Catalysing GLC Transformation

Green Book – Enhancing Board Effectiveness
Information Pack – Theme II: Improving the quality of SOE boards: nomination, competence and functioning
2007 Asian Roundtable on Corporate Governance - Cebu, Philippines, 18-20 April 2007
## 10 overarching themes of the GLC Transformation initiatives

<table>
<thead>
<tr>
<th>Initiative</th>
<th>Description</th>
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<tbody>
<tr>
<td>1. Enhance Board effectiveness</td>
<td>Enhance Board effectiveness through revamping Board practices and processes</td>
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<td>2. Strengthen Directors capabilities</td>
<td>Develop a strategy to match Directors to the right Boards and also establish a Director’s Academy</td>
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<td>3. Enhance GLIC Monitoring and Management functions</td>
<td>Reinforce the ability of GLICs to monitor and manage GLCs</td>
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<td>4. Improve regulatory environment</td>
<td>Enhance regulatory capabilities at GLCs and create a Regulatory Knowledge Network</td>
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<td>5. Clarify social obligations</td>
<td>Understand and make transparent GLCs’ social obligations and the implications of meeting them</td>
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<tr>
<td>6. Review and revamp procurement</td>
<td>Enhance the effectiveness and efficiency of the procurement process in GLCs</td>
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<td>7. Optimize capital management practices</td>
<td>Guidelines for GLCs to optimize their capital structure</td>
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<tr>
<td>8. Manage and develop leaders and other human capital</td>
<td>Improve GLC capabilities in attracting, developing and retaining talent through adoption of best practices</td>
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<tr>
<td>9. Intensify performance management</td>
<td>Encourage adoption of performance management best practices at GLCs</td>
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<tr>
<td>10. Enhance operational improvement</td>
<td>Enhance value creation of GLCs through managing non-core assets. Establish guidelines for GLCs to enhance their customer service levels</td>
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Introduction to Green Book – Enhancing Board Effectiveness

① Overarching objective is to raise the overall effectiveness of Boards

② Consistent with Malaysian Code of Corporate Governance, Bursa’s Listing Requirements, and all other rules, regulations, etc.

③ Different from existing materials as the Green Book is:
   • Focused on Boards, which is at the heart of corporate governance
   • Tailored to address biggest challenges that GLC Boards face
   • Practical and action-oriented, instead of just guidelines
Good Corporate Governance is correlated to financial performance

Sample size: 216 Asian companies with S&P CG scores and corporate level data

**Share price performance (Market-to-Book)**
- Top one-third: 1.9
- Middle one-third: 1.75
- Bottom one-third: 1.39

**Operational performance (ROCE %)**
- Top one-third: 5.84
- Middle one-third: 4.67
- Bottom one-third: 3.74

Source: S&P, McKinsey
Investors are willing to pay a premium for well-governed companies, particularly in emerging markets

<table>
<thead>
<tr>
<th>Region</th>
<th>Yes</th>
<th>No</th>
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<tbody>
<tr>
<td>Western Europe</td>
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<td>North America</td>
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<td>Latin America</td>
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<tr>
<td>Eastern Europe/Africa</td>
<td>73</td>
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</tr>
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**Are you willing to pay a premium for strong corporate governance?**

**How much of a premium are you willing to pay?**

Average premiums of those investors willing to pay premium:

- Indonesia: 25
- China: 25
- India: 23
- Malaysia: 22
- Philippines: 22
- Japan: 21
- Singapore: 21
- South Korea: 20
- Thailand: 20
- Taiwan: 19
- EU: ~13
- US: 14

Source: McKinsey
The Board is at the heart of Corporate Governance

Corporate Governance landscape

I. Legal/regulatory system
• Strength of regulators
• Securities & company law
• Level of corruption
• Role of government

II. Capital market
• Equity market development
• Institutional investor ownership
• M&A activity

III. Stakeholder power
• Creditors
• Employees
• Media
• Community/NGOs
• Government

IV. Talent pool & culture
• Managerial/director talent
• Collective vs. individual mindset
• Respect for rule of law

Shareholders
• Owners of company
• Appoint Board members

Board of Directors
• Strategy development and target setting
• Performance management
• Human capital management
• Risk management
• Adopt shareholder’s perspective
• Stakeholder management

