#### THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF KENYA

Board Evaluation: Enhancing Value Creation and Accountability to Stakeholders

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#### **Presentation Outline**

Introduction

Appointment of Board Members

- Good Corporate Governance
- Role of Boards
- Managing Stakeholder Relations
- Board Evaluation

#### Introduction

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Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals.....the aim is to align as nearly as possible the interest of individuals, corporations and society."

Sir Adrian Cadbury Corporate Governance Overview, 1999 World Bank Report

#### **Evaluating CG in Organisations**

Is an ongoing process of reviewing performance of Individual Directors, the Board, the Chairperson and CEO for purposes of determining actions to be undertaken to escalate individual and corporate output.

#### Introduction Contd.

- Effective evaluation of Boards requires an understanding of the purpose of Boards of Directors.
- The owners of companies thus the shareholders will not have time to oversee the operations of their company and therefore appoint a team of competent people or professionals.
- The Board and its directors shall act in the best interest of the company.
- The board has a reflective role with collective authority and decision making as a Board.

#### Introduction

- The history of human development has always been performance evaluation at every stage.
- Most evident of evaluation is done in the school system on regular basis.
- In the case of one society in Kenya, the Maasai people have a way of evaluating if a boy has come of age. This can sometimes be fatal.

### Introduction Contd.

- Board evaluation should be seen from that perspective that it is a necessity of life where ever you are appointed to take care of other people's assets.
- The owners of the asset will always want to know the extent to which to you have looked after the asset and what value addition you have made to that asset.
- Does evaluation of Board work? In state owned enterprises? In Private Companies?

## **Appointment of Board Members**

- The law prescribes the membership of Boards especially in state owned enterprises. In the case of Zambia examples may include ZESCO, Zamtel, Zambia Revenue Authority, NAPSA, etc. ESCO in South Africa
- Provided in the articles of Association particularly in private companies, or shareholders agreement,
- In either case, it is important that the Board is properly balanced in terms of skills mix and experience.
- Trophy board members? Common?

### **Good Corporate Governance**

#### **King III Board Principles on governance**

1. Leadership – good governance is essentially about effective leadership.

With leadership, there should clear definition of strategy, provision of direction, and established ethics and values that will influence and guide practice and behaviour.

### **Good Corporate Governance**

#### King III Broad Principles Contd.

2. **Sustainability** – this is a moral and economic imperative for the  $21^{st}$  Century and the most important source of opportunities and risks for businesses.

- Nature, society and business are interlinked in many complex ways.
- This requires a radical paradigm shift in the way public affairs are managed.

#### Good Corporate Governance Contd.

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#### King III Broad Principles Contd.

- 5. Innovation, Fairness and Collaboration key aspects in transition to sustainability.
- Innovation provides new ways of doing things including profitable responses to sustainability.
- Fairness is vital because social injustice is unsustainable and collaboration is a prerequisite to any large scale change.

### Corporate Governance Contd.

#### King III Broad Principles Contd.

4. **Sustainability and Social Transformation** – leads to greater opportunities, efficiencies and benefits for bot the company and society.

5. **Sustainability Reporting** – meant to respond to concerns of civil society on the intentions of big business and the concerns of business decision makers that sustainability may not be achieved in the most effective way. Raising the CSR matters.

### **Role of Board Members**

#### **Duty of Individual Directors**

- Has a duty to exercise a degree of care, skill and due diligence that would be exercised by diligent person
- Has a fiduciary duty to act in good faith and in a manner that the director reasonably believes to be in the best interests of the company.
- The board and its Directors should manage conflicts of interest thus personal interests of directors should not take precedence over those of the company.

- Boards should act as the local point for corporate governance. The Board should have governance Charter to set out the responsibilities for all players in the governance of the entity,
- The board should exercise leadership, enterprise, integrity and judgment in directing the company so as to achieve continuing survival and prosperity of the company.
- Ensure that the company acts and is seen to be a responsible citizen.
- □ Adam Smith's Economic Model about CSR.

Cultivate and promote an ethical corporate culture – promote ethical conduct and set values to which the company will adhere. The Board and management should ensure that integrity permeates all aspects of the company thus through its vision, mission with sound objectives

The Board should not be mere recipients of strategy but appreciate that strategy, risk, performance and sustainability are inseparable.

- The Board should consider sustainability as a business opportunity: primary reason for the existence of the company is to create value in terms of the triple bottom line – social, economic and environmental performance.
- Sustainable business practices require that the needs of the present are met without compromising the ability of the future generations to meet their needs.

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- Appoint the CEO and establish a framework for the delegation of authority.
- Board should also have an input in the appointment of other top management staff such as the CFO, COO and put in place a succession plan.
- Delegate without abdicating its duties and responsibilities

- Responsible for the process of risk management set the risk appetite or tolerance levels for the company based on its strategy taking into account its sustainability, ethics and risk compliance.
- Ensure that there is an effective risk based internal audit. Ensure that the internal control procedure provides reliable, valid and timely information and report on the effectiveness of internal financial controls.

