Board leadership

MCCG Intended Outcome 1.0

Every company is headed by a board, which assumes responsibility for the company's leadership and is collectively responsible for meeting the objectives and goals of the company.

MCCG Practice 1.1
The board should set the company's strategic aims, ensure that the necessary resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards, and ensure that its obligations to its shareholders and other stakeholders are understood and met.

The internalisation and application of the content "Why" and "How" should be read in tandem with the line of sight outlined by the Intended Outcome.

Why — The case for change

The board is the apex governing body of a company that is responsible for leading the company and ensuring that the interests of shareholders and stakeholders alike are protected whilst enabling the company to achieve long-term sustainability. For a company to be well governed and managed, it is paramount for the board to consist of capable, dedicated, ethical and dynamic directors.

Directors appointed to the board play an integral role by undertaking to oversee and manage the strategies and matters of the board. A McKinsey survey covering approximately 1,600 directors globally yielded surprising results in this regard – one of which is that only 21% of directors claimed to have complete understanding of the strategy of their company[1]. Strikingly, about a quarter of directors have only a limited understanding (or none at all) of their company's strategy. This certainly makes for a sobering reading.

What could go wrong:

- Implementation of poor strategies and policies that do not align with the objectives of the company.
- Management does not follow the direction of the board.
- The company is unable to address the challenges it faces.
- Company is unable to respond to the dynamic nature of the business circumstances.
- Inadequate focus on strategies in the meetings.
- Too much emphasis on short-term financial performance measures.
- Environmental, economic and social ("EES") aspects of sustainability are not embedded in the strategy and operations of the company.

[1] Bhagat, C et al 2013, *Tapping the strategic potential of boards,* McKinsey

How The practice in substance

Practice 1.1 of MCCG calls upon the board to set the company's strategic aims and ensure that the necessary resources are in place for the company to meet its objectives and review management performance. **Practice 1.1 of MCCG** also calls the board to set the company's values and standards, and ensure that its obligations to its shareholders and other stakeholders are understood and met.

Guidance to Practice 1.1 of MCCG further outlines the factors that would enable a board to discharge its responsibilities. All directors should objectively discharge their duties and responsibilities at all times as fiduciaries in the interests of the company. Every director is required to keep abreast of his responsibilities as a director and of the conduct, business activities and development of the company.

Key considerations relating to the application of this Practice are discussed below:

What are the key responsibilities of the board?

Guidance to Practice 1.1 of MCCG states that the board in meeting its goals and objectives of the company, should amongst others, undertake the following responsibilities:

- **together with senior management, promote good corporate governance culture within the company which reinforces ethical, prudent and professional behaviour;**

  The board should foster a healthy corporate governance culture which is founded on the principles of transparency, objectivity and integrity. The board should set the "tone from the top" by formalising and committing to ethical values.

- **review, challenge and decide on management's proposals for the company, and monitor its implementation by management;**

  The board should bring objectivity and breadth of judgment by scrutinising management's proposals. The board should satisfy itself that management has taken into account all appropriate considerations in tabling the proposals. The board must demarcate the day-to-day operational functions of the management and the overall responsibilities of the board by clarifying the duties and responsibilities of the both parties. In addition, the board must ensure that the goals and targets set for management are met and in line with the company's long-term objectives.

- **ensure that the strategic plan of the company supports long-term value creation and includes strategies on economic, environmental and social considerations underpinning sustainability;**

  Stakeholders are now more aware of the impact that businesses have on the economy, environment and society. This impact may be positive or negative. As such, relevant economic, environmental and social considerations should be embedded in the company's business strategies and operations.

  Sustainability-related issues, can significantly impact a company's risk profile, potential liabilities, reputation and overall value. For example,

Dos

- ✓ Make strategy a key matter reserved for the board's deliberation and decision.
- ✓ Seek advice on factors affecting the company's strategy, e.g. resourcing situation, regulatory considerations, competition and external risks.
- ✓ Consider avenues to gauge management and employee sentiment on the company's culture, e.g. survey or pulse checks.
- ✓ Live out the company's code of ethics in daily business dealings.