Management
• Manages company
• Accountable to Board and shareholders

Owners of company
Appoint Board members
Strategy development and target setting
Performance management
Human capital management
Risk management
Adopt shareholder’s perspective
Stakeholder management
Manages company
Accountable to Board and shareholders
Improving Board Effectiveness is at the centre of GLC Transformation
GLC Boards have built the ‘conformance’ components of governance, and must now focus on the ‘performance’ components

**Transformation journey**

**Good board composition**
- Adequate size (e.g., 9-15)
- Composition (e.g., majority of outside independent directors)
- Diverse mix of board members (e.g., background, experience, expertise of members)
- Compliance requirements

**Good board practices and processes**
- Schedule of board meetings are provided in advance
- Sub-committees for critical tasks are established
- The board and individual directors are evaluated
- Pre-reading materials highlight key business drivers and do not provide excessive information
- Board can fire and hire the CEO
- Asking the right questions

**Trust-based board interactions**
- Board members actively participate in discussions during meetings and constantly ask probing questions
- 6 key roles are carried out by board
# GLC Boards should resolve several key issues

## Key areas of opportunity for GLC Boards

| Broaden breadth and mix of Board composition | • Composition to reflect skills and experiences in line with company’s requirements; most GLCs need real commercial and operational experience and/or specific industry or functional knowledge  
| | • Tighter selection criteria for Chairman – need ‘leadership skill’ and have appropriate ‘stature’  
| | • Nomination Committee (with GLIC representation) to make recommendations to Board – against an established selection criteria  
| | • Any conflicts of interest to be removed – no regulators on Boards  
| Increase focus on ‘key’ roles of Board | • Move away from over-focusing on operational details – refocus attention on key Board roles  
| | • Co-owning strategy through active and joint development with management  
| | • Intensifying performance management against pre-agreed KPIs and targets  
| | • Oversee development of human capital and future leaders  
| | • Understand and oversee management of key risks  
| | • In fulfilling roles, should adopt a shareholders’ perspective and balance valid stakeholder interests  
| Improve individual Director and collective Board accountability | • For continuous improvement and renewal, Chairman to lead an annual evaluation process of individual Directors and collective Board  
| | • Thereafter to apply consequences for non-performance – including removal or no re-election – and/or develop Board and individual improvement programs  
| Increase trust among Directors and between Board and management | • Clear boundaries to be drawn between Board and management  
| | • Board priorities to be aligned with overall company’s and CEO’s mandate  
| | • Board to function as a cohesive team – while constructively challenging and supporting management  
| | • Management, in turn, to furnish Board with necessary material to make informed decisions, and follow-through on decisions made  
| Streamline Board logistics on priority issues | • Board logistics, including charters, calendars, agendas, and discussion time should be focused on pre-identified priority areas  
| | • Board papers and presentations should be clear, relevant and synthesised – and provided to the Board with sufficient notice  

Components of an Effective Board

- Structures the Board to match the company’s requirements
- Defines committees’ role, structure and composition to complement the Board’s requirements
- Selects and nominates Directors using a disciplined process
- Evaluates the Board as a whole and each Director regularly
- Makes every Board meeting productive
- Ensures the quality and timeliness of all Board information
- Build trust via positive interaction dynamics and open communication within the Board and with management

Structuring a high-performing Board

Ensuring effective Board operations and interactions

Fulfilling the Board’s fundamental roles and responsibilities

- Contributes to developing corporate strategy and setting of targets
- Upholds a strong corporate performance management approach
- Oversees development of the company’s future leaders and human capital
- Understands and manages the company’s risks
- Adopts a shareholders’ perspective when making decisions
- Balances valid stakeholder interests
## Chapter One contains best practice guidelines – Structuring a high-performing Board

### Select Key Guidelines

#### Structures Board to match company’s requirements
- Board is preferably no larger than 10 Directors; in special circumstances up to 12 Directors
- Balanced composition; no more than 2 EDs and at least 1/3 independent
- Clear separation of Chairman and CEO
- Skills and experiences in line with company requirements; for most GLCs – commercial, operational, and/or specific functional or industry knowledge
- Align compensation to 50th percentile of appropriate peer group
- Additional ‘leadership skills’ and ‘stature’ required of Chairman
- Cap directorships in listed companies to 5 and in non-listed companies to 10

