



## A V Vedpuriswar: Sarbanes-Oxley`s not the solution

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### **Independent directors, audit committees or ethical guidelines hardly improve performance or prevent failures.**

As the subject of corporate governance becomes more relevant and important than ever before, we must not miss the woods for the trees. We must remember that many of the companies in the US which ran into big trouble, had all the corporate governance mechanisms in place, at least on paper.

For example, the Enron board was a model board. When Enron declared bankruptcy, it was in full compliance with the governance provisions of the much publicised Sarbanes-Oxley Act, with the exception of loans to some corporate officers.

Enron also had a truly independent board. Only Ken Lay and Jeff Skilling were insiders in a board of 14 directors. Many of the directors were highly qualified.

Some were heads of major corporate or non-profit organisations. Others had significant governmental and regulatory experience. All the audit committee members were independent.

In 2002, the Enron board was judged one of the five best boards in the country by the Chief Executive magazine. Most of the other major firms charged with accounting scandals through 2002 were also in full compliance with the prescribed standards for board and audit committee independence.

According to William Niskanen, chairman of the prestigious Cato Institute, there is no evidence that a company's performance is related to the proportion of independent directors.

Over the past 20 years, many studies have tested this relationship and have reached that common conclusion. Audit committees, compensation committees and codes of ethics, have been of little use in preventing corporate governance failures.

There is also not much evidence that multiple board memberships affect firm performance.

In our country, several committees have been set up to improve corporate governance. But talk to people who sit on several boards and they will admit in private conversation that nothing much has changed.

More high profile people may have been added to the board. Sitting fees might have gone up. But the real challenges in corporate governance are far from addressed.

As Jeffrey A Sonnenfeld, has pointed out in an influential article, "It's time for some fundamentally new thinking about how corporate boards should operate and be evaluated... We'll be fighting the wrong war if we simply tighten procedural rules for boards and ignore their more pressing need — to be strong, high-functioning work groups whose members trust and challenge one another and engage directly with senior managers on critical issues facing corporations."

Improving corporate governance requires important steps that are not covered

by the growing number of rules and guidelines for corporate governance.

The most important is to create a climate of trust and candour. CEOs must share important information with directors in time for them to read and digest it.

Most board meetings spend a lot of time on trivial issues and gloss over the important ones. A culture of open dissent must be encouraged.

Directors must not get trapped in rigid, typecast positions. They should be encouraged to develop alternative scenarios to evaluate strategic decisions, