

THE SEARCH FOR INDEPENDENCE

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In a recent forum, the non-executive chairman of a Singapore-listed company spoke about the search for independent directors (IDs). He said that while a search process can expand the pool of ID candidates, it is “still good to know a person so that you have some assurance of the type of character you are dealing with”.

He further remarked that with more than half of businesses in Singapore being owned by a substantial shareholder, it will be “very awkward if an ID’s mind-set is to challenge the management”. “They will see you as a necessary evil because they have to comply with the Code . . . (of corporate governance). The ID needs to prove that he or she can be trusted and is not there as a policeman.”

THE DILEMMA

The chairman succinctly captured the dilemma of substantial shareholders of listed companies.

On the one hand, the pressure is for them to comply with the Code of Corporate Governance which stipulates that: “There should be a strong and independent element on the Board, which is able to exercise objective judgement on corporate affairs independently, in particular, from management and 10 per cent shareholders. No individual or small group of individuals should be allowed to dominate the Board’s decision making.”

The Code has specific guidelines on what makes a director independent. But, in principle, an ID should be one who can make objective judgements without any vested interest, any conflict of interest, or the undue influence of interested parties.

On the other hand, it is human nature to prefer to work with people who generally agree with us, people who share similar backgrounds as us.

That is why we have the current situation where a large number of IDs appointed tend to be friends of, or, at least, personally known to existing board members or management.

ROLE OF INDEPENDENT DIRECTORS

Good corporate governance requires a framework for directors to exercise their fiduciary duties and work with management to deliver long-term and sustainable value for the company.

IDs have a big part to play in that framework. They are valued for the independence in their views and their ability to bring diversity and an outside perspective into the board meetings. They aid in balancing the interests of the shareholders, employees and creditors.

In addition, independent directors also bring with them their expertise, experience and leadership qualities.

In theory, independent directors – chosen well, and given the right support and cooperation – can add significant value to companies.

However, in practice, some of the worst corporate failures have been boards which, on paper, are made up of predominantly IDs. Of Enron's 17 board members, 82 per cent were independents. It had a non-executive chairman and its Audit Committee comprised all IDs. Other major corporate failures such as WorldCom, Tyco, and HIH Insurance all shared similar statistics.

TRULY INDEPENDENT?

The problem may, however, lie in whether the IDs are indeed truly independent. Those who are roped in by friends are likely to place their loyalties with their friends. Those who stayed long enough on the same board can become close buddies with management.

In one listed company that I came across, a director who is identified as an ID and sits on the company's Audit Committee and Remuneration Committee, is the brother-in-law of the company's executive chairman and CEO.

Although technically the Code does not specifically preclude a CEO's brother-in-law from being an ID, the relationship does raise the issue of whether the director is or can be truly independent. The notion of independence should comply with the spirit, not just the letter of the Code.

Independence of judgement, sufficiency of self-esteem and confidence to stand up for an independent point of view, and a firm commitment to serve all shareholders with due diligence and integrity – these are hallmarks or tests of true independence.

However, these characteristics are by no means easy to ascertain. Which is why the next best thing may be to shine the spotlight on the search and nomination process of IDs.

Stronger emphasis should be put on the objectivity and transparency of the search process. There has to be proper due diligence done to match the competencies and capabilities of independent directors with the company's needs.

To cater to this need, the Singapore Institute of Directors (SID) has a Board Appointment Service to help companies find potential candidates for boards. There are more than 1,700 individual directors in SID's membership database alone, making it a lame excuse that there are not enough qualified IDs in Singapore.

On the part of substantial shareholders, they have to get over the mental block that IDs are "policemen". Independent-minded IDs with prerequisite skills, domain knowledge and contacts are a valuable part of the team that can ensure long-term performance, resilience and sustainability of the company. ■