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Insights for boards and audit committees

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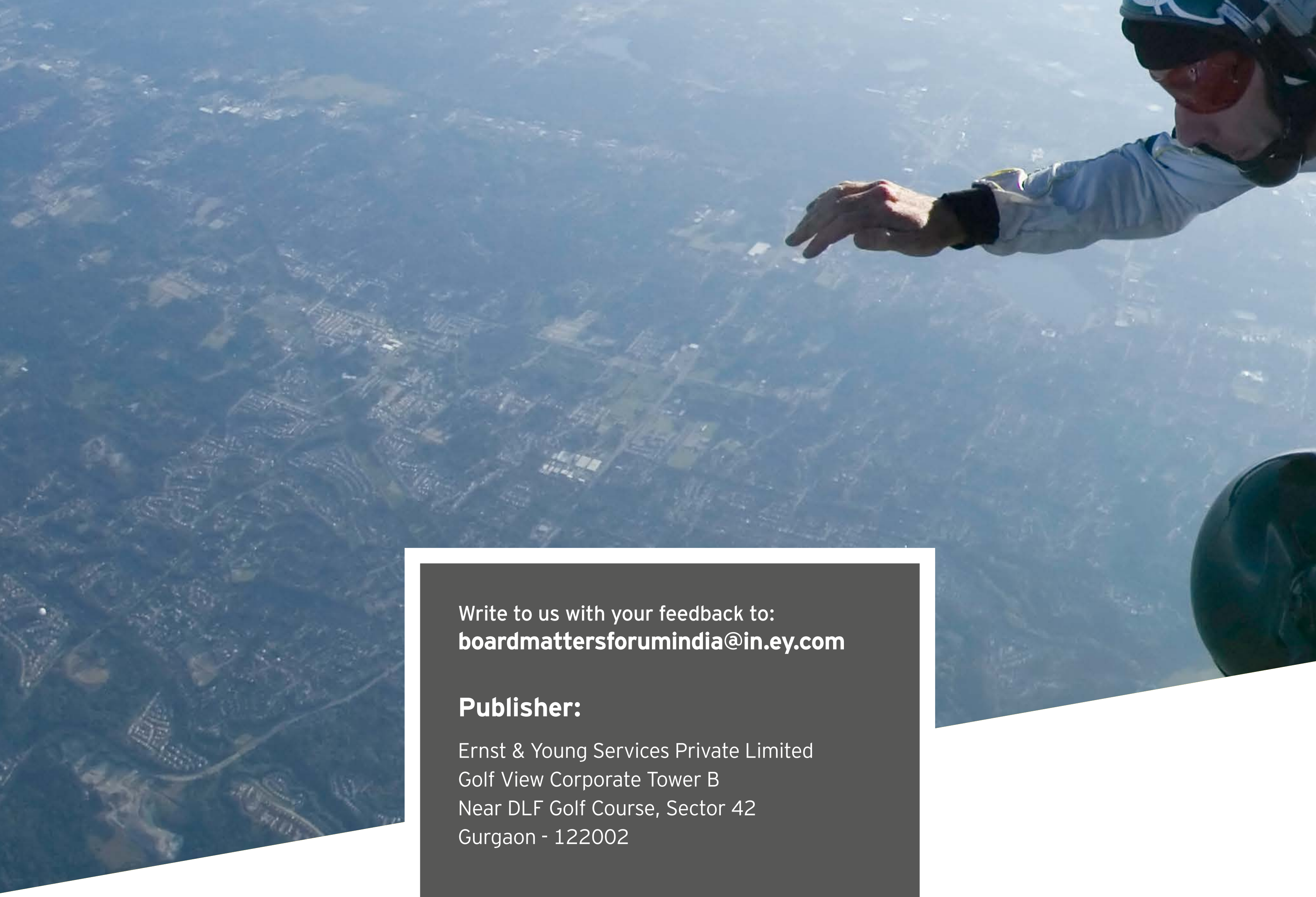
Building a better working world

In this issue

This edition of the BoardMatters Quarterly identifies the ways in which board members could engage with managements through the critical stages of an M&A deal. The issue also highlights the action areas for directors as companies navigate several risks including geopolitical changes, work-force transformations, digital and emerging technology disruptions.

EY hosted the twelfth edition of the BoardMatters Forum in New Delhi on 12 April 2019. A summary of the keynote address by M. Damodaran, Independent Director on several leading Indian Boards, Chairperson, Excellence Enablers Pvt. Ltd. and former Chairman, SEBI is captured in this issue of the Quarterly.



Write to us with your feedback to:
boardmattersforumindia@in.ey.com

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Ernst & Young Services Private Limited
Golf View Corporate Tower B
Near DLF Golf Course, Sector 42
Gurgaon - 122002

As deals get more complex and M&A grows, so does the board's role

Ajay Arora
Partner and National Leader - Investment Banking Advisory, EY

The Indian economy appears to be on a stable footing in the context of a volatile global geo-political scenario and the renewed mandate given to the current government. Despite recent headwinds, factors like the robustness of India's domestic demand story, attractive demographics - a young and predominantly English-speaking population, a skilled labor force and well established cost competitive manufacturing, make India an attractive investment destination for both global and domestic companies.

In this context, it is pertinent to note that India in 2018 for the first time clocked US$100 billion in mergers and acquisitions (M&A) for the first time, led by record growth in inbound and domestic deals. While high growth led by domestic demand typically augurs well for a sustained surge in transaction activity, it may also lead to some unwelcome side-effects, especially when it comes to managements that aggressively pursue M&A at the peak of the cycle. It has been noticed that the easy availability of capital in a growth environment fuels competitiveness in deal-making, which has an upward effect on valuations especially in high quality platforms of a certain scale. It is in this context that the role of the board of directors and particularly independent directors, cannot be underestimated.

Experienced boards are well positioned to look at long-term value creation from a strategic perspective. They view a deal less as a project or a milestone that must be accomplished and more as an episode, which may or may not fit into the ongoing journey in the lifespan of a business or corporation. At its core, an effective board sets the strategy, monitors performance, oversees risk management and champions good governance. These are plausible benchmarks against which any M&A deal can be credibly evaluated.

