

Independent Director Recruitment: The New Challenge



Much has been written in recent months about the pressures on Boards of Directors, and the increasing level of accountability for their actions. Media, institutional investors, and government regulations have all created demands for compliance with corporate governance requirements, many of which are relatively new. These external bodies are demanding ever-increasing levels of transparency into the workings of the company, and failure to provide same can ultimately affect the company's ability to attract investors. As a result, many Boards and Board Chairmen are now grappling with the challenge of attracting a new breed of Independent Directors to help strengthen both performance of the company and that of the Board itself.

Traditionally, non-management directors were often known as Non-Executive Directors, or NEDs. In Singapore, many companies have long

been nurtured through the attention of directors whose interests aligned with those of the founders or senior executives. Interlocking directorships have been common, creating an environment of high trust. However, NEDs could be persons who were former officers of the company or who had close business alliances with the company or the Chairman, and thus often did not have the degree of independence which is being demanded of Directors today. This shift toward requiring greater independence from non-executive directors has created challenges for many publicly-listed companies whose leaders have previously relied upon persons close to them to act as directors.

The Impact of Corporate Governance Requirements

It is well-known and substantially documented that corporate governance, delivered primarily through

the oversight of the board, has become considerably more stringent in recent years. As a result, boards must now answer to shareholders directly and occasionally in courts of law, when shareholders do not approve of their actions. This has very significant implications for board member selection, and the sitting board should use every vacancy opportunistically. By focusing their member recruitment, the board can strengthen itself by regularly and consistently adding skills and capabilities to its membership.

One precipitating factor driving the move toward Independent Directors was the passage of the Sarbanes-Oxley (SOX) act in the United States. The level of scrutiny and transparency required by SOX has been emulated by companies listed on non-US exchanges as well, as these companies want to ensure that they are able to continue attracting foreign institutional investors - and

these investors look closely at board composition and board practices. In addition, the Singapore Code of Corporate Governance requires that the committee chairs of the Nominating, Audit, and Compensation Committees must be independent directors, and that at least one-third of the board be composed of independent directors.

However, the push for greater independence on the part of external directors can and should be used to the company's advantage. By expanding the pool of potential directors to non-traditional sources, the board (and the company) will gain access to individuals who can be recruited to for their ability to support the Company's strategic direction. The first question that the Chairman and the Nominating Committee should therefore ask themselves when a new board member is to be appointed is: "How will this person lend value to and support

the company's strategy?" By carefully considering the existing gaps in the board's knowledge and experience (against the stated strategy), the committee can shape the selection criteria each time a new board member is selected.

These new members may bring to the board:

Functional Expertise: Today's independent directors are as likely to be functional experts as they are CEOs. Senior executives from Finance, Human Resources, IT and Marketing are all in demand as directors. Fewer are CEOs: great pressure on CEOs to take fewer directorships, along with factors noted above plus the increasing daily demands made on CEOs make taking directorships less attractive. However, this means that there is a now cadre of "future CEOs" taking directorships, gaining valuable boardroom experience before they cross the threshold to the CEO suite.

Diversity: Many Boards are now striving to ensure that their composition adequately reflects their customer base. For companies that are expanding into overseas markets, it can often be valuable to have a board member who is resident or a native of those markets, who will bring a perspective that could greatly accelerate the company's success.

Customer View: For companies that deal with customers in particular industry segments, it can highly useful to have a board member who has held a senior management position within that industry. However, care should be taken if considering any current customer, in order to avoid the appearance of any conflict of interest. Recently retired executives from current customers, however, may be both acceptable and valuable, provided that their association with their former employer remains at arm's length.



Global Outlook: Companies that are expanding overseas, whether through joint ventures, acquisitions, greenfield sites, or enhanced distribution networks, may benefit greatly from the perspective brought to the board by an executive from an overseas firm with a global footprint. This individual can be particularly valuable if he/she has played an active role in the expansion of his/her firm into markets that are have been targeted by the company.

Emerging Industries/Emerging Market Segments: Companies whose businesses are dependent on industries or market segments that are experiencing rapid change may do well to consider attracting independent directors from these emerging industries or segments. Having the benefit of an expert view may help to shape decisions that could be of great significance in determining the future success of the company. However, it should be understood that such directors should not be major customers of the company, nor should they be expected or allowed to profit from any decisions made by the board.

Institutional Investor View: An institutional investment professional (but one who does not include the company's shares in his or her portfolio) can also lend value to board discussions and decisions. By sharing with the board the interests and concerns of such investors, a direc-

tor from this sector may provide insights into how certain business decisions may be received by the investment community.

Thought Leadership: Some boards are reaching into the academic community, in order to tap the knowledge and thinking of those who have distinguished themselves through research and scholarly thought. Such individuals can pose a constructive challenge to board thinking by suggesting other points of view on current issues. In addition, other academics may be sought for their research into areas directly associated with the company's strategic intent.

Strengthening Committees of the Board

The Compensation Committee now is increasingly expected to provide guidance to the rest of the board regarding the compensation of the Chief Executive Officer. As the committee must be chaired by an independent director, it may be wise for the board to seek a member who is familiar with compensation practices and understands how to balance the need to pay competitively with the need to ensure that pay is adequately linked to performance. In addition, the Compensation Committee will likely also lead the rest of the board through an evaluation of CEO performance. Therefore, this Chair must be completely comfort-

able with the challenge of balancing an understanding of the many constituencies served by the CEO.

The Audit Committee is also required to have an independent director as its Chair. Increasingly, companies are seeking independent directors with CFO or Audit experience to chair this committee. Company financials are being scrutinized by shareholders, investors, analysts and government agencies right down to the footnotes. The chair of this committee therefore has a key fiduciary responsibility to ensure that other board members clearly understand the content of the financials and any risks inherent therein.

The Nominating Committee has assumed responsibility for ensuring that executive director positions, including that of the CEO, are filled with qualified candidates. Nominating and selection processes now more rigorous and formal, but should be transparent. In addition, this committee is increasingly being asked to propose and monitor a process for assessing overall board performance, as well as the performance of each individual member. Additional transparency requirements ask that the process of assessing board performance be disclosed in the annual report. As a result, the appointment of an independent director to the leadership of this committee is extremely important. It is highly recommended that the indi-

vidual appointed as committee chair be an experienced board member.

The Role of Executive Search in Board Selection

Executive search firms, with access to boards, CEOs, and other senior executives, can often be of assistance in the identification and selection process of new board members. Engaging a search firm removes any suggestion of bias in the process, and will likely offer the NomCo and the board a wider choice of candidates for consideration. With the increasing external scrutiny on both process and performance, the benefits of engaging an unbiased third party to assist in identifying candidates may be greater than ever before.

Conclusion

By taking steps toward increasing independence and effectiveness of their boards, companies position themselves for stronger long-term growth and financial performance. Expanding the candidate pool well beyond traditional sources can greatly enhance a company's ability to enrich and expand the capabilities of its board. The benefits for selecting skillfully have never been higher, and will accrue to those companies who invest time and effort in ensuring that their board has the qualities required to meet the challenges ahead. ■