Don'ts

The following would render the application of this practice ineffective:

- × Allowing management a free hand to manage the company without any strategic direction or check and balance from the board.
- × Failing to keep abreast of the conduct, business activities and developments of the company.

companies involved in the oil and gas industry are increasingly faced with the challenges of volatile crude oil prices, geopolitical risks, climate change, and emission reductions – all of which has a bearing on the company. Having in place a sound sustainability policy would enable the company to be well-placed to deal with these challenges and create value in the long term[2].

- **supervise and assess management performance to determine whether the business is being properly managed;**

  The board must ensure that there are measures in place against which management's performance can be assessed. The board is obligated to oversee the performance of management whilst maintaining a relationship that is supportive yet vigilant. There should be a comprehensive process for requesting, and considering reports from the nominating committee on the performance of the board, board committee and individual directors.

  The board should also put in place key performance indicators ("KPIs") for the executive management to ensure the management's strategy and performance would align with the company's strategic objective. The KPIs should relate with the company's business activities, the targets set by the board and the company's short, medium and long-term objectives. The KPIs may include the following:

  - financial performance and targets (e.g. earnings before interest, tax, depreciation and amortisation; returns on asset; returns on equity; and earnings per share);
  - strategic performance in line with the company's strategic plan and direction including short, medium and long-term value of the business (e.g. market share, market development and sustainability ratings);
  - operational performance (e.g. productivity rate, time to market new products, reduction in carbon footprint); and
  - corporate culture of the company (e.g. outcome of cultural surveys and pulse checks, regulatory and supervisory findings pertaining to the company).

- **ensure there is a sound framework for internal controls and risk management;**

  The board should ensure that there is a framework of prudent and effective internal control and risk management systems which enables risk to be assessed and managed. Further considerations on the establishment of framework for internal controls and risk management are provided in the write-up to **Practices 9.1 and 9.2**.

- **understand the principal risks of the company's business and recognise that business decisions involve the taking of appropriate risks;**

  The board should be cognisant of the significant financial and non-financial elements that could result in exposures and alter the risk profile of the company. Considerations in this regard are provided in the write-up to **Practices 9.1 and 9.2**.

Hot-button issue

When directors are side-lined

Who calls the shots – directors or management? Whilst in theory the board of directors is the supreme governing body, situations can occur when the company is driven by executive management instead. Reasons for this include the following:

- Controlling shareholders who are also active in management consider it as their right to dictate the direction of the company;
- Management perceives the directors to lack in-depth knowledge about the company and its challenges particularly from an operational perspective; and
- Ineffective members of the board who are overly reliant on the chief executive officer or senior management for information on company performance.

[2] Guidance can be drawn from **Bursa Malaysia Sustainability Reporting Guide** which aims to assist listed issuers in improving their sustainability-related disclosures and **Bursa Malaysia Sustainability Toolkits** which have been designed to provide more detailed guidance on some of the steps that listed issuers can take to embed sustainability into their organisations and meet their disclosure obligations.

- **set the risk appetite and establish a sound framework to manage risk;**

  The board should set the risk appetite within which the board expects management to operate and ensure that there is an appropriate risk management framework to identify, analyse, evaluate, monitor and respond to risks factors. Detailed considerations on the framework of internal controls and risk management are provided in the write-up to **Practices 9.1 and 9.2**.

- **ensure that senior management has the necessary skills and experience, and there are measures in place to provide for the orderly succession of board and senior management;**

  The board should ensure that candidates appointed to senior management positions are of sufficient calibre and that the collective competence of senior management would allow them to effectively lead the operations of the company. The board should also be satisfied that there are plans in place to provide for the orderly succession of board members and senior management. The absence of succession planning can result in hasty promotion of individuals who may be unsuitable or not ready for the position.

