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Corporate Governance: The role of independent directors

Singapore Management University

CORPORATE GOVERNANCE: THE ROLE OF INDEPENDENT DIRECTORS

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Companies in Singapore may now have to spend more time and resources to look for independent directors for their firms after the recent revised Corporate Governance Code, but the efforts will be worth it, said Jeremy Goh, associate professor of finance at SMU at a panel discussion during the 3rd Singapore Corporate Governance Week.

The event was organised by the Securities Investors Association of Singapore and Sim Kee Boon Institute for Financial Economics to discuss the challenges faced by listed companies with the latest revisions of the Corporate Governance Code.

Goh noted that independent directors offer their expertise to a company to provide strategic advice and monitor business performance. Research has quantified the importance of independent directors to a firm. It has been shown that stock prices of a company fall by 0.85 percent for a four-day period after the announcement of the death of an independent director, he said.

The Singapore Code of Corporate Governance was first introduced in 2001 and a revision to the code was made in 2005. In May 2012, the Monetary Authority of Singapore issued a new round of changes to the code which took effect in November.

One of the key areas of change was on independence and the composition of the board. Around 40 percent of companies in Singapore will have to appoint more independent directors or change their board composition to comply with the Revised Code of Corporate Governance, which takes effect on November 1.

Looking for the independent director

Associate Professor of Law at SMU Wan Wai Yee, who was speaking at the conference, estimated that there will be at least a 25 percent increase in demand for independent directors. Coupled with the liabilities and reputation risks involved with the job, there will continue to be challenges recruiting independent directors with the required expertise, she said.

However, Annabelle Yip, joint head of the corporate governance and compliance practice division at WongPartnership feels that the perception of a shortage of independent directors is “self-fulfilling”.

The current board selection process is limiting the pool of candidates and a more structured board selection process will be able to feel the business need, she said.

Companies should identify the needs of the board and look for candidates with the qualities to fill that gap, suggested Yip.

Immediate past president of the Institute of Internal Auditors Singapore, Loh Uantchern, proposed for civil society to “flush out” talented people to serve on the boards.

He said: “Training is one avenue to get professional independent directors. The other thing that we need more is participation from a civil society that promulgates best practices…I think more research is needed to showcase case studies of best practices. And if you are a family-owned company and see best practices, why wouldn’t you want to follow?”

Non-executive chairman of Baker Technology Lim Ho Seng felt that if a company has a good board, the directors will have the contacts to select good people to complement the skills of the board. While conducting a search for an independent director can expand the pool of candidates, it is still “good to ‘know’ somebody that you have contacted before so that you have some assurance” of the person, he said.

The role of independent directors

And when a company appoints an independent director, what should be the role of the director?

Lim said that independent directors should join a company with a mind-set of helping the company and to be a sounding board as even good entrepreneurs do not know everything.

With 70 to 80 percent of businesses in Singapore being family-owned, it will be a “very awkward situation” if the independent director’s mindset is to challenge the management.

He said: “They will see you as a necessary evil because they have to comply with the code…You need to prove that you can be trusted and that you are not a policeman.”

Given the liabilities and reputation risks associated with the job, what kind of incentives should be given to independent directors to encourage them to fulfil their duties, asked a member of the audience.

Goh said the paradigm that people will not work until they can cover their costs does not work here. He feels that there may be a group of people who want to serve but do not have the opportunity to, and suggested a clearing house be used to meet the need of companies.

Lim suggested that a “fair remuneration”, in terms of cash or shares, be paid to the independent director. “But we must not do it to the extent that we attach it to the performance of the company, as it means they will be more aligned to management.”

While there has been a lot of attention being paid to the issues of independence, it is not the only cornerstone of good corporate governance, reminded Wan.

“When you are considering various corporate governance initiatives, one must be mindful that the purpose of corporate governance is a means to an end, rather than the end itself…the goal of corporate governance is to put in place a framework for boards or directors to exercise their oversight role, promote integrity within the company and work with management to deliver long term and sustainable value for the company.”