#### Committee roles, structure and composition to complement Board
- Only necessary committees, e.g. Audit, Nomination, Remuneration, maybe Tender, etc. are established
- Adheres to clear charters as established by Board – and not usurp management functions
- Committees composed of the ‘right’ Directors, e.g. independent where necessary

#### Selects and nominates Directors using a disciplined process
- Clear selection criteria exists – and in line with company’s needs
- Nomination process is objective; no pressures from external parties with vested interests
- Broaden pool from which Directors are currently selected
- Regularly evaluates Directors and collective Board – with follow through on consequences, e.g. removal or no re-election
Chapter One contains best practice guidelines
– Ensuring Effective Board Operations and Interactions

Select Key Guidelines

Make every Board meeting productive

- On average 6-8 meetings a year (with maybe 1-2 additional off-sites)
- Follows a pre-set 12 month rolling schedule
- Chairman determines agenda in consultation with CEO
- Adheres to a clear charter – which should contain Board priorities that are aligned with overall company’s priorities and CEO’s mandate

Ensures the quality and timeliness of all Board information

- Board papers are clear and relevant – preceded by a 1-2 page executive summary
- Agendas distributed 14 calendar days in advance
- Board material distributed 7 calendar days in advance

Builds trust via positive interaction dynamics and open communication (within Board and with management)

- Positive Boardroom dynamics and environment such that Board functions as a cohesive team – discussions should be constructive, productive and effective
- Constructively challenges; thereafter supports management
- Management, in turn, to furnish Board with necessary material to make informed decisions, and follow-through on decisions made
- Board decisions communicated promptly to management – verbally within 1 working day and key extracts within 3 working days
## Chapter One contains best practice guidelines – Fulfiling the Board’s fundamental roles and responsibilities

### Select Key Guidelines

| Contributes to developing corporate strategy and setting targets | Guides the strategic direction  
|                                                               | Co-owns strategy with management after challenging underlying assumptions  
|                                                               | Set targets for management  |
| Upholds a strong corporate performance management approach | Ensures that KPIs provide a balanced view  
|                                                               | Reviews corporate performance and follows-up  |
| Oversees development of future leaders and human capital | Selects CEO and proactively plans CEO succession  
|                                                               | Reviews the performance management philosophy  
|                                                               | Evaluates the CEO  
|                                                               | Endorses performance and development plan of pivotal positions  
|                                                               | Understands pool of future leaders  |
| Understands and manages the company’s risks | Sets the company’s risk parameters  
|                                                               | Understands major risk exposures  
|                                                               | Considers the risk factors in all major decisions  |
| Adopts a shareholders’ perspectives | Should take into account capital market perspectives, those of the majority shareholders, while protecting minority interests  |
| Balances valid stakeholder interests | In making decisions, to carefully balance and manage the sometimes opposing interests of stakeholders  
|                                                               | Key stakeholders include employees, customers, suppliers, regulators, and the government  |
GLCs TO CONDUCT BOARD EFFECTIVENESS ASSESSMENT (BEA)

**Step 1**
Conduct Board Effectiveness Assessment (BEA)
- Chairman to lead assessment
- Board has option to conduct assessment in-house or obtain external support to facilitate process

**Step 2**
Develop an actionable improvement program
- Based on gaps identified, Board agrees on rectifying actions
- Clear milestones and accountabilities set

**Step 3**
Implement initiatives in program
- Individual Directors or members of management lead specific initiatives

**Ongoing**
Review progress against milestones
- Every 6 months, plan time in Board meeting to review progress and make adjustment to programme as necessary
- Annually, conduct shorter Board evaluation and incorporate inputs into program
**ASSESSMENT TOOLS AND TEMPLATES FOR THE BEA**

Complete the BEA ... 

... guided by the assessment grids criteria

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<td><strong>Strengthening the Board to meet key expectations and requirements</strong></td>
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<td><strong>Ensure balanced, non-conflictual relationship with key stakeholders</strong></td>
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<td><strong>Set clear, measurable objectives relevant to the board’s activities</strong></td>
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<td><strong>Continuously develop the board’s role and powers</strong></td>
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<td><strong>Assess, monitor and promote the board’s effectiveness</strong></td>
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A COMPLETED BEA IDENTIFIES AREAS OF STRENGTHS AND WEAKNESSES...
… TO INFORM DEVELOPMENT OF AN ACTIONABLE IMPROVEMENT PROGRAM