  When putting a succession plan in place, it might not be necessary to identify persons by name relative to a position on the board. Instead, a clear direction as to what the board is facing and the type and depth of experience required in order for the board to continue functioning effectively should be considered by the board in its succession planning programme.

  In considering a senior management vacancy, the board should benchmark internal candidates against external applicants. A well thought-out succession plan considers a process that recruits employees, develops their skills and abilities, and prepares them for advancement. Succession planning involves:

  - developing a recruitment and communication strategy;
  - identifying expected critical position vacancies;
  - determining critical positions;
  - identifying current and future competencies;
  - identifying gaps in current employees' competency levels;
  - identifying high calibre internal candidates;
  - developing individual development plans for employees;
  - developing and implementing coaching and mentoring programmes; and
  - assisting with leadership transition and development, i.e. the right leader at the right time.

- **ensure that the company has in place procedures to enable effective communication with stakeholders;**

  The board should promote effective and timely communication with its stakeholders. The procedures in this regard should include how feedback received from its stakeholders is considered by the company when making business decisions. Considerations in this regard are provided in the write-up to **Practice 11.1**.

- **ensure the integrity of the company's financial and non-financial reporting.**

  The board should ensure that there is a sound framework on corporate reporting, including financial and non-financial reporting. Due cognisance should be given to the disclosures on corporate governance, sustainability and other non-financial aspects. The board should draw guidance from relevant documents such as:

  - Statement on Risk Management and Internal Control: Guidelines for Directors of Listed Issuers issued by the Taskforce on Internal Control with the support and endorsement of the Exchange;
  - Sustainability Reporting Guide and Toolkits by Bursa Malaysia;
  - Management Discussion and Analysis Disclosure Guide by Bursa Malaysia; and
  - Guidance on Disclosures in Notes to Quarterly Report by Bursa Malaysia.

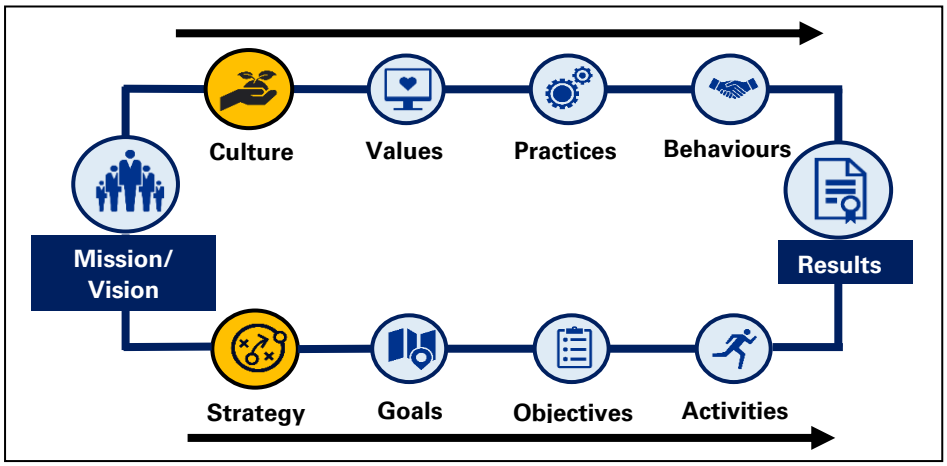
What are key aspects that the board should be cognisant of in leading the company?

The board's roles and responsibilities and related considerations such as effective conduct in meeting its obligations may be articulated in a formal and authoritative document which is commonly known as board charter. Refer to the write-up to **Practice 2.1** for detailed considerations regarding the board charter.

The responsibilities of the board in leading the company are closely related to four distinct elements:

- setting the strategic direction;
- monitoring the outcome of efforts to reach that direction;
- setting the company's culture and outlining its values; and
- meeting obligations to shareholders and stakeholders.

A company's culture and its strategic direction are intrinsically linked. The culture and the resultant ethical tone determine how much risk the directors are willing to take to achieve their goals, and set the moral boundaries in the pursuit of these aspirations. The diagram below illustrates the process of how culture and strategy drive the outcome of a company's actions.