Given this context, boards and particularly independent directors, have a rich and differentiated perspective. They could serve as an effective counsel to the management, aiding in better decision-making in line with the company's stated objectives and representing the values of the organization. Subjects and areas where boards could opine and perhaps even challenge the management maybe quantitative - including valuation, accretion to earnings in the context of a board approved strategic business plan, existence of hidden liabilities or changes to capital structure for consummating the transaction; or qualitative -anticipating cultural or integration issues, having the right set of advisors, obtaining market intelligence through proprietary networks, anticipating potential risks from ongoing litigation, environment, health and safety (EHS) considerations, obtaining fairness opinions or judging the impact on a larger set of stakeholders like customers, employees, etc. Above all, the key role of an independent director is to stay independent throughout the process, avoid getting unduly influenced or pressured by any extraneous factors that may sometimes lead to an emotional attachment to the transaction.

An important consideration is also the subtle but crucial difference in the role of a board when the company is on the *sell side* as opposed to the *buy side*. Particularly when it comes to the sale of a significant portion of the company or the whole company, boards are likely to take a more proactive role in their quest to maximize stockholder value, protect the interests of minority shareholders and bring effective oversight to the entire process. This may involve boardroom discussions at the time of the conceptualization of the transaction, influencing key aspects such as the timing and process of the sale and continued discussions at various stages of the deal cycle. In such a scenario, it is usually the management of the target that functions independent of the sale process but is under active oversight of its board considering the ongoing process. In most cases, they are kept duly informed of any material developments. In contrast, when the company is on the *buy side* it is usually the management that takes the lead in evaluating the deal and therefore, should keep the board duly informed.

Some of the key questions that the board may ask to play a more proactive role in certain critical stages of an M&A transaction could be as follows:

Valuations:

- Has the right valuation methodology been adopted?
  - Have any other alternate methodologies been examined and why have they not been considered or shortlisted?
  - Does the valuation leave any room to incorporate potential adjustments that may arise out of due diligence or due to a potentially competitive scenario?
  - How does the proposed bid multiple (sales, EBITDA, PAT or book value) compare with the multiples at which comparable transactions have taken place?
- Has the valuation been carried out in a standalone manner i.e., 'base case' valuation?
- Have any upsides from post deal synergies been considered?
- Has the robustness of the underlying assumptions been stress tested?
- If the company is on the *sell side* – is the target buyer subset relevant and exhaustive, depending on the nature of the process?

Process related considerations: usually in a *sell side* scenario:

- Should the process be run as an open auction or a tight one with a small set of specific counterparties?
- What is the approximate timeline within which closing is anticipated?
- At what level of the organization should the process be managed on a day-to-day basis?
- What is the quality and authenticity of the non-binding offers or term sheets that have been received? Do they have the approval of the acquirer at the highest level?
- How does the process ensure confidentiality of the transaction – especially in listed company deals?

Accounting and tax diligence issues:

- From where are the key growth drivers of revenue and profitability stemming - the core business or non-core business?
- How dependent is the performance on transactions with related parties?
- What are the adjustments required to arrive at a normalized or sustainable EBITDA?
- What is the present status on tax compliances and are there any open tax litigations?
- What are the material off-balance sheet items (quantified to the extent possible) including the impact of any outstanding litigations?

Commercial diligence issues:

- Why are historical growth drivers expected to continue as in the past?
- Which industries have the new entrants come from and what is the source of their competitive advantage?
- What is the potential for disruption - digital, technological or in any other form in the general industry or the business of the target?
- Which regulations impacting the business may likely change and why is that change being contemplated?
- What is the target's strategy to achieve the business plan numbers? Does the target have adequate resources - human, technical and financial to put this strategy into action?

Legal diligence issues:

- What is the status of key pending litigations, proceedings or disputes, potential liabilities and indemnity protection?
- Are the promoters of the target or any of their affiliated entities or relatives receiving any money other than for the share-purchase transaction? This could include non-compete fees, earn-out based on future performance, etc.?
- Does the target comply with all applicable environmental laws? What internationally recognized health and sustainability standards does it adhere to?
- In case the target is listed, have the promoters of the acquirer or any of their affiliated entities or relatives traded in the securities of the target (if its shares are listed) in the recent past?

Post-merger integration:

- Have SMART (Specific-Measurable-Actionable-Realistic- Time bound) value creation initiatives that should be taken post-closing, been identified upfront?
- What mechanisms are being used to rigorously track the realization of synergies? In case realization has not played out, how will timely course correction take place?
- Who is responsible for translating the deal vision into strategic initiatives that pan across multiple business functions?

The board including the independent directors can play an important role at almost every stage of the transaction. The management would therefore be well advised to leverage their experience and keep them well informed, so they can benefit from expert in-house counsel during the difficult phases of the transaction. Greater collaboration and honest communication will lead to robust solutions, resulting in better thought through M&A decisions where the entire organization is whole-heartedly invested in the process, motivated to achieve the objectives from the deal in line with the company's overall strategy and the board's governance philosophy.

Navigating the transformative age in geopolitics: the board's role

Jon Shames
Global Leader - Geostrategic Business Group, EY

A series of long-term geopolitical undercurrents are challenging global business operations. What is the board's role in navigating the transformative age in geopolitics?

According to the World Economic Forum, the world has moved into a new and unsettling geopolitical phase. Discontented populations, the allure of nationalist campaigns, technological change and new approaches to global leadership are creating a cocktail of transformation in geopolitical relationships — with direct impact on the movement of goods and services, capital, ideas and people.

The transformative age in geopolitics propels companies to challenge long held hypotheses around global expansion and integrate an understanding of geopolitical risk into strategy and operations.

