Getting the Best out of your Independent Directors

Tarun Bhatia
Managing Director & Head of South Asia, Forensic Investigations & Intelligence
Kroll Associates (India) Pvt.Ltd.

It has been both fascinating and enriching to observe how companies and their leadership (executives and the board) have navigated the unknown over the last two years. Some of the most critical takeaways have been:

- The growing interlinkage between businesses and society—COVID-19 has reinforced this view.
- The global business environment is likely to remain volatile for an elongated period due to the changing political, economic and social dynamics.
- Boards are now focusing beyond return to shareholders and thinking about other stakeholders.
- There has been greater accountability on independent directors and higher scrutiny on their contributions.

Despite the above, companies remain heavily glued to the theme of value creation. Senior executives in organizations have set KRAs (key result areas) and their compensation linked to the company's performance. They are also operationally involved on a day-to-day basis and thus the success or failure of the business gets directly linked to them. However, companies and CEOs who have effectively used their board, tend to have a better chance to outperform and create value. Increasingly, independent directors are getting more actively engaged with companies—beyond the quarterly meetings. Since the pandemic, executives are seen to be relying more on independent directors to manage business and risks.

A *McKinsey Quarterly* survey indicated that 70% of privately held company boards are involved in core performance and value-creating activities (up from 59% about a decade back). However, only 43% of respondents said their boards and members are effective in "REALLY" affecting the increase in enterprise value. This reflects that organizations seek much from their independent directors.

On the other hand, independent directors have been under greater market and regulatory scrutiny given the failures of large listed companies in the recent past. Investigations reveal that many of these companies had serious corporate governance failures and adverse actions of management had gone unnoticed. The overall impact of such failures on the system is massive and the debate around who is ultimately responsible for such failures is still ongoing.

But are independent directors adequately equipped to help the company and stakeholders? Kroll has been in India for over 25 years and has looked closely at many listed and private companies, and also investigated company failures. Over these years, the following five questions seem to be the most critical when looking at Independent Directors:

1. Why is the independent director on your board? Do they know their role?

While the regulators have introduced series of guidelines around tenure, renumeration, diversity, etc. of the directors, the question of fitment is most important. Historically, the construction of boards in India wasn't so transparent and was more to be in compliance with regulations. We have come a long way over the last 10 years with greater influx of private and global capital. However, many companies still don't have a structured and independent process of board hiring. Adding an independent director should go through the same level of rigor and diligence as hiring a CXO. Similarly, beyond the broader expectations from an independent director, having clearly defined expectations goes a long way. Effective boards exponentially increase the probability of success when the roles and agendas of the Directors are rightly structured.

Similarly, appointment of a chairman should not be based on years of experience or market stature only; they may not be as relevant to what a company needs at present. The chairman generally sets the tone and hence thinking seriously about the role is a must.

2. Which specific values do independent directors bring?

We are increasingly talking about the convergence of corporates and society and also the need to look after all stakeholders. Independent directors are generally successful professionals, entrepreneurs, academicians or bureaucrats. However, what made them successful in an executive role is different from adding value in a non-executive role. It thus becomes important that the company knows what they are seeking from each of their directors. Given that the agendas of board meetings are long, you may get limited time/question per director. Knowing what you seek from whom is a great asset and ensures your board meetings are effective. A recent *Harvard Business Review* article classified independent directors in four categories: police, data junkies, architects and pilots. You need to know who is playing what role in your board.

3. How informed is the independent director of the business and the marketplace?

Independent directors need to upskill themselves. You can't rely only on your past experiences to help the company. Globalization and technology are changing the way we operate. During COVID-19, overnight, the business models changed. Diversified boards were able to adapt much faster. This would also mean that companies need to be more disciplined about updating their board on business and strategy, sharing board agendas much in advance and having adequate time for discussions. Many companies believe that a quarterly or annual presentation to the board about business and future plans is adequate—you could not be far from the truth; a focused five-slide deck with relevant insights on business, market, competition, people and risks is what the board seeks. They trust the management on the background work. Still, many companies make the mistake of throwing too much information at the board.

4. **Does the Independent Director have access to people other than executive directors?**
   From our experience of investigating large-scale frauds, not having access to people other than executive directors has been a major deficiency. Independent directors predominantly rely on the CEOs for information. They are extremely few companies that provide Directors' access to senior- or mid-management. However, it is important for an independent director to get a 360-degree view. Majority of companies that have failed are because the board relied on one person for all the information. In one recent example, we saw a board actively reviewing the nature of whistleblowing allegations—from a simple complaint about food in pantry to CEO using company resources for personal use. On the face of it, this seemed like a waste of time but constantly reviewing the nature of allegations has helped the company to both develop a culture of listening and also accountability.

5. **Are independent directors allowed to show dissent?**
   Board room discussions that are open and where independent directors are allowed to speak up tend to get the best value from their board. This doesn't happen as often due to the perceived conflict of interest. However, constructive criticism and open debates on board agendas create high degree of trust among stakeholders. The ability of the board or a board member to show the mirror, is a reflection of how responsible the board is and how open the management is to being questioned.

We have come a long way in how we run our board meetings. However, it is time to move from a procedural approach to one that involves greater responsibility and accountability. To end with words from Abraham Lincoln: **"You cannot escape the responsibility of tomorrow by evading it today."**

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