholders for ensuring that appropriate and effective processes are in place for carrying out the key tasks that enable it to fulfil that responsibility. These key tasks include:

- the identification and management of the principal business risks
- setting the company’s risk appetite and keeping it under review
- the oversight of the company’s operations and control structures to maintain their integrity and effectiveness
- the development and implementation of strategy
- the development and maintenance of management structures that are consistent with enhancing shareholder value over the long term.

The board is responsible for ensuring that the company complies with all relevant laws and regulations and should ensure that relevant controls are in place to enable such compliance.

In addition, the board is responsible for determining the company’s purpose and values, and for ensuring they are upheld and reflected in business practices adopted throughout the company. These tasks, for which the board is responsible, are important and complex. The correct composition of skills and experience of the individual directors on a board is needed to deliver these tasks.
The creation of a well-balanced and effective board does not happen by accident and we therefore rely heavily on the Chairman and his or her ability to manage the board to ensure that it contains the right skills and experience and makes the best use of the individuals on the board. Management of the composition of the board needs to be a purposeful and continuous process to deliver the ongoing continuity of the directors’ skills and experience needed to manage a sustainable business over the long term.

We expect the Chair of a company to be able to describe with clarity how the correct composition is maintained. This will include a good description and explanation of the skills and experience needed, a well-defined succession plan to maintain the correct composition and where necessary appropriate development plans in order to fill possible gaps. In our experience, based mainly on engagement in the UK, companies have significantly improved their processes in this area and there are a number of service providers that offer expertise and tools to help manage the composition of boards and searches for high quality candidates to fill any vacancies.

In order to create boards of the right quality, companies do rely on a good supply of high quality candidates to fill any vacancies they may have. Historically many roles were filled through personal networks rather than through professional searches for the candidate with skills and experience needed by a particular board. It is apparent that there has been movement toward more career based professional directors. This ‘professionalisation’ of the role of directors, particularly non-executive directors, is an ongoing journey and there remains some differentiation by country and company.

It does appear that the need for the development of professional directors is becoming more widely recognised, which is evidenced by projects such as that led by the European Confederation of Directors Associations (ecDa) and Korn Ferry entitled ‘Beyond the Old Boys’ Network’ which contains the fourteen steps to effective board building. We welcome these developments as we believe that they will assist in the delivery of successful companies over the longer term and in turn the economic growth so keenly sought around the world.

The skill and experience of board members are important components of a company delivering success over the long term. We are pleased that the role of being a director is becoming more of a career with the skills, experience and professionalism of candidates being the selection criteria of most boards. In some markets this journey is just beginning and we would encourage that boards, investors and policy makers continue their efforts to continue on this journey to help deliver successful companies and economic growth.
As President of IFAC, I lead an organization which consists of 175 members bodies in 130 countries that represent over 2.8 million accountants. Our entire profession views corporate governance as a critical link in the financial reporting supply chain and for the success and sustainability of any organization – regardless of size or mission.

But my personal perspective on this is derived not only from inside the accounting profession, but is greatly contextualized by my experience inside the boardroom. I have served as a non-executive director of several publicly listed companies over the past 20 years, and on boards of many other organizations of all types. I have seen the difference robust governance can make to enhance decision-making in any organization.

In this contribution, I would like to highlight three areas that I have found can really move the needle towards stronger and more effective governance.

1. Executives as well as boards have critical roles to play in corporate governance reform

First and foremost, Boards and their committees must conduct a challenging assessment of their adequacy and qualifications to protect and represent investors and stakeholders.

Boards must be willing to honestly assess themselves - as a group and each director individually - and ask:

- Do we truly understand the business, the issues, and the risks?
- Are we equipped to effectively represent our stakeholders?
- Are we sufficiently informed and able to understand the implications of basic judgment calls in order to offer credible challenge?

It is hard for people to answer “no” to these questions, so I emphasize the “understand” point. If any director does not understand the business model, the risk, the transaction, the market, then that is a problem.

