

The role of the Chairman as well as value of a non executive chairman



The role of the Chairman and considerations in appointing a non-executive Chairman

It has become common for shareholders to attach more value to the quality of corporate governance structures. This is especially the case in public (listed) companies, where the company has many shareholders (some of whom may hold relatively diversified investment portfolios). Shareholders must be able to rely on appropriate corporate governance structures, risk management systems and board processes to safeguard their interests and ultimately enhance shareholder value. Some of the indicators of a well-developed and embedded corporate governance structure include: high-calibre directors; independent board committees; effective board chairing; and prevention of the concentration of power in one individual or a special-influence group through, for example, an independent chairman, strong independent representation on the board, and shareholder agreements specifying the powers of controlling shareholders.

Ensuring an effectively functioning board may seem obvious, but in order to achieve this it is important to attend to the balance of leadership and structuring of the board. The structure of the board will also have the biggest influence on the way in which corporate governance will be practiced on an on-going basis.

There should be a division of control between executive and non executive board members, and no subset of individuals on the board should dominate. The chairman should lead the board and there should be a clear division of responsibilities between the chairman and the chief executive officer (CEO). Most governance codes (e.g. the King report on Governance for South Africa 2009 (King III) and the UK Corporate Governance Code (the Code) which are both held in high regard internationally), as well as the listings requirements of numerous international bourses require a clear division between the position and role of the chairman and the CEO. In most instances it is a requirement that the chairman should be an independent director, and that the chairman should not also be the chief executive of the company.

Independent Chairman

The chairperson of the board is the individual charged with providing the board with leadership, and to harness the talents and energy contributed by each of the individual directors.

King III recommends that the chairperson should be an independent non-executive director. The chairperson should not also be the CEO. While the chairperson is required to retain an objective viewpoint of the affairs of the company, the CEO is often required to become intimately involved in developing and executing management plans for the company.

The independence of the chairman is paramount to the successful implementation of good corporate governance practices at board level. To ensure the chairman acts in an independent manner, internationally recognised governance codes state that the chairman should not have previously been the CEO of the company. In most cases, this is the most prudent structure and the preference of the market. In German corporate law, the role of the (independent) non-executive director is emphasised by the legislative provision that precludes employees (executives) from serving on the board of directors of the company.

The chairperson of the board should be independent and free of conflicts of interest at appointment (for example a potential conflict of interest will include having share options material to his or her wealth at the date of appointment). However, there are certain circumstances where it is understandable, and beneficial to the company, if the chairman has had a previous involvement in its operations. This is most common in businesses where the chairman is the major shareholder and founder but no longer wishes to be CEO. Investors can accept this type of arrangement (in effect non-compliance with both King III and the Code) although in situations like this it is advisable to have a strong pool of independent non-executive directors to maintain a balance in the boardroom.

If the board appoints a chairman who is a non-executive director, but is not independent or is an executive director, this should be disclosed in their reporting to shareholders, together with the reasons and justifications for the appointment. An explanation in this regard is also required in terms of, for example the Johannesburg Stock Exchange (JSE) and the London Stock Exchange (LSE) Listings Requirements. As the reasons and justification for such appointment will be a matter of public record, companies should consider carefully why they opt for the appointment of a non-independent chairman rather than the (best practice) independent chairman.

In terms of both King III and the Johannesburg Stock Exchange (JSE) Listings Requirements where an executive chairman or non-independent chairman is appointed, the board should appoint a lead independent non-executive director (LID) (another independent director, usually the deputy chairperson). In situations where the independence of the chairperson is questionable or impaired, a LID should be appointed for as long as the situation exists. The role of the LID would be to act as the 'independent conscience' of the chairperson, i.e. to ensure that all decisions of the chairperson are justifiable from an independent point of view. The Code stresses that in instances where the chairman is not independent, the senior independent non-executive director (similar to the LID in terms of King III) will often act as the de facto point of contact for the shareholder community.

Alongside a chairman, the LID is a role that should be filled as early as possible in order to ensure the right corporate governance structure is put in place.

Functions of the Chairman

The most obvious role played by the chairman is to govern the workings of the board, including directing the meetings of the board and acting as a conciliatory element when elements of the board differ.

The chairman is obliged to use this power appropriately and not to influence the outcome of the meetings towards a specific agenda.