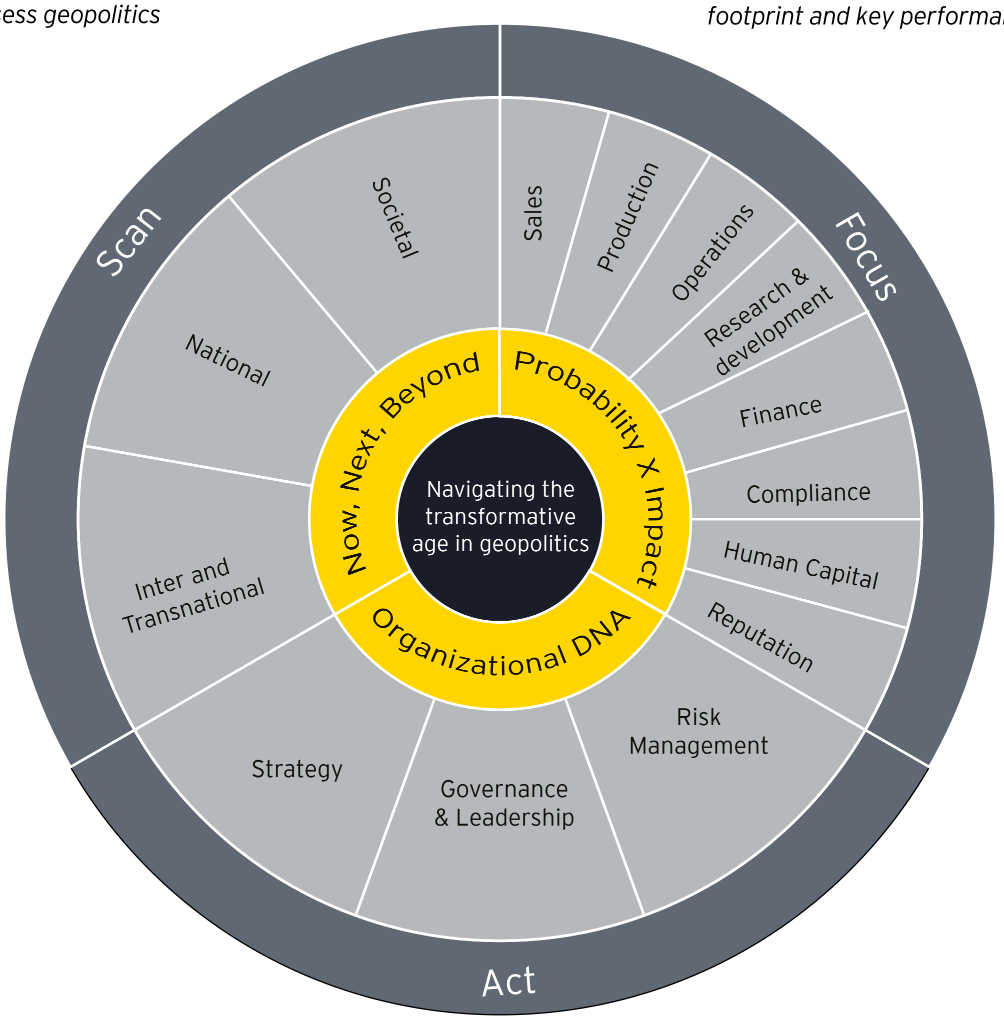
To thrive in today's changing world, we believe businesses need a **geostrategy**. To get there, companies need to **scan** the environment – establishing and maintaining the ability to identify, monitor and assess geopolitics; **focus** the impact on key performance indicators – mapping the geopolitical environment to company footprint and **act** in developing a portfolio of robust geopolitical risk management instruments and building a growth-oriented geostrategy.

Scan

Establish and maintain the capacity to identify, monitor and assess geopolitics

Focus

Map the geopolitical environment to company footprint and key performance indicators



Act

Develop a portfolio of robust geopolitical risk management instruments and build a growth-oriented geostrategy

Scan: Mapping the landscape

At a time when global economic integration is peaking, fragmentation and competition are becoming a growing trend in geopolitics forming a series of long-term disruptive geopolitical undercurrents.

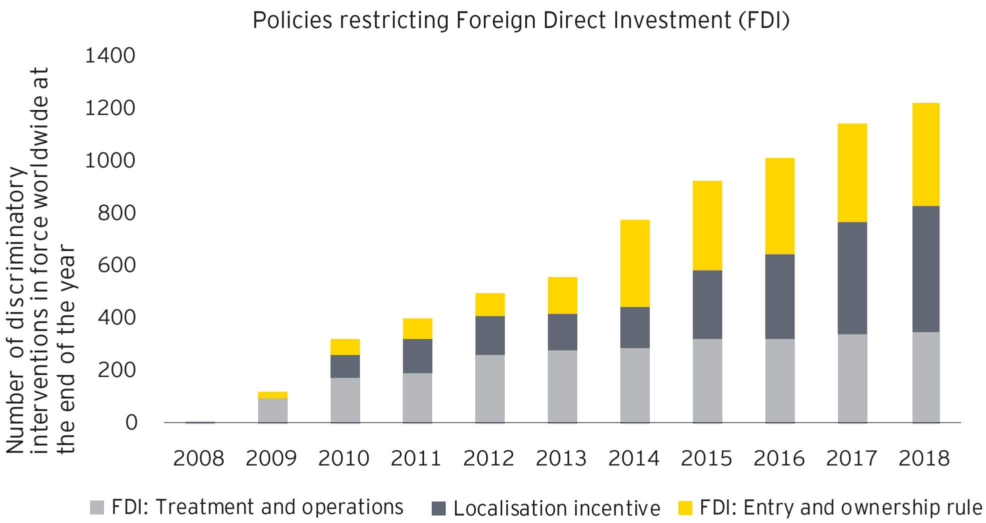
- **Global rebalancing:** We are moving away from a unipolar world, where a single state exercised global dominance and maintained order, to a multipolar one where geopolitical rivals are setting the rules of the game in their respective spheres of influence.
- **Challenged democracy:** With the emergence of alternative political systems, which proponents see as considerably resilient and stable, the effectiveness of democratic models of governance is being questioned. Competition between political systems is on the rise, exacerbated by rising nationalism and populism.
- **The Fourth Industrial Revolution:** Global leadership has and will continue to be anchored in technological superiority. Countries' ability to shape the ways in which critical technologies are developed, their disposition in cyber statecraft and their ability to set global tech standards will give them the upper hand in the global fight for power.