Therefore, the first step to be addressed by the board is to include strategy setting and review of culture as an integral part of matters reserved for the board's deliberation and decision.

In setting the strategy and direction of a company, it is imperative that appropriate measures and processes are put in place to allow the directors and management to:

- create, review and assess strategic decisions of the company;
- understand what are the key drivers of company performance;
- ensure that the company's strategy is in line with the operations and external environment; and
- evaluate and understand potential risks and incorporate risk management as well as sustainability considerations into strategic decision-making.

Management is key in collecting, scrutinising and elucidating strategic options to the board for its review and consideration. Hence, it is important that both management and the board work cohesively to successfully formulate and implement the company's business strategy.

In defining the board's role in maximising shareholders value whilst considering the interests of stakeholders and setting and monitoring strategies that cater to the growth of sustainable performance of the company, it is helpful for the board to consider some key parameters, as follows:

- Directors must showcase critical thinking in setting goals and strategies during board meetings. The personal needs of a director cannot supersede the needs of the board. Questions on business operations that lead to insights into strategy, performance, investment decisions, hiring or removal of key personnel and risk assessment must take priority. In certain instances, directors can be seen micromanaging by picking up on a small point and challenging it for the sake of showing who is right or what could have been done differently. Trivial matters must not be discussed in length and hindsight discussions should be minimalised[3].
- When devising a strategic plan, the board must include the elements of strategic risk, i.e. linking business strategy to the critical risks the company faces including, but not limited to, sovereign risk, risks related to reputation, ethics, e-commerce, and safety, health, and environment (not just financial or insurable hazards) and should not just relate the level of risk to size of investment. There are many cases of small and apparently inconsequential investments having very serious consequences on large companies.
- Off-site strategy session serves as a valuable platform to explore strategic issues in depth for several days[4]. The factors that should be considered in having off-site strategy sessions include nature of strategy discussions, off-site plans, number and identity of invitees, as well as timing of off-site strategy sessions[5]. However, board should be cognisant that organising an off-site session may be challenging in certain instances as it may be difficult to get all directors present to participate. Directors may have their responsibilities on other boards coinciding with the scheduling. It may also not be applicable for companies with a large board structure where discussion on issues may take longer than anticipated.

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[3] *What Is and Isn't Micromanaging,* 2013, Strategy+business
[4] Frish B and Chandler L 2006. *Off-Sites That Work*, Harvard Business Review
[5] Bhagat C et.al 2013, *Tapping the strategic potential of boards*, McKinsey

- Visits to operational sites or key subsidiaries assist in deepening the board's understanding of the company, in particular for the non-executive directors. For example, in the case of The Home Depot, Inc., directors are required to visit four stores annually and have in-depth meetings with four different members of the senior management team[6]. The involvement of directors by frequently "spot checking" is a useful way of ensuring the management is kept on its toes. This also gives the directors an opportunity to directly talk to operational staff and receive feedback on their implemented plans.
- The board should receive both, information on financial and non-financial matters in relation to the company's performance including, but not limited to information on company's performance benchmarked against its competitors and industry players. The board must specify the required information to management and work with management on refining the board information package to tailor it to the board's needs and wants. Examples of non-financial information may include:
    - market positioning and performance of key brands;
    - customer satisfaction index;
    - employee turnover rate and satisfaction;
    - product development and research; and
    - social and environmental performance.

  The case study on the following page demonstrates the importance for board members to scrutinise the information that has been presented to them.

[6] *Corporate Governance Guidelines* 2016, The Home Depot, Inc.

Case study: Transmile Group Berhad (Malaysia)[7]

Background:

- Two independent directors of Transmile, who were members of the audit committee at the material time, were charged in court under Section 122B(b)(bb) of the Securities Industry Act 1983 for knowingly authorising the furnishing of a misleading statement to the Exchange in relation to the company's quarterly report on the unaudited consolidated results for the financial year ended 31 December 2006.