The core functions of the chairman, among other, include:

- setting the ethical tone for the board and the company
- providing overall leadership to the board
- formulating (with the CEO and company secretary) the yearly work plan for the board against agreed objectives, and playing an active part in setting the agenda for board meetings
- presiding over board meetings and ensuring that time in meetings is used productively
- managing conflicts of interest
- acting as the link between the board and management and particularly between the board and the CEO
- ensuring that complete, timely, relevant, accurate, honest and accessible information is placed before the board to enable directors to reach an informed decision
- monitoring how the board works together and how individual directors perform and interact at meetings
- ensuring that good relations are maintained with the company's major shareholders and its strategic stakeholders, and presiding over shareholders' meetings
- upholding rigorous standards of preparation for meetings, and
- ensuring that decisions by the board are executed.

Further responsibilities of the chairperson would be to identify and participate in selecting board members (via a nomination committee), and overseeing a formal succession plan for the board, CEO and certain senior management appointments such as the chief financial officer.

The chairperson should ensure that all directors are appropriately made aware of their responsibilities through a tailored induction programme, and ensuring that a formal programme of continuing professional education is adopted at board level. Also, he or she should ensure that directors play a full and constructive role in the affairs of the company and taking a lead role in the process for removing non-performing or unsuitable directors from the board.

Lead Independent Director

According to King III a company may have sound reasons for appointing a chairman who does not meet all the criteria for independence or being non-executive and should be prepared to justify its decision.

Appointing an LID can assist the board to deal with any actual or perceived conflicts of interest that arise in these or future circumstances.

The main function of a LID is to provide leadership and advice to the board, without detracting from the authority of the chairman, when the chairman has a conflict of interest. Such assistance may be provided:

- at any board meeting (including meetings of committees of the board) or at any other meeting of the company;
- at any meeting the chairman might initiate with the LID;
- in any consultations that any other director or executive of the company might initiate with the LID;
- in any consultation that the LID might initiate.

The LID should at all times be aware that the role is that of support to the chairman and board and not in any way to undermine the authority of the chairman.

The LID should also chair the board meetings which deal with the succession of the chairman and the chairman's performance appraisal.

The term of the LID's appointment will depend on the circumstances of the company and could either be an on-going appointment or one of limited duration for so long as the actual or perceived lack of independence or conflict of interest of the chairman endures.

The role of the LID and deputy chairman, if one is appointed, may be combined.

Similarly, the Code requires the appointment of a senior independent director (SID) from among a company's independent non-executives (or an explanation as to why no such appointment has been made). The Code identifies six elements to the role:

- to provide a sounding board for the chairman — someone on whom he can test out ideas and seek a second view
- to serve as an intermediary for the other directors — particularly where there is an issue concerning the chairman
- to be available to shareholders if they have concerns that have not been resolved by their regular contact with the chairman, chief executive or finance director, or that would be inappropriate to raise with them
- to attend sufficient meetings with a range of major shareholders to listen to their views and understand their issues and concern
- to lead the annual evaluation of the chairman's performance, with input from other non-executive directors
- to lead the non-executives at times when it may be necessary for them to meet as a separate group without the chairman, because of his personal involvement with a particular issue.

To avoid any risk of confusion between the roles of the chairman and the LID/SID, a brief job description for the latter might be agreed by the board and be available on the company website along with other governance documents.

Conclusion

As shareholders and investors attach significant value to effective corporate governance the importance of the independent non-executive chairman is emphasised in several governance codes and listings requirements for international bourses. The independent chairperson can act as the main point of contact for shareholders and may assist to ensure objective board decisions, i.e. to ensure the board establishes a balance between the interests of management and the company's stakeholders (including shareholders).

The design and implementation of best practice corporate governance structures and processes contribute to the level of comfort of shareholders and the market in general. The willingness of prospective shareholders to vote with their feet and their wallets in favour of the higher, more sophisticated and independent governance standards (as set out in King III and the Code, and required by both the JSE and the LSE) demonstrate the benefits of those standards.

This can lead to a meaningful increase in a company's continuing market valuation — and has done so. Shareholders may derive comfort from the appointment of skilled and experienced directors, strong independent representation on the board, independent board committees, effective board chairing, and prevention of the concentration of power in one individual or a special-influence group — through an independent chairman.

Where a company opts to appoint a non-independent director as chairman, the reasoning should be explained to shareholders in the Integrated Report. As a general rule, the JSE requires companies to explain non-compliance with King III. A similar rule is embedded in the LSE Listings Requirements.

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