

# Board evaluation – A cornerstone for effective corporate governance

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## Key takeaways:

- *With the increased focus on corporate governance globally, shareholders and investors alike are pitching for effective governance over Boards and their processes.*
- *Board evaluation is an effective way to ascertain and measure the performance and alignment of Boards with the organisational strategy and governance standards.*
- *This article touches upon the need for Board evaluation, the regulatory requirements prevalent in India, the evaluation process followed and leading practices in the space.*

## Executive summary:

Board evaluation in India is primarily driven through regulatory interventions with it being mandatory for listed organisations. It is being picked up in both letter and spirit by an increasing number of unlisted organisations as well. Increasing shareholder awareness, focus on governance, changes in business environment and regulatory pressure are now nudging organisations to re-look at how effectively their Boards are functioning.

Boards are required to evaluate performance for their committees and empanelled directors holistically with inputs (self-evaluation, peer assessment, direct reports' assessment and investors review) sought from the directors themselves. These inputs are used to make decisions on improving the performance of the Board, director appointments, re-appointments and pay, among others. The outcomes from the Board evaluation indicate developmental areas for the Board, the individual Directors and can provide inputs on re-appointments.

## What is Board evaluation?

Board evaluation is the process to assess the functioning of the Boards and its committees towards achieving the desired objectives, remaining within the ambit of the regulations, and working effectively to meet the business strategy. Board evaluation is mandated in India through regulations. It was introduced by the Companies Act 2013, followed by the SEBI (Securities and Exchange Board of India) Listing Obligations and Disclosure Requirements (SEBI LODR), 2015; effective from 1 December 2015. SEBI LODR requires companies to create and publish the criteria for evaluation of Independent Directors. SEBI published a guidance note to educate companies and their boards on various aspects in the evaluation process. Additional recommendations have been shared by the Kotak Committee on corporate governance such as Board composition, number of Independent Directors, etc. to broaden the horizon for Board evaluation.

## The need for Board evaluation

Besides the guidelines specified by SEBI, there are additional guidelines mentioned in the Companies Act, on Board Evaluation, such as:

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*Section 134(p) of Companies Act 2013:* In case of a listed company, and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation of the performance of the Board, its committees and of individual directors has been made must be provided in the report by its Board of Directors.

*Section 178(2) of Companies Act 2013:* The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down. It shall recommend to the Board their appointment and removal and shall specify the manner for effective evaluation of performance of Board, its committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance.

With increased awareness of investors, retail and institutional investors alike, calls for effective evaluations of Board's performance are expected to pick up.

### **Typical committees in the Board**

While all formal committees of the Board are evaluated, not all management committees are evaluated as a part of this exercise. The following committees are typically included under the evaluation ambit.

- Board of Directors
- Management Committee (ManCom) – Business Strategy
- Audit Committee
- Nomination and Remuneration Committee
- Risk Management Committee
- IT & Digital Strategy Committee
- Corporate Social Responsibility Committee
- Committee to monitor large value frauds and defaults (banking specific)
- Stakeholder/Shareholder management committee

### **Predominant trends in the Board evaluation space**

Research indicates that companies in countries, such as The U.S., U.K., New Zealand, and Canada perform evaluations even in instances where it is not prescribed as a part of good governance initiatives. Progressive Boards globally, not only conduct Board evaluations voluntarily, but they also look to bring in external evaluators, as well as use the outcome of these evaluations to make decisions around Director hiring, continuation, termination, pay and succession planning.

### **Conducting effective Board evaluations**

Effective Board evaluations are holistic in nature encompassing multiple areas, such as:

- a. **Corporate governance:**
  - Whether the Board is aligned with the business objectives
  - Monitor performance of the Board against plans
  - Ensure protection of minority interests
  - Provide guidance to stakeholders and financial markets on the company's plans
  - Evaluate the Board composition and the experience and backgrounds of the Directors to contribute to the business
- b. **Effective practices:**
  - Accountability of the Board towards the agenda
  - Provide direction for the Management
  - Demonstrate Ethical Leadership

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- Promoting defined culture and values
- c. **Compliance and regulatory requirements**
- Compliance with statutory guidelines and evolving regulatory landscape
  - Disclosure as per regulatory requirements
- d. **Build a long-term view**
- Ensure alignment with the long-term business strategy
  - Build robust processes
  - Ensure consistency of evaluation
  - Ensure feedback and follow up on the agenda items identified as a part of the evaluation process

#### **Common Board evaluation assessment parameters:**

The assessment in the Board evaluation is centered on four broad pillars:

- Board composition and structure, which covers aspects around composition (skills and diversity), number of Directors, their skill sets to drive the strategic agenda, number of committees, quorum across meetings, etc.
- People factors, including aspects around driving collaboration, commitment, Board room behavior, etc.
- Process and procedure, to capture inputs on role clarity, accountability, decision making, Board operations, information flow, etc.
- Increasingly progressive organizations are looking to assess their directors on their alignment to the organisation's values.

#### **Typical Board evaluation process:**

While different companies tend to adopt their own processes within the ambit of the specified regulations, the overall process is typically a subset of the steps highlighted below

- Review 'as-is' processes to identify past scores, trends, issues and/or key concerns in the evaluation process or scoring methodology
- Capture inputs from the Chairman, Nomination and Remuneration Committee Chair and Independent Directors on the evaluation process and outcomes
- Benchmark practices followed across other organisations in the industry and leading organisations scoring high on Corporate Governance across industries
- Design and validate the questionnaire from the NRC
- Initiate the self-assessment phase where – every Director reviews themselves and their performance
- Peer review where – every Director reviews their peers for their performance in the overall Board and in the committees that they work with
- Shareholder review on business strategy and outcomes (majority shareholders)
- Independent Directors review of the overall Board and every Board member
- Results from different assessments are compiled and analysed
- Results are shared with the Board and 'continuous improvement' agenda is created
- In many cases there is an additional 360-degree review where the Executive Directors and Non-Executive Directors are reviewed by their immediate reports, or the incumbents identified in the succession pipeline

#### **The challenges in Board evaluation**

With close to two out of three Indian listed companies being family held or including Board Members in relation to the promoters or the promoter group, maintaining objectivity in the process or working towards action-oriented evaluation becomes important. Companies and progressive Boards today have started going beyond the hygiene factors around

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quorum, number of meetings attended, committee composition, peer evaluation, etc. and looking at varied aspects to drive higher Board effectiveness.

**As India moves towards becoming a USD5 trillion economy, Board evaluations are expected to play a crucial role in ensuring companies' competitiveness by helping unlock more value.**

**Key takeaways:**

- Board evaluation in India is driven through SEBI LODR (listed entities) and Companies Act, 2013 and is primarily done to comply with the regulations
- Board evaluation is done primarily through detailed questionnaires and are focused on 'as is' functioning and processes of the Board
- Increasing shareholder activism is bringing the spotlight on how Board evaluation is done and how the outcomes need to be reviewed
- Board evaluation when done effectively, can help organisations in identifying and improving Board Effectiveness through identifying which Directors need to be re-appointed, providing improvement areas for the Board and the Directors, helping identify successors, assist in decisions related to executive compensation, etc.
- Progressive Boards evaluate Board performance not just on preceding years' performance and contributions but also on the alignment of the Board, its committees and Directors with the strategic objectives of the organisation, its values, culture, mission and vision

The added emphasis on ESG and governance in recent times has increased the focus on conducting Board evaluations effectively and bringing in independent third parties to conduct the

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