Directors must be equipped to ask the tough questions about:

- specific transactions, expenses, revenue streams and new initiatives; and
- Board composition - whether member “renewal” is required in order to achieve deeper experience and understanding.

This need for assessment and challenge was highlighted by the financial crisis.

2. Governance within the management structure is also critical

As executives, we must challenge ourselves and our organizations to gain a deeper understanding of complex business models and issues. As with effective Board governance, it begins with continually examining whether the right people with the right skills are working in the critical risk and control areas: within operations (first line of defense), accounting, finance, risk management (second lines of defense) and internal audit (third line of defense).

As business models and business complexity changes, we must ask: do our employees have technical skills, and deep operational understanding and experience? Do we have the right mix of people and skills?
If management teams and employees cannot comfortably explain the overall picture of business direction, the effect of decisions, and assess enterprise-wide risks, then how can a board member do her or his job effectively?

This may seem to be an oversimplification, but we need to challenge our business and staffing models. No business can ride into the future with mismatched people skills and roles, and poor systems and structures.

3. Professional accountants are uniquely qualified and stand ready to help

There are three kinds of gaps that boards must address: gaps in information, gaps in oversight, and gaps in expertise. I am convinced from many years serving on boards that the accounting profession is uniquely positioned to help companies address those gaps. Information is our business. Industry and financial expertise are our core competencies. In many countries, audit committees and our profession initially led the way for improved corporate governance. The accountancy profession stands ready to help organizations understand the essential elements, structures and processes for strong corporate governance.

“Financial expertise” and “professional skepticism” are two of the most important factors in effective board and oversight functions. These are at the core of highly developed professional accountant competencies.

At the end of the day, effective governance comes down to knowing what information is needed, and then having honest, frank and informed discussions on significant issues and risks. Professional accountants can contribute greatly to this discussion – both as participants and facilitators.

Key Take-Aways

I would like to conclude with the following three “take-aways” on further strengthening corporate governance:

1. ADVOCATE - for strong corporate governance. Be interested in all aspects of governance, initiate dialogue on its most effective forms, and share experiences – with each other, across organizations and industries.

2. EVALUATE - Consider conducting a “governance review”— and identify improvement opportunities. Seek out what has been effective elsewhere, highlight existing gaps in company practices, and create an action list to bridge those gaps. This would create immediate value for individual companies, and benefit the national economy.

3. PARTICIPATE - We all need to lead by example - including inside the boardroom, as board members, demonstrating effective information flow, constructive challenge and strong accountability processes. The competency and expertise of new board candidates has escalated to the top of the list as the world recovers from financial crisis. Today’s boards seek qualified candidates with strong relevant experience including risk management, internal controls and executive compensation structures and incentives. These needs need to be filled as part of Board “renewal” efforts.
Rita Benoy Bushon  
CEO, Minority Shareholder Watchdog Group  
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In many developed markets around the world, the 'appropriateness' of executive and non-executive board compensation has rightly come under the close scrutiny of shareholders. These developments came in the wake of massive and systemic abuses, and it appears that Malaysia could be approaching this stage if board and shareholders ignore the matter of excessive compensation. It is indeed for this specific reason that a need to highlight this matter though sensitive and unpopular is imperative.

Amidst the onset of this AGM season, we in the MSWG have witnessed instances where resolutions on directors remuneration that were proposed were substantially higher - in some cases increases of almost a hundred percent.

From statistics compiled by MSWG, it showed that the average total remuneration in over 800 companies of PLCs for non-executive directors was in the region of 90 to 100 thousand ringgit per year for the past 2 years. Whereas the finance industry topped the averages, we still see an average of about 200 thousand ringgit when you take out the outliers. The figures appear to be reasonable comparable to regional averages.

We noted, however, that this year the amount had surpassed 600 thousand ringgit per director in some of the finance companies without clear justification for the increase. Some went as high as 800 thousand ringgit.

