A Diverse Board – Positive Impact on Performance

Kalpana Unadkat
Partner
Khaitan & Co.

Jaidev Mehrotra
Trainee Solicitor
Khaitan & Co.

The board of directors (Board) is often considered to be the engine that drives an effective corporate governance mechanism in a company. It plays a critical role in providing comprehensive guidance and direction to a company. Moreover, it has also been observed that the financial performance of a company depends on the effectiveness of the composition of its Board. A diverse Board comprising members collectively possessing a variety of skills and coming from a variety of cultural as well as geographical experiences is not widely regarded as essential.

Over the years, certain regulations have evolved regarding the composition of the Board such as Section 149 of the Companies Act, 2013 and Rule 3 of the Companies (Appointment and Qualifications of Directors) Rules, 2014 which mandate the appointment of a woman director on the Boards of all listed companies or other public companies having a paid-up share capital of INR 100 Crores or a turnover of INR 300 Crores.

However, simply appointing women directors to the Board and claiming to be promoting gender diversity is insufficient. That is not the only form of diversity that makes the composition of the Board effective. It is equally important to ascertain the skill sets of each member of the Board and ensure that they each bring a core area of expertise individually so that collectively, the Board has all the skills, expertise, and experience while taking crucial decisions. An example of this would be to bring together a chartered accountant, lawyer, information technology (IT) professionals, and others with expertise in strategy, finance, manufacturing, and supply chain, sales, and marketing. This would ensure that the Board has all round expertise to tackle any situation it might encounter. Additionally, having a retired government employee or bureaucrat on the Board would be of significant advantage to companies in sectors such as mining, construction, pharmaceuticals, and that have to often deal with the government and regulatory bodies.

On May 9, 2018, the Securities and Exchange Board of India (SEBI) through the SEBI (Listing Obligations and Disclosure Requirement) (Amendment) Regulations, 2018 introduced a requirement for listed companies to identify the core skills, expertise, and competencies of each of the Board members from the financial year ending March 31, 2019. The Regulations also mandated that listed companies specify the names of directors who possess such identified skills effective from the financial year ended March 31, 2020. Both these details are required to be disclosed in the corporate governance report, annexed with the annual report of the company.

Diversity amongst Independent as well as Executive Directors

While looking at a diverse set of directors to constitute the Board, diversity in skills sets, ethnicity, age, experience, and geography must not only be sought after while appointing external, Independent Directors but must also apply to the whole-time executive directors of the company who are also members of the Board. As the executive directors are involved in the day-to-day affairs of the company, it is extremely important to ensure that they possess varied skills, expertise, and experience which would enable them to be better equipped to make critical decisions without having to wait for external advice or for the availability of the independent directors who would often have other commitments as they are not involved full time in managing the company.

Nomination and Remuneration Committee should ensure Diversity

There must be a specific and streamlined method by which potential board members (both in an independent as well as an executive capacity) are identified and selected. Currently, there are no regulations stipulating any particular criteria apart from what has been introduced through the Amendment to the SEBI LODR Regulations dated May 9, 2018.

The possible methods by which the Nomination and Remuneration Committee (NRC), under Section 178(3) of the Companies Act, 2013 may set criteria and identify different skill sets, expertise, and experience are:

i. Identify certain professionals whose expertise, skills, and experience is likely to be required by the company at regular intervals to meet regulatory compliances such as chartered accountants and lawyers with vast experience who would be able to attend board meetings regularly and share their inputs on the subject matter at hand by bringing their professional knowledge and experience.
ii. Based on the industry sector in which the company operates, the NRC may look to appoint retired bureaucrats and government officials who could guide the Board in dealing with the government and regulatory bodies, especially in heavily regulated sectors such as oil and gas, pharmaceuticals, and power, thereby enhancing the effectiveness of management.
iii. Bringing in people with varied geographical exposure, having worked in different parts of the world would bring in a wealth of knowledge and experience given the increasing number of Indian companies operating overseas, thereby acquiring a global outlook for its management.
iv. The NRC must also look to include individuals whose expertise and experience would be required regardless of the sector in which the company operates. Examples of this would be to appoint members who have vast experience in the field of marketing, to guide the Board in areas such as brand positioning of the company. This would also help companies in identifying target markets and businesses in which the company can expand and to assist the Board in handling crises in public relations, something that is extremely critical, especially in the fast-paced world of social media which can make or break the reputation of a Company in seconds.
v. Another example would be professionals from the field of finance and information technology. Finance professionals would be of great help in assisting the Board in finding sources to raise funds and provide general inputs in matters of allocation of capital and revenue management. With the advent of digitization, it would be very beneficial to have the presence of an IT professional on the Board to assist in ensuring optimum utilization of technology by the Company to not just enhance efficiency and streamline systems and processes but to also identify new technologies that can keep the business ahead of the competition.
vi. Lastly, appointing someone from the social sector such as an NGO or any other part of the development sector would be an added advantage to the Board. This would be particularly useful in assisting the Board frame the company's CSR-related activities and engage with the community and help identify ESG risks and strategies.

By having a framework and identifying a wider pool based on which potential talent can be selected, companies would gradually be able to do away with the current standard practices of appointing Directors simply on their nomination by the promoter group. This would go a long way to further democratize listed companies and enhance the confidence of the shareholders and dispel doubts about any nepotism.

Role of Women Directors and their importance

Before the introduction of Section 149 of the Companies Act, 2013 and Rule 3 of the Companies (Appointment and Qualifications of Directors) Rules, 2014 mandating the appointment of women on the Board of a company, Boards often comprised of only men, often closely acquainted with one another which in many cases resulted in a saturation of ideas. However, the enactment of the above regulations has proved to be a game-changer with companies now required to appoint women directors on their Boards failing which they would be liable to heavy penalties under the Companies Act.

Of late, we have seen various major corporations in the country and across the globe having woman leaders at the helm and in key managerial positions which have often resulted in those firms having a stellar financial performance and doing phenomenally well. Various studies and surveys have shown that companies with women directors tend to fare much better, justifying the provision in the Companies Act and Rules mandating their appointment to the Boards of certain categories of companies.

Conclusion

In today's ever evolving and increasing globalized world, having a diverse boardroom comprising a variety of skill sets, ethnicities, both geographical and cultural, as well as professional experiences gives a whole new dimension to the way business is conducted. It brings in an array of ideas from people of different backgrounds which helps the Board take decisions by viewing each issue from various perspectives thereby making an informed choice. This would enable better performance of the Company as professionals identified through a streamlined process would be motivated to provide their best, objective inputs, without any prejudice or bias. Therefore, diversity in the Board certainly has a positive impact on the performance of the Company and it is important that all stakeholders should ensure that companies have diverse boards.

Authors

Kalpana Unadkat (Partner) and Jaidev Mehrotra (Trainee Solicitor) are lawyers with Corporate and M&A practice at Khaitan & Co. The contents of this document do not necessarily reflect the view of Khaitan & Co but remain solely of the authors.