This tension – created by economic interdependency and geopolitical disruption is having profound consequences for companies across industries, markets, and business lines. We believe these are only early consequences of the transformative age in geopolitics.

Trade and investment barriers have risen in the last 10 years

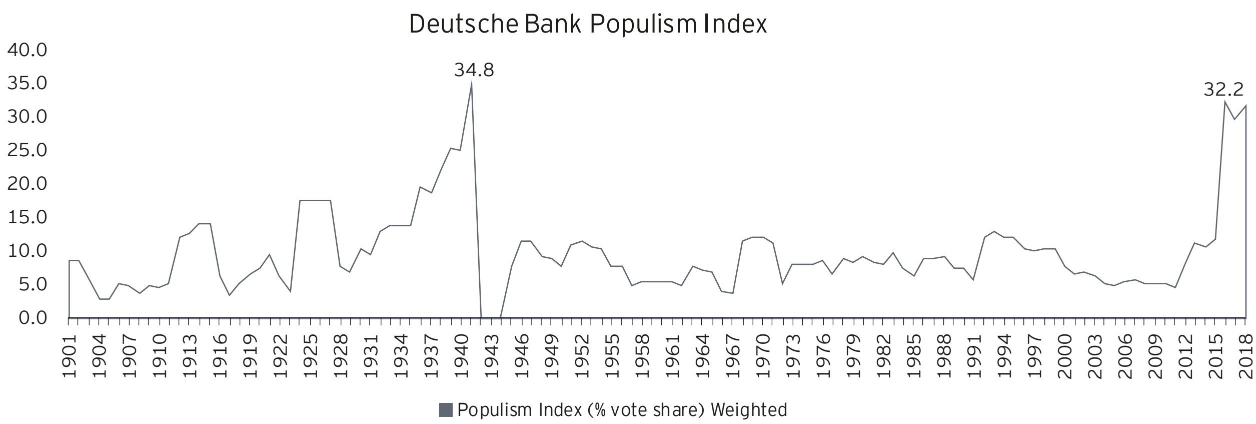
257%

The number of discriminatory trade interventions implemented globally peaked in 2018, to 1,308 – a 257% increase from 2009.

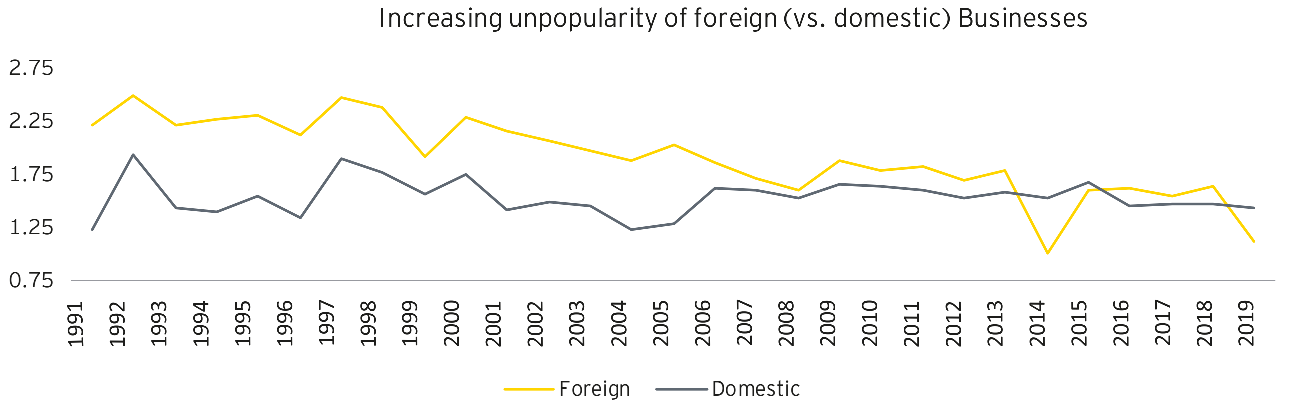


Source: Global Trade Alert

Support for populism is at its highest level since WWII.



Source: Deutsche Bank Research



Source: Global Database of Events, Language and Tone

These undercurrents manifest themselves across three primary levels of political risk – the transnational (or geopolitical) level, national (or country) level and societal level.

Transnational risks include political conflict, trade wars, sanctions, or a retreat from multilateral accords whereas national risks include political (regime) changes, policy shifts, or a lack of law enforcement. Societal risks – an area of increasing relevance – include boycotts, protests, or corporate espionage.

In mapping the geopolitical landscape, we recommend that companies:

- Identify and evaluate the geopolitical developments and political risks that can impact your business
- Look at risks across three levels: transnational, national and social
- Look at risks across different time frames – now, next, beyond
- Update dynamically as developments unfold/add new risks

Questions to consider

Q *Do we use an outside provider of political risk intelligence?*

Q *Are we tapping into the intelligence of our own company?*

Q *Do we have a dynamic process around communication of risks?*

Q *How do we stay informed around the important risks we face?*

Focus: Political risk and corporate performance

Where and how does political risk affect corporate performance? How can business leaders – and board members – filter through the noise to assess what really matters?

Political outcomes have a multi-dimensional, material outcome on firms in myriad ways.

Political risk affects:

- Consumer behavior
- Government decisions on fiscal policy, including procurement
- Evaluation by corporate business development, analysts and financiers of the future profitability of an investment
- Governance of overseas subsidiaries
- Management of supply chains
- Location and modularity of research and development
- Allocation of the budget for legal enforcement and security
- Cost of capital and insurance
- Government and public affairs strategy
- Ability to attract and retain workers
- Incidence of corruption and fraud
- Nature and durability of a firm's reputation

Examples of the impact of political risk across areas of corporate activity

Source: EY Geostrategic Business Group

Yet each of these channels is typically the focus of a different functional manager. The impact of political risk on sales is managed by individuals separately from that on the scope and continuity of operations, on R&D, on corporate finance, on regulatory or legal compliance, on human capital, on governance and on reputation.