Typically in the finance industry, a non-executive director would devote around 60 days in a year to the company assuming there were 15 meetings a year with about 4 days for reading the board papers for each meeting. When annualized, this average surpasses 3 million ringgit a year if they were full-time employees.

We would think that this kind of compensation would be appropriate for executives whose role amongst others would include the day-to-day operations of the business encompassing marketing and bringing in the top line and bottom line numbers in a highly competitive environment. A non-executive director is not expected to undertake this role. They are appointed to the company to provide the oversight role in the company with a check and balance function. We acknowledge that being a director in the finance sector is a complex one thus scouring for talent is vicious and thus fair remuneration is critical to attract, retain and motivate directors so that they work for the betterment of the company.

Similarly, the said remuneration packages must also appropriately reflect the extent of the responsibilities, requisite expertise and technical complexity the director brings to the board. Having a board with the appropriate mix of skills, knowledge and experience is an important governance aspect to ensure a well-functioning and effective board. Thus, companies will need to have an appropriate compensation strategy to attract potential directors with the required critical and specific skills to provide board leadership and governance and together drive company performance. A robust and transparent remuneration framework for directors will assure shareholders of alignment with company’s goals.

The subject of appropriate compensation goes far beyond merely justifying a fee increase. It also equates to a need for disclosure of each individual director's compensation. The reasons are quite simple.
Company shareholders can decide if the directors are adequately compensated for the role he or she is fulfilling.

Where external consultants are deployed to manage this key function, the recommendation ought to be provided and fees adequately justified. A proper rationale must be offered, with detailed information on the parameters and benchmarks proffered in its decision on the director’s compensation package.

Special consideration is given to a company Chairman for his leadership role in the board and the company. And more so if in the finance sector where he or she is expected to be devoted to one specific financial institution. Special consideration is also given to directors who sit on the boards of group subsidiary companies or committees and are, therefore, entitled to higher compensation for these additional duties.

However, the requisite procurement of shareholder approvals on the total compensation ought to be tabled for good governance practices and not just the fee in the holding company. We observed that in several cases the bulk of the non-executive directors’ total remuneration resided in the subsidiaries where approval was not sought from shareholders.

One thing must also be added. Financial entitlements like bonuses and ESOS ought not to be given to non-executive directors including independent directors whether in the main board or subsidiaries.

The reason is simple. Independent non-executive directors (INEDs) are supposed to remain exactly that: independent. They are present to oversee the governance aspects of the company and must therefore at all times remain independent, while endeavoring to negate any conflicts of interest that may arise. We reiterate that INEDs should instead be paid a fee that is commensurate with their role and responsibilities, and the size and operation of the company.

We do however take note that initiatives have been taken to address remuneration practices of Non-Executive Directors (NED) in financial institutions in Malaysia. A study was commissioned by the FIDE FORUM in 2010 to provide a framework for setting and structuring remuneration for NEDs in financial institutions in Malaysia.

The report outlined six reasons for the need to change the (then) current remuneration practices, in tandem with increased Board performance: current remuneration practices are based on peer group benchmarking, not performance drivers and do not take into consideration the risks and responsibilities; fees vary widely and diminish with increasing time commitment and complexity, and are not always competitive; structuring of fees is not aligned to reflect and remunerate membership on Committees; there is limited use of innovative remuneration mechanisms; fee expectations of directors are two to four times higher than current levels; and current remuneration practices are impeding the ability to attract directors to Boards of FIs.

A new study has now been commissioned to keep abreast with the developments in remuneration practices of NEDs in financial institutions locally, regionally and internationally. This is a timely development, given that more and more shareholders want to see the link between pay and performance.

In summary, the message is that there must be adequate disclosure of directors’ compensation and justification for any substantial increase.

A reasonable trade-off must, therefore, be achieved between paying directors a fair compensation, that while attractive enough to retain and attract their talents, nonetheless prevents them from retreating into a “comfort zone” that can impair or - perceived by shareholders to impair - their independence.