

# Preparation by an Independent Director for Board Contribution including on Business Model

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# Regulatory Expectations

# Role of the Board of Directors

- Regulation 4 (2) (f) (ii) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR) -Key Functions of the Board of Directors – Some Items relevant
  - Reviewing and guiding
    - corporate strategy
    - major plans of action
    - risk policy
    - annual budgets; and
    - business plans
  - setting performance objectives
  - overseeing major capital expenditures, acquisitions and divestments.
  - Selecting, compensating, monitoring key managerial personnel and overseeing succession planning
  - Ensuring diversity of thought, experience, knowledge, perspective and gender in the board of directors
  - set a corporate culture and the values
  - shall act on a fully informed basis
  - ability to ‘step back’ to assist executive management by challenging the assumptions underlying: strategy, strategic initiatives (such as acquisitions), risk appetite, exposures and the key areas

# Independent Directors

- Regulation 25 (7) of LODR
  - The listed entity shall familiarise the independent directors through various programmes about the listed entity, including the following:
    - nature of the industry in which the listed entity operates;
    - business model of the listed entity;
    - roles, rights, responsibilities of independent directors; and
    - any other relevant information.

*Sum and Substance*

*Role of Board and thereby Directors is not only to police*

*[Policing is an important function but not the only one]*

*Shadows of Satyam, Altico, Firestar, Yes Bank and now IL&FS*

Pre-Acceptance

# Pre-acceptance – Management Evaluation

- Evaluation of the Management
  - Transparency – Past Board Agenda, time taken,
  - Receptiveness to the Suggestions
    - Especially family owned company with absolute majority to the promoter group who are also in management
  - Other companies in the group
  - Outlook towards the shareholders
  - Cohesiveness = Promoters - Management
  - Professionalism – Delegation of Authority
  - Co-directors – diversity, stature, effective independence
  - Nomination Process for new directors

# Pre-acceptance – Company Evaluation

- Evaluation of the Company
  - Industry Segment
    - comfort with the Segment
    - Benchmarking the Company with peers – where do they stand and explanations
    - Sources of information, Reference Points,
  - Borrowings and other ratios [Inventory, Creditors, Receivables, Cash, etc.]
  - Market Information / inputs
  - Management Team – All leadership positions
  - Control Environment
    - Auditors (Statutory and Internal) including effective rotation
    - Compliance Culture [EHS and Statutory]



# Why DD before Acceptance

- Carry out proper due diligence before acceptance
  - Leaving mid-way your term or not seeking re-appointment when eligible sends very wrong signal, unless for very cogent reasons
  - It can also have reputational risk to yourself and can affect your candidature in other companies
- It would be wise to do the selection carefully
  - Responsibility would far outweigh the remuneration
  - It is important that you make a positive contribution to the board
  - The time spent should be most effectively utilised
  - Should not be looked upon by the board as a burden or a necessary evil
- Evaluating your ability to contribute is most essential and for that purpose making due enquiries before the acceptance is most importance
  - A generalist like CA can have a wider choice but still there are some sectors where you may not have any knowledge like infra-structure, IT, Pharma research, etc.

On acceptance

# Induction Process

- Insist on a formal induction process
- The induction process must include the following:
  - Visit to their operational sites (if more than 1 then at least 1)
    - This would give an idea of their general work culture, safety norms, adherence to environmental awareness, etc.
    - A chance to meet the operational team
  - Discussion and presentation on the business by the CEO
    - If more than one business segments then head of each of the segments
    - To understand their businesses and what are their plans / vision for the future
    - Manufacturing process
      - major raw-materials, their availability, resources constraints
      - Environmental norms applicable and method of dealing with the same
      - Process improvement carried out
      - Research and Development (if not covered separately)
    - Major customers, industrial segments served, application areas, etc.
    - Who are the peers, competitors and challenges likely to arise in future