As a result, a political risk management strategy should choose between strategic responses that include (but are not limited to) changes in:

- Pricing or sales strategy more broadly to overcome shifts in customer willingness to pay
- The geographic location of economic activity, including manufacturing, R&D and sales (each of which may be pursued by M&A, greenfield expansion, alliances, licenses or contracts)
- The governance of the existing network of international economic activity
- Security protocols and processes
- Information provided to investors, analysts and creditors, or the financing strategies pursued with them
- Government or public affairs strategies
- The balance between expatriates and national staff and the best means to ensure inclusiveness and diversity nationally as well as across the company
- Efforts to root out corruption, fraud and rent-seeking
- Investment to build and maintain corporate reputation

When considered in isolation, managers responsible for sales, business development, operations, research, finance, compliance, human capital, governance and reputation rationally treat political risk as a complication they must react to, while they have little control over it or incentive to build capacity. However, if the impact of political risk is considered holistically at the corporate level, the cumulative impact on the organization is much larger. Furthermore, the ability of the company to influence the incidence and magnitude of these impacts also grows. The negative impact on sales might be altered through strategic response in sourcing. The negative impact on regulation could be altered by additional hiring domestically. The threat of corruption could be mitigated by a different regulatory strategy.

Board members should challenge management in building a cross-functional capacity to assess and manage political risk. This requires real-time coordination and is a high-level strategic function.

In mapping the impact of political risk on corporate performance, we recommend companies:

- Assess the overall exposure to individual risks (probability x impact)
- Establish a process to update dynamically
- Engage in strategic long-term thinking around possible outcomes (scenario analysis)

- Expand the impact analysis beyond financial impact (sales/revenue) to understand:
    - People / human capital
    - Supply chain
    - Regulatory positioning (compliance)
    - Research and development
    - Reputation / license to operate
    - Corporate finance
    - Security costs
    - Market expansion plans / M&A
    - Overall strategy

Questions to consider

- Q *Who is responsible for a "whole firm" understanding of geopolitical risk impact?*
- Q *Are all functions touched by risk communicating?*
- Q *Do we have a dynamic communication network?*
- Q *Can we build a bespoke risk model? What new measurement efforts could be helpful?*

Act: Geostrategy

Understand what risks to accept, what to mitigate and what can be influenced

Companies may consider a range of potential reactive and proactive strategic approaches to managing political risk. The most passive strategies are the (implicit) acceptance of lost sales and revenue, devalued assets, disrupted supplies, delays, a higher cost of capital, risks to workers or governance challenges. Slightly more proactive strategies include avoiding riskier host countries for foreign direct investment, sourcing and R&D, or pricing in risk. Intermediate strategies include enhancing the redundancy, depreciation or interdependence of capital or technology at risk and allocating greater resources to due diligence and monitoring. Finally, and most proactively, companies can change their entry strategy to enhance the strength of relationships with politically influential stakeholders, including by providing equity ownership, top management team authority and other desired local value-adds in the hope of aligning interests with politically powerful stakeholders.

Companies will choose from this menu of political risk management strategies based on the maturity of their political risk capabilities.

The least capable companies have no choice but to accept the negative outcomes of political risk that repeatedly surprise them. As companies become more sophisticated, they will begin to develop the capacity to effectively monitor or sense risks in the external environment and engage more proactively. Early efforts will focus on monitoring externally sourced information, followed by hiring specialists in the area and eventually, having senior leadership engage external stakeholders on an ongoing basis.

Next, companies will develop the capability to link what they learn to what they do. In other words, signals from the external environment will be recognized as leading indicators of risk and opportunity and will be tied to key performance indicators. Initially, such systems will treat each type of political risk and each impact as a discrete risk to be mitigated or opportunity to be seized. Eventually, the strategies adopted to address these risks will draw upon the expertise and capacity of private sector, public sector and civil society partners with whom the local company and its management develop trusting relationships.

Even more advanced companies will recognize the linkages across transnational, national and societal risks and across the impacts and respond to the full spectrum in an integrated manner. The most sophisticated companies will deploy these abilities not only to manage downside risks but also to seize upside opportunities, making the case for value-enhancing changes in core functions and practices in response to real-time signals from the external environment, including the capacity to sift through subtle dynamics in coalitions, issues and interdependencies.

> **The most sophisticated companies not only to manage downside risks but also seize upside opportunities, making the case for value-enhancing changes in core functions and practices in response to real-time signals from the external environment.**

Questions to consider

- *Are we too reactive to political risk?*
- *How can we work with local stakeholders to manage political risk?*
- *Do we understand the interests of local stakeholders?*
- *What strategies have worked for us in the past?*
- *What strategies have worked for others?*
- *Do we have the right skills on the board to help manage risks?*
- *Who is accountable for effective geopolitical risk management?*

Conclusion

In this era of transformation and transition, the board plays a critical role in advising organizations on being more systematic about the monitoring and management of political risk. As with many areas of strategy, companies need to increasingly think cross-functional and communicate, respond and iterate in a more dynamic way.

The transformative age in geopolitics challenges board members to cultivate political risk management competencies at the board-level and throughout the organization. To scan the environment, focus the impact on key performance indicators and act in developing a growth-oriented geostrategy.

What boards can do today to prepare for a geopolitical disruption tomorrow?

- Assess skill sets and experience of the board members considering global, government, policy and military experience. Cultivate geopolitical risk management competencies. Improve board readiness for crisis.
- Enhance board expertise through third-party consultants and specialists, as appropriate.
- Have the right directors, committee structure and access to information to oversee key geopolitical and regulatory risks – and to challenge management.
- Understand management's framework for managing geopolitical risks and opportunities; assess whether management's reporting to the board is sufficient. Include short- and long-term geopolitical analysis as part of the organization's growth strategy.
- Approach impacts as part of a broader socio-political analysis that is updated with dynamic, holistic monitoring and not only from an "event" lens.
- Ensure that responsibility for political risk management lies in a cross-functional office that is responsible for coordinating the strategies for all external stakeholders and has a voice in the design and implementation of initiatives in the enterprise's key functions (such as finance, operations, marketing, human capital, R&D, etc.).

