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Synthesis

The Fundamentals of Corporate Governance

Corporate directors exchange on how governance can build an effective organization

On April 28, 2022 Egon Zehnder held "The Fundamentals of Corporate Governance," a discussion exploring the changing landscape of corporate governance for board directors of India's top public sector banks. Two speakers—Shailesh Haribhakti and O P Bhatt, both veterans of multiple company boards—outlined their thoughts on what makes an effective board director, and how that role has evolved as new technologies, responsibilities, and world events shape companies' relationship to their shareholders and the wider stakeholder community.

What Makes a Great Board Director?

The goals and strengths of a board director are very different than those of executives. Yet this distinction is complicated by the fact that executives often transition into board directors, and must adapt to a new environment and skillset to thrive.

"Who is the person who becomes a director?" asked O P Bhatt. "They may have been CEOs. They would be well known, well respected. They're professional. They're distinguished in many ways. They know how to get things done. They know that when they say something, it means something and it gets addressed." However, Bhatt cautioned, this is not how it works in the boardroom, and the ensuing culture clash can create turbulence across the company. "If you are not able to move from where you are, if you are not able to mentally, emotionally, and psychologically transit from your earlier role mindset to the new role mindset, you will not be able to do justice to it," he said.

When asked about the elements of good corporate governance, Shailesh Haribhakti said "purpose" is the key word: "The purpose of engagement of contribution, of bringing in moral capital of the highest order, of being able to express freely and fully what he or she believes in, of being on purpose in terms of being clear in taking decisions in conveying decisions, in making sure that it should not be clouded by how somebody will think about it." He stressed the need for board directors to approach their role with honesty and transparency, and objectively question business decisions to provide optimal feedback.

Bhatt echoed these sentiments, and specifically called out independent board directors as a company's "guiding force." "The word independent means independent of every conflict," said Bhatt. "The word independent means independent of every interest, vested or otherwise. The word independent means that this person is completely loyal to this company and to this board in every which way…The independent director is the most important person on the board."

Above all, the speakers agreed, board directors must be stewards of their organization, and utilize their power and oversight to ensure the sustainability of their business and all who depend on it. "There are so many people whose lives are dependent on a company," said Haribhakti. "We must stretch every muscle to make sure that you can give as much as you possibly can to maintain the sustainability of the organization, keep it as an entity that will prosper over generations. Because that's the whole purpose."

Evaluating Risk as a Bank Board Director

In speaking to an audience of bank board directors, O P Bhatt highlighted important ways the role is distinct from board directors of non-bank organizations. While at a basic level, the tenets of good corporate governance are the same across both, Bhatt explained that evaluating risk is a vital difference.

"Banks, by the nature of their business, have the ability to take on risk very quickly," he said. "It could come in investments, it could come via Treasury, it could come because there are certain technically complex changes that are taking place, and therefore many of these signals whether risk is increasing or not can be picked up only by specialists. How much specialization is there on the board of a bank to be able to pick up signals with regard to risk and which direction it is going, whether it is increasing, whether it is within the appetite of the bank, whether they will be able to deal with that?"

If such decision-making on risk goes wrong, it could have a domino effect on other institutions, other banks, and even the entire economy. "If you are aware of this, then you will think and speak differently," said Bhatt. "If you are aware of this, then you will keep up to date on everything relevant on your bank, on your bank boards, or other things that are interconnected."

Another key consideration for bank board directors is the depositor—the source of the vast majority of a bank's funds, yet one who is regularly "completely neglected" in the board, according to Bhatt. "Who is there to watch his interest? They watch the interests of the shareholders. They'll watch the interests of the regulators. They'll watch the interests of other people. But nobody is watching the interests of the depositor." Bhatt implored board directors to assess risk and strategy so as not to compromise depositors' interests, despite the lack of official representation. These concerns speak directly to an emerging form of "conscious" or "stakeholder" capitalism, the importance of which was stressed by the event's two speakers.

'Conscious Capitalism' and Ensuring that Organizational Change Happens

Recently, a wave of recognition has swept over many corporations that underscores the need to develop a broader, more inclusive form of capitalism that delivers value beyond just shareholders. This "stakeholder" or "conscious" capitalism is particularly relevant for boardrooms and company directors, who can exert influence over such long-range corporate directions.

Related to stakeholder capitalism are the "ESG" criteria, which stands for Environmental, Social, and Governance. This is a set of standards for socially conscious investors to evaluate companies based on their commitments to issues such as environmentalism, diversity, and transparency.

To meet these standards and achieve a more inclusive form of capitalism, however, businesses and boards need to take targeted and measurable actions. Shailesh Haribhakti described how board directors need to change their mindset to fit these standards and lead companies toward a path of accountability through independent external evaluation.

"We said let's take actual targets year by year as to what will be our percentage of diversity," Haribhakti said when recounting actions to address diversity and the "social" aspect of ESG. "So, where it is X today, how much time will it take us to get to, let's say, 3X to be close to where it should be, which is in terms of simply gender diversity, a ratio of 50:50. Now, if that is the way that you can create the impulse to make the change, then things will work out. Systems, processes, policies, SOPs, orientation, actions. All of that will play out to help you to reach but it is critical to monitor whether you are reaching that goal on an ongoing basis."

O P Bhatt spoke more on the difference between talking about ESG goals and actually achieving them. Instead of just "glossy brochures" and "hype," Bhatt said that metrics and measurements are needed to make sure there is substance behind the pledges.

Board Directors Must Always Be Ready to Learn

The decisions that board directors make touch virtually everything in their organization, and in order to ensure they are making the right decisions each time, they need to know what they don't know. In other words, board directors must perpetually keep learning—about new technologies, emerging ideas, and the minute facets of the organization they help manage.

"The most important thing for a director is continuing learning, continuing education," said O P Bhatt. "And this is one of the things which is my ask from all the boards that I am on."

Bhatt gave the example of a car company that he sits on the board of. “Now I cannot look at cars the way I used to look at them before,” he said, explaining that he continuously analyzes cars’ costs, technologies, even their shape. He then uses this data in board meetings.

“Are directors this sensitive to the company that they serve that this happens?” Bhatt proposed. “When I read an article or a newspaper report which is about cars, I look at it differently than the way I used to look at it before. Something has changed… not only has it changed intellectually, it has changed my values. It has changed my attitude. It has changed so much.”

Board directors’ work is not just confined to the handful of hours they spend in meetings, Bhatt concluded. “Their work is 24 hours a day,” he said. “Unless you have that insight, and unless we have the commitment, unless you’re willing to go that way, you will not be able to do justice to your role as a director.”

For more information, contact:

Rahul Rana
New Delhi
rahul.r.rana@egonzehnder.com

Namrita Jhangiani
Mumbai
namrita.jhangiani@egonzehnder.com

Vineet Hemrajani
Mumbai
vineet.hemrajani@egonzehnder.com

Darpan Kalra
New Delhi
darpan.kalra@egonzehnder.com

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