# Induction

- Discussion with the CFO
  - Accounting Practices and policies
  - Control environment
  - Compliance assurance process
  - Peer comparison with the peers and reasons for deviations
  - Pain Points
- Similar discussions with CM(arketing)O, CI(nformation)O, CP(eople)O, etc.
  - To understand their respective organisation structure, future plans, their business practices (like marketing network, employee recruitment, retention policies, accounting system, policies, etc.)
- Ensure that you have exchanged contact details of each person you have met in induction
- Spend good time for understanding the business
  - It is not possible to understand the whole business in one go but a good start goes long
  - It effectively sends signals that you are serious in knowing the business and also puts you in touch with several internal data points
  - You create your own network within

# Induction Process

- At the end of the induction process, you must have a mental picture (and if necessary a chart)
  - Organisational structure
  - Major Products, their processes, manufacturing locations, capacities, expansion plans, raw-materials, constraints, etc.
  - Marketing Organisation and sales policies including pricing methodology
  - Peers, Competitors, USPs, etc.
  - Financial Parameters (especially specific focus areas)
- Create your data points – Internal as well as external
  - Always useful to have interactions between the meetings
  - When you are visiting a place, if there is a set up, to make a meeting request there to the local operational staff
  - Areas that you should track regularly (like prices of some raw-material, Government spend on that sector, etc.)
- Fix your order of priorities for contributing to the Company and identify the star performers (products, people, processes, etc.)

Board / Committee Meetings

# Agenda Documents

- Insist on detailed agenda together with background note
  - Especially on the items on which decision is sought especially capex decisions, business plan, annual budgets, senior level appointments, etc.
  - If you need any further information on an agenda item, write and call for that information.
  - Due to confidentiality, it may not be possible to share all the information in advance
- Read the Agenda documents carefully and try to understand
- Carry out your own analysis
- Do the benchmark analysis yourself by reference to your data points
- Make your notes for the discussion
- See the items of discussion in the earlier meetings from your notes and see whether the points of implementation have been reported
  - Action **to be** taken and Action **Taken** Reports should be insisted upon
  - All A to be taken report should be immediately after a meeting and it should have responsible person and the date by which compliance is expected

# Meeting Schedules

- Proper time should be allotted for
  - Audit Committee, NRC, Other Committees and Board
  - Good idea to quickly finish “pure procedural” matters like “taking note”  
*[Saving Grace – Start and End times are to be recorded]*
- Combination of Formal Board and Committee meeting and business presentations
  - Good idea to have presentation of business and functional areas
    - HR Presentation may cover HR / IR Practices, improvements brought about, attrition issues, incentive or retention practices, HRD practices, compliance with laws, etc.
    - Each Plant can give presentation on their performance and plans
- Typically 75 % of the time can be given to formal agenda and 25 % time to the business presentation for each business / process presentation
  - The Business presentation should be made by the respective business / process heads



# Special Agenda – Specific Items

- Major items require special attention
  - Mergers and Acquisition proposals including sale or disposal of a business or unit or substantial parts
  - Major expansion plans
  - Restructuring proposals (legal or business)
  - Annual Business Plans approval
- If possible, insist on a separate meeting to consider these items such that enough time is devoted for the same
  - Understand fully the proposals
  - Carry out your own research
  - Ensure that the company is advised by credible advisors
  - Verify the process followed
  - Examine the management “interest” in the same
  - See the pre and post scenario
  - Risk Assessment and mitigation strategy including possible “Plan Bs

# Preparing for the Meeting

- Do not accept a board appointment if you are unable to devote enough time
  - It is precarious to get into a board without spending enough time on various matters
  - It is also doing injustice to the shareholders
  - You would become a show piece
- Agenda documents
  - Read the agenda carefully beforehand
    - Looks to be too basic but admittedly quite a few IDs read the agenda papers in the flight for the meeting
  - Touch your data points
    - Persons (internal and external), databases (stock exchange, published research reports, Government documents (RBI), Google)
    - Last minutes, action to be taken reports, your notes in last meetings, etc.
    - Benchmark the data with information provided
  - Make your notes, agenda point wise
  - If necessary, discuss with other independent directors