This article was adapted from the EY Geostrategic Business Group's upcoming "Political risk and corporate performance: Mapping impact" report including contributions from Mary Cline, Insights Leader, Geostrategic Business Group; Witold Henisz, Deloitte & Touche Professor of Management, The Wharton School, University of Pennsylvania; Kyle Lawless, Assistant Director, Geostrategic Business Group and Sven Behrendt, Senior Advisor, Geostrategic Business Group.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Can boards have the right answers if they don't ask the right questions?
The EY Center for Board Matters helps directors navigate complex roles in the Transformative Age and ask the right questions.
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The better the question. The better the answer. The better the world works.

Top priorities for boards in 2019

In today's world of unrelenting disruption and innovation, a company's board plays a more active role than ever before in overseeing strategy and risk management amid digital and emerging technologies, industry convergence and workforce transformation, increased climate risk, political polarization and various other megatrends shaping the business environment.

To help boards navigate the challenges ahead, the EY Center for Board Matters presents five priorities for 2019, along with actionable questions for boards to consider.

- Embrace the duality of strategy
- Transform the governance of risk management
- Accelerate the talent agenda and activate culture as a strategic asset
- Strengthen communication and engagement with stakeholders
- Continue to enhance board performance

Embrace the duality of strategy

Companies today must strategize for challenges beyond the horizon while driving current business. This duality is key to surviving and thriving in this period of seismic disruption. The lifespan of S&P 500 companies is shrinking. Innosight reports that by 2026, the average tenure of S&P 500 companies will be only 14 years, with around half of the index being replaced over the next decade.[1] To endure, businesses must initiate and respond to disruption.

The need to focus on driving near-term growth while pursuing innovation that supports long-term opportunity and sustainability, presents management with an inherent challenge. They must demonstrate short-term performance while simultaneously investing in the future, which can dampen short-term results. The board's role in helping management navigate and find balance within this tension is an especially critical one. Rather than see the duality as a strain, boards can help management embrace it as a synergy that can help to form a stronger and more resilient strategy. To allow for these strategic discussions, the one-off, annual board strategy session needs to be challenged. Boards should work with management to frequently revisit the strategic plan and its key elements and

[1] *Scott D. Anthony, S. Patrick Viguerie, Andrew Waldeck, "Corporate Longevity: Turbulence Ahead for Large Organizations," Innosight, https://www.innosight.com/wp-content/uploads/2016/08/Corporate-Longevity-2016-Final.pdf*

assumptions. They should encourage management to regularly evaluate the full potential of the company and its existing business units, including critically evaluating underperforming assets or operations most at risk from technology, digital and customer disruption. With record levels of shareholder activist campaigns and increasingly coordinated stakeholder interests and demands, chances are that if the board isn't challenging management on the status quo, others will.

Questions to consider

- **Q** *How is the board helping to shape an agile, multi-stakeholder strategy that drives current business while considering future innovation and opportunities?*
- **Q** *How is the company preparing for competitors that may emerge? Is the board challenging the current business model by widening its view into edge geographies and adjacent industries?*
- **Q** *Has the board confirmed that management and director bias do not impede innovation?*

Transform the governance of risk management

As companies transform their business models, leading boards are transforming their governance of risk management. Fundamentally, the governance of risk management starts with having the right composition of board members aligned with the company's strategy and risk oversight needs.

Boards are revisiting their overall tone, engagement and messaging to management to echo the utmost importance of living the values of the company. Leading boards are also enhancing their approach to critical enterprise risks by obtaining third-party research and analysis to understand investments and changes occurring within their industry that may portend future disruption. Third-party resources are being leveraged by the board to validate risk mitigation and the consideration of strategic opportunities in areas such as culture, workforce transformation, the environment, geopolitics and regulation, along with the ever-evolving cybersecurity and data privacy landscape.

Boards should challenge whether management is intensifying its efforts and focus with educating their employees broadly on their personal responsibilities related to risk management. This includes verifying that employees have a thorough understanding of the company's values, code of conduct, ethical business practices and are exercising the appropriate compliance hygiene related to cyber and physical security. Compliance functions need to be reviewed to confirm that coverage is appropriate with the growing risks of cybersecurity, data privacy, social media and geopolitics and to make sure that reporting lines are sufficient (i.e., should the CISO have some form of reporting outside of the technology function?). Boards are also challenging audit functions to update their risk assessment process in a more continuous manner and to drive greater efficiency and effectiveness through the use of predictive analytics and the leveraging of technology tools.

Questions to consider

- *Are the board composition and committee structure appropriate to provide effective oversight of the company's risk profile?*
- *What external data is the board using to evaluate emerging and disruptive risks? What third-party resources are being used to validate the company's risk mitigation on such things as cybersecurity, data privacy and geopolitics?*
- *Have messaging and education increased within the company's employee base related to the importance of their overall role with risk management?*

Accelerate the talent agenda and activate culture as a strategic asset

Boards understand the need to oversee talent and culture more closely to boost the company's performance and enhance its reputation. With this recognition, some boards are looking beyond the C-suite to better understand and oversee talent issues and culture across the organization.

Research shows that today's talent, from top executives to early career professionals, seek to work for companies that have a clear purpose, strong culture and respected reputation. They prefer organizations that at least consider and address environmental and social issues and those that provide learning and growth opportunities. It is critical that boards investigate and understand these evolving talent trends. A company's culture must be a strategic asset. The board should have a strong pulse on how executive, mid-level and lower-level management demonstrate and communicate the company's values. They should also understand how a company's programs promote culture and drive the right behaviors and actions. This requires the board to review culture across the organization and look at talent-related performance metrics, including employee engagement scores, attrition rates, diversity and inclusion metrics, learning and development ROI, whistle-blower hotline activity, themes from employee onboarding and exit interviews and code of conduct violations.

Digitization and the impact of robotics, automation and analytics in business processes and services will continue to transform business and the workforce. Companies must be flexible by expanding the use of technology, retaining more contingent and remote workers and reskilling and redeploying their traditional labor to focus on more strategic work. These developments also highlight the strategic role of the chief human resources officer (CHRO). Leading boards are having regular interactions with and reporting from the CHRO in a manner similar to the CFO as they assume a greater role in overseeing the company's culture and talent goals and assessing the company's overall return on invested talent.