- Ensure that the company makes a full and timely disclosure of material matters concerning the company.
  - Ensure that there is transparent and relevant communication with stakeholders
  - The integrated report is an important mechanism for formal contact with stakeholders.

- Ensure that the company implements an effective regulatory and legal compliance framework and effective processes.
- Directors should be familiar with all regulatory and legal environment of the company.

- Take account of legitimate interests of stakeholders in its decisions.
- Identify legitimate stakeholder and not individuals but groups – shareholders, creditors, lenders, suppliers, customers, regulators, employees, the media, analysts, auditors and potential investors relevant to the company's long term sustainability.

- The Board should proactively manage the relationships with stakeholders. Develop strategies and suitable policies of how to manage its relations with those stakeholder groups.
- Strive to achieve the correct balance between the various stakeholders groups in order to advance the interests of the company.

- Promote mutual respect between the company and stakeholders.
- The stakeholder policy should always recognise government as a stakeholder and address particular company duties to comply with the law
- □ See itself as a stakeholder in government.

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- Government Stakeholder Policy should among others:
- Guide directors, officers and employees in their interaction with government, politicians and civil servants;
- Set out principles on such matters as financial contributions to political parties or apolitical therefore no donations
- Not participating in an activity that may corrupt a civil servant or corruptly undermine any government functions.

- Board Evaluation is basis for renewal of appointment or removal from the board.
- Effective boards will be responsible for two critical functions namely strategy development and CEO succession Planning
- Effective board will adopt the policy of "nose in and hands out" to allow management carry out their roles and the Board plays its oversight roles.
- Board evaluation should be against their key roles.

- Cadbury Report 1992 recommends an annual assessment of Board's performance as a best practice in governance now part of the UK Code
- OECD notes that regular evaluation of the board's performance is one of the key responsibilities of the Board.
- NYSE, King III require that all listed companies conduct an annual assessment of the performance of Board and its committees

- The TSX in Canada, the Dey Report 1994 recommended that boards should conduct an annual self assessment.
- TSX Guidelines recommends Board and Individual Director self-assessment,
- In many jurisdictions, there is no prescribed format for conducting the assessment.
- Assessments are not filed anywhere for future reference.
- Board Evaluation can be a waste of time if not properly conducted

- Many evaluations are not effective
- In an assessment carried out by the NACD, who rated board effectiveness in private (329 directors) and public (703) corporate boards found the following:
- □ Highly Effective Private (9.3%) Public (15.6%)
- $\square$  Effective Priv. (25.4%) and Public (42.1%)
- □ Somewhat Effective Priv. (36.9%) Public (33.9%)
- □ Ineffective Priv. ( 28.4%) and (8.4%)

#### Who conducts the evaluation?

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- The Company secretary is a useful tool in guiding the Board Chairperson or the Chair of the Nominating/ Governance Committee on best practices.
- Avoid closed ended questions for director's response.
- An Independent Consultant carries out the evaluation?

#### Methodology

Clearly set out the objectives for Board evaluation.

- Is it purely for compliance with Kenya Stock Exchange/Luse or for best practice? Choose a survey method.
- Is it to enhance board performance? Invest in an interview process with an experienced third party include management comment or feedback.
- For maximum impact but with minimum budget use survey supplemented with focus group discussion.
- Survey will use a Scale of 1- 5 with 1 = strongly disagree and 5 = strongly agree

#### Who conducts the assessment?

- Self assessment individual Directors and the Board
- Chairperson of the Board, or Chair Nominating Committee or Board Secretary;
- □ Focus groups

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Consider feedback from the senior Executives and review the minutes

#### **Purpose of Feed Back**

- Analyse the emerging themes
- Identify strengths and weaknesses of the Board
- Strengths are areas for potential improvement
- Discuss not more than five areas of improvement
- Develop strategies around areas of potential improvement to effectively address
- Create action plans a road map for the board to use in the next 12 months for possible improvement.
- No issues in the board evaluation red flag

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- Best Directors who add value play two distinct watchdog roles Building Better Boards, Jossey – Boss 2006:
- Focus on corporate oversight: Approval of management's decisions and actions, challenges management's assumptions, raises challenging and sometimes difficult issues;
- Sounding Board role: Focus on partnering with management to benefit the company, provide advice, counsel, guidance and mentoring to the CEO and senior management, facilitates creation of networks.

### Conclusion

- The Board should focus on the key success factors or KPI for the business namely strategy development and demanding for performance from management.
- Board evaluation is important for continuous improvement of boards and corporations.
- If Boards do not know how they are performance, improvements can only be a pipe dream and become involved in management roles.
- Despite its importance, Board evaluation is still not very common in many board

### Conclusion

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- Many CFOs play the role of Company Secretaries.
- CFOs are the most trusted among the members of the management team.
- CFOs can therefore play an important role in promoting good governance in organisation and encourage board members to undertake board evaluations/assessments.