# Conduct in the Meeting

# In the Meeting

- Remember that the Meeting is for contribution by you and not for showing knowledge
  - At times the discussion veers from the issues which are relevant to the issues which an ID knows
  - This takes away time from the meaningful discussion
- Do not be under any pressure for finding answers. This is not your job. Your job is to “ask questions” constructively
  - Asking questions for confirming whether these issues are covered or not?
  - Example – Capex Decision for expansion – How the demand forecast is done? How capital cost is determined? How the raw-material is assured? What is the planning for recruiting the people?
  - To ensure that there are no loose ends
- A fish cannot see the water around it.. Your job is to be outside the “aquarium” and guide the management.
  - The moment you find that you have started thinking like a management it could be a time to quit;
  - It is not only perils / risks that you need to point out but you can throw in your experience of doing the things more efficiently – Example – Uber for Services

# Difference between Operational Vs Strategic

- Role of the Board is primarily strategic
  - It would not be appropriate to go deeper into operational areas
  - The focus should be on process followed for operational decisions
  - Whether there is a policy for risk mitigation and risk consideration at the time of decision making
  - Whether the persons entrusted with the decision are capable of taking such decisions
- Operational items should be left to the executive management
  - The management team should feel enabled and not constrained
  - In fact the IDs are not (and should not be) capable of going into operational items
  - Example – You may suggest that the Company should have Remuneration benchmarking or broad policy of linking KPIs with remuneration and increments but should not go into the aspect of what should be KPIs or increments of individual employees (except KMPs)
  - Avoidable discussion example – Airline Mileages utilisation policy

# Annual Budgets / Business Plan

# Business Plan / Annual Budgets

- This is one of the most important item on the agenda
- Maximum time should be given to the same
- Responsibility of the BP / AOP / AB should be exclusively on the management and role of ID should be only to review and question the same
- It is not uncommon to have Excel Sheet Budgets / Business Plan
  - Last Year performance plus 5 % or 10 % and the plan is ready with some modification
    - Entire discussion focuses on 5 % / 10 % and other deviations, if any
- The first few fundamental questions on any Business Plan or Annual Budget would be to check the following:
  - What is the process of making it? Top – Down Vs. Bottom Up, Time taken for the budget, involvement of persons / agencies, advisors in the same, etc.
  - Whether there is a total buy in for the Budget or Plan
  - Measures taken for ensuring its adherence
    - Spreading the planned goals to people on the basis of expectation from them
    - Linking incentives, KPIs with the budgets

# Reviewing the Business Plan / AOP

- Questioning each of the items about its basis
  - Revenue Projections –
    - Whether on account of volume or price?
    - If price increase, what is the market research carried out?
    - If Volume, whether capacity, whether it is general growth in the industry or gaining market share from competition, if so, what is the external data or strategy they relied upon
    - How linked to KPIs of various people? Targets Vs. Budget analysis
    - Whether the RM, People, Services, Approvals, tied up?
  - Raw-material cost projections
    - Whether deviation expected from the past? If yes, then what is the basis, if not then why no? No deviation need not be the satisfactory answer
    - Availability
  - Overhead / Working Capital / Cash Flow / Capex, etc.
  - Ratios (liquidity, leverage, margins, returns)
- Benchmarking with the external data (of competition / peers, economic indicators) and internal data (past results and strike rate with the projections)



# Reviewing Business Plan / AOP

- Evaluation of the Risks
  - Most important, business continuity risk if there is a failure, especially for expansion -  
*Example : If an expansion, need to see the debt servicing in absence of the cash flows from the new project fails*
  - Risks related to approvals / permissions, availability of RM, EHS, competition
- Significant expansion – Management Bandwidth evaluation
  - Continuity of the people
  - Tying up of employee incentive (like continuity bonus) for the period upto which the project is on its own feet
- Sensitivity analysis on all variable parameters including delays
- Quality of external agencies sought to be engaged
  - Toss up between internal resources Vs. external agencies
  - Third party view may be important even in existing line of business

# Before parting...

- It is important to remember that independence should not only be of financial but should be of thought processes
  - You should be capable of giving your inputs independent of that of the management
- While it is important to be participative in the process with the management and supportive of the management's efforts in enhancing the shareholder value – the primary function continues to be of being a proper check on the operating management
- Selection of the family owned company to be part of is very important and unless the management is receptive to the suggestions and questioning do not become member of the Board
- Increasing trend of having IDs in private companies (joint ventures or partnership between groups) or in family boards

Thankyou