Questions to consider

- *Is the board continuously reviewing its governance of culture, talent and innovation given the ever-growing significance of intangible capital to competitive advantage?*
- *Which talent-related metrics is the board reviewing and how often?*
- *How much visibility, access and reporting is the CHRO providing to the board around human capital management/talent related risks and opportunities?*

Strengthen communication and engagement with stakeholders

As boards and executives work together to tackle ever-more complex and quickly evolving challenges, they are also finding that a growing range of stakeholders – corporate leaders and employees, customers and suppliers, communities and investors – are increasingly focused on the broader purpose of the corporation. These diverse stakeholders increasingly seek greater insights into how companies are strategizing for business sustainability, including addressing environmental and social matters that impact long-term value. There is growing evidence of a significant shift in corporate efforts to increase engagement with stakeholders and enhance disclosures and other communications – far beyond traditional financial reporting requirements. Organizations are also applying a multi-stakeholder approach aimed at enabling more multi-stakeholder partnerships and collaboration.

Well-governed companies understand that they need to be responsive to key stakeholder interests. If companies respond to customer needs, invest in their employees for the long-term, do right by the communities and physical environments in which they operate and have a strong, fundamental purpose, their shareholders should benefit. The real opportunity for boards and companies in 2019 and beyond is to drive a long-term-oriented strategy. This includes strong stakeholder communication and engagement practices.

Questions to consider

- *Has the company considered how it might harness their purpose to reveal a path through business model disruption and concurrently prioritize stakeholder engagement and communication efforts?*
- *How is the company communicating to all stakeholders – in a consistent, comprehensive manner – its efforts to provide sustainable, inclusive growth integrated with core business strategy?*
- *To what extent is the company familiar with the governance specialists, as well as the portfolio managers and equity research analysts who follow the company? Has the company engaged in outreach and established a relationship such that it can quickly engage as appropriate?*

Continue to enhance board performance

To better address the growing demands and complexity of their work, boards should rigorously and continuously examine and evaluate their performance. While most boards formally evaluate performance annually, leading boards do so more regularly. Intra-year evaluation enables boards to conduct a deep evaluation in phases that focus on one or more of the multiple aspects of overall board performance. More regular evaluation also encourages more candid, real-time feedback that can be quickly acted upon, improving information flow, decision-making, dynamics and performance.

When conducting evaluations, boards should use a tailored process that demands thoughtful and objective self-inquiry and raises questions that elicit feedback cutting to the core of performance, such as:

- How did our prior thinking and decision-making impact company operations, strategy and competitiveness?
- Were we proactive enough in responding to and initiating disruption?
- Were we successful in engaging with stakeholders in ways that enhanced mutual understanding and stakeholder support?
- Did we support the company's expanded use of technology in ways that make systems, processes and controls more efficient and secure?
- Did the performance goals we approved for CEO incentive compensation positively and measurably impact CEO performance and corporate value in the past year?
- Did our succession planning and talent management programs give rise to new leadership and innovation and increased employee engagement?

An equally (and related) key purpose of evaluation is for boards to regularly consider, objectively within the right context, the fundamental question of whether the current directors have, collectively and individually, all the experience, background, perspective, foresight, integrity and communication skills needed to consistently exercise informed judgment and effective oversight of their many complex duties and responsibilities. And, even if so, does the board support a culture that fosters rigorous inquiry and deliberation that promote agile and effective decision-making?

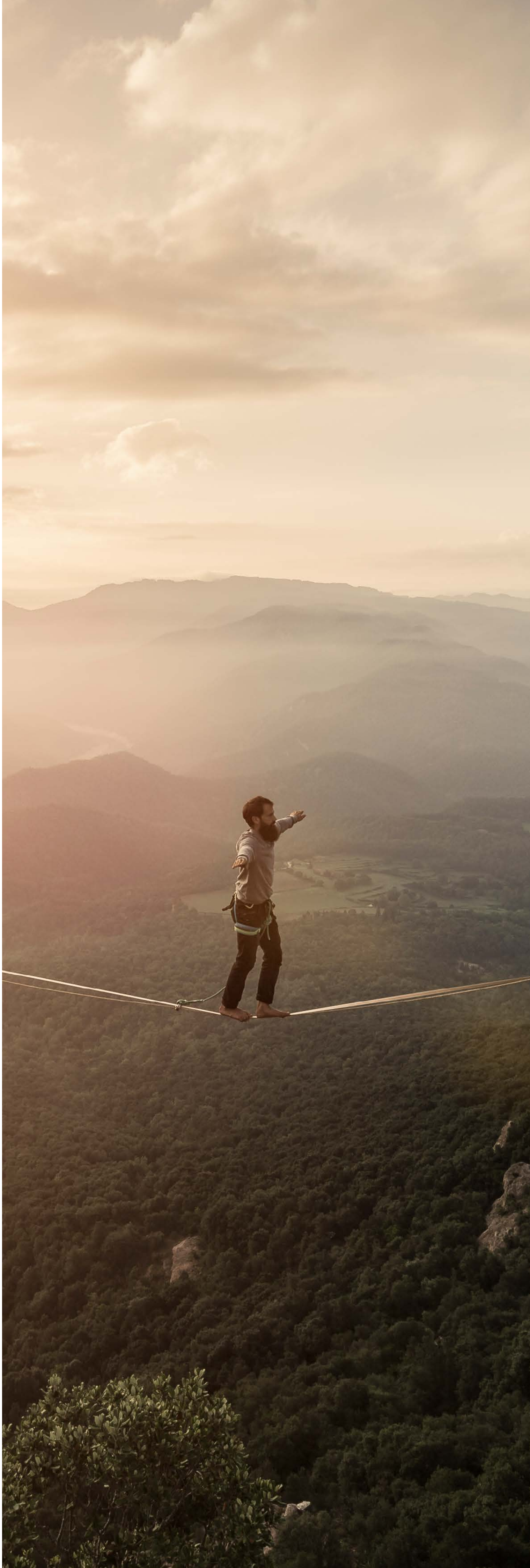
As boards make composition determinations, they should simultaneously consider board structure. Boards should ask whether adding a new committee or establishing an ad hoc committee may enhance oversight capabilities or ease workload issues, whether committee membership should be refreshed, and whether reallocation or expansion of duties and responsibilities can improve performance.