Facts:

- Transmile reported to the Exchange that its revenue was RM 338.4 million for the last quarter of 2006 and RM 989 million for the financial year ended 31 December 2006. Transmile had in fact suffered losses for financial year end 31 December 2006.
- A special audit further revealed that Transmile had actually suffered combined losses up to RM496 million for the years 2005 and 2006. In 2006, its losses were RM126.3 million instead of a profit of RM157.5 million and in 2005, its losses were RM369.6 million instead of a profit of RM84.4 million as reported.
- The two former independent directors of the company were found to be guilty and a sentence of one year imprisonment and a fine of RM300,000 (in default six months imprisonment) were meted out against both individuals.
- In the aftermath of the incident, the company was classified as a Practice Note 17 company and its securities were subsequently delisted.

Lessons Drawn:

- Directors are entrusted with duties and responsibilities to safeguard the interests of the company and that of its stakeholders. It is therefore clear that directors must carefully review the information that is presented to them prior to approval, with due regard to the information that they know about the company when undertaking that review. Directors are expected to ask questions of management with respect to issues that arise from their review of the documents.

- Boards should ensure that the information required to aid them in performing their duties is provided in a timely and orderly manner. Directors should allocate time to consider their information needs and the integrity of information by asking the following:
  - what information would they require to perform their roles effectively?
  - what measures should be put in place to ensure their information needs are met and the integrity of the information is intact?
  - when should the information be given to them?
  - in what form must the information be presented to the board?

[7] *Enforcement* 2017, Securities Commission Malaysia

- It is vital for the board to take interest on whether the data regarding the company including its performance is properly recorded and maintained so as to be assured of the integrity of the information presented to them. Management should present the information in a clear and systematic format that can be easily understood by the board. A typical report can be set out under the following headings:
  - an executive summary that clarifies major themes of the report and its main conclusions;
  - emerging issues that may affect business in the future;
  - strategic issues for discussion;
  - market and competitor news;
  - financial and non-financial performance;
  - key value drivers' performances;
  - business unit performance; and
  - company's performance in relation to strategic initiatives.

What are symptoms or indicators which may indicate concerns on the discharge of duties by the board?

The following would be considered as red-flags in this regard:

- lack of oversight over management by the board;
- presentation made to the board does not have sufficient information to guide the board or contains too much information that leaves the board with little time for thoughtful and reflective deliberations and that hinders the board in scrutinising the management;
- lack of alignment between the board's strategic goals and the management's goals;
- inadequate focus by the board on the core issues that are impacting the company; and
- insufficient time spent by the board to educate themselves on the company's operations.

Where — Regional/international perspectives

As in the case of Malaysia, the board's role in strategy and ethics has been addressed in corporate governance codes around the world.

Country	Provision(s)
Singapore	The Board's role is to: a. provide entrepreneurial leadership, set strategic objectives, and ensure that the necessary financial and human resources are in place for the company to meet its objectives; and e. set the company's values and standards (including ethical standards), and ensure that obligations to shareholders and other stakeholders are understood and met. ***(Guideline 1.1)***
Australia	Usually the board of a listed entity will be responsible for: • providing leadership and setting the strategic objectives of the entity. ***(Commentary of Recommendation 1.1)*** The board of a listed entity should lead by example when it comes to acting ethically and responsibly and should specifically charge management with the responsibility for creating a culture within the entity that promotes ethical and responsible behaviour ***(Commentary of Principle 3)***.
United Kingdom	The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met ***(Supporting Principles of A1).***
South Africa	Members of the governing body should assume collective responsibility for steering and setting the direction of the organisation, approving policy and planning; overseeing and monitoring of implementation and execution by management; and ensuring accountability for organisational performance ***(Recommended Practice 1 of Principle 1)***. The governing body should oversee that the organisation's core purpose and values, strategy and conduct are congruent with it being a responsible corporate citizen ***(Recommended Practice 13 of Principle 3)***.