Today, boards and their committees are seeing reasons to expand their oversight into new areas. To stay ahead of the information curve, boards need to strategically plan sessions with management and independent third-party experts.

Questions to consider

- **Q** *How does the board, its committees and directors stay fully informed? What steps does the board take to make sure its knowledge and perspective enable agile decision-making and identification and solving of problems?*
- **Q** *Does the board represent the right mix of relevant skills and specialized expertise, industry knowledge, understanding of key stakeholder views, diverse backgrounds, experiences and perspective that stimulates effective oversight and direction? How is this disclosed?*
- **Q** *Do board discussions and decisions demonstrate that all board members are highly informed and engaged, respectful even when challenged, appropriately inquisitive, and attentive to and informed about both big-picture concepts and important details?*
- **Q** *Is the board engaged with the company's investors, employees, customers and regulators such that it clearly understands their key views and priorities and can appropriately incorporate them into the company's strategy?*

The detailed article is available on the EY Centre for Board Matters at ey.com/in/boardmatters

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‘We have complicated the entire legal and regulatory arrangement relating to governance. It could have been simpler.’

M. Damodaran
Independent Director on several leading Indian Boards and Chairperson, Excellence Enablers Pvt. Ltd.

EY hosted the twelfth BoardMatters Forum in New Delhi on 1 April 2019. In his keynote address, M. Damodaran, Chairperson, Excellence Enablers and Former Chairman, SEBI, addressed the current state of corporate governance in India, the legal and regulatory framework and the mismatch in expectations from board members.

Given below is a summary of the key points:

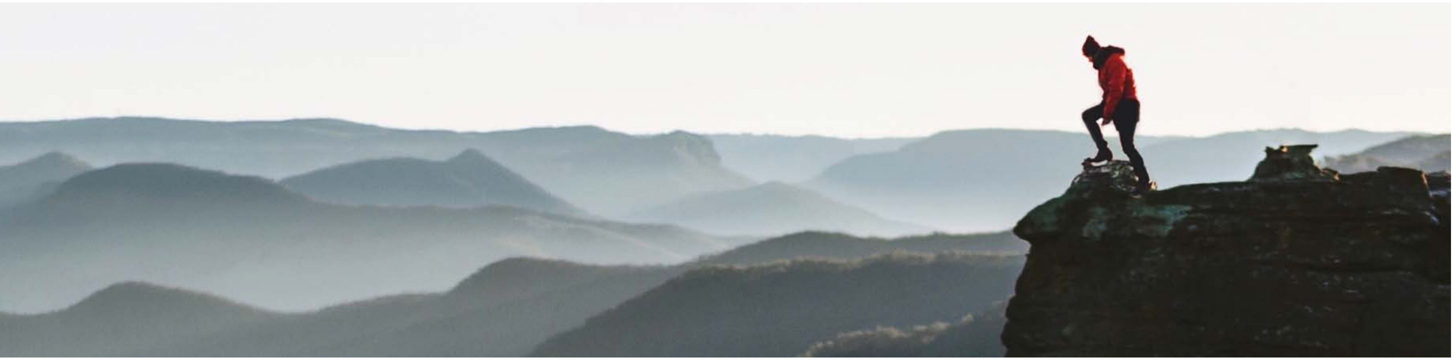
Board responsibility: The regulatory framework on governance in India is provided in the Companies Act, 2013 and SEBI’s LODR (Listing Obligations and Disclosure Requirements). The role of a Board of Directors is superintendence, direction and control, and it should not get into the operational details of running a company. Boardroom discussions could include a healthy difference of opinion. These discussions would be unknown to persons outside of the Boardroom. In this situation, it is easy to point a finger at directors in case of company failure and accuse them of collusion or negligence, but such an accusation would not be correct.

Board composition: Board composition extends beyond merely getting the arithmetic right. It is also about diversity. In the name of diversity, regulations mandate at least one woman independent director on the board of every listed company. However, boards should differentiate

between talent and tokenism. So widespread is tokenism that "woman director" has become a category of directors in the minds of a number of persons. Companies must recognise that she is a director who happens to be a woman, and that she is not on the board because she is a woman. Law also states that the Nomination and Remuneration Committee must decide the skillsets required on the board. The danger is that if one were to travel too far on the path of getting all specialists, the company may have a board of consultants, and not a board of directors. Looking for specialization at the board level may lead to getting the board's role mixed up with that of the management, and the board constantly second guessing management decisions.

Board committees: Increasingly, a lot of the work of the board will be done by the committees of the board since each committee would be in a position to deep dive into matters relevant to it. As a result, while onboarding a new director, boards must be focus on inducting individuals who are willing to serve on two to three committees.

Boards opinion: Directors must express their opinion. There is a cultural issue in Indian boardrooms where some directors may shy away from expressing their opinion, especially in the presence of the promoter. There should be constructive tension, and not peaceful co-existence between the Directors and management. Directors should constructively challenge management. Boards and committees have limited protection under the statute. A cursory reading of Section 149(12) of the Companies Act, 2013 gives the impression that an independent director is only responsible for what she/he gets to know through a formal board processes. However, the sting in the tail is at the end of the section, and it states – 'or if he has not acted diligently'. Also, this protection is only under the Companies Act, 2013, but there could be liabilities under other Acts and Regulations. Directors and Officers Liability (D&O) insurance policy too has limitations, and has exclusions such as when fraud is alleged. There is limited protection under law and through D&O policy. Further, the role of independent directors as distinct from management is not understood by most persons. Against this background, independent directors must voice their thoughts, even if there is a serious difference of opinion with the management and/or promoters. No compensation is high enough as a trade-off against the risk of reputation and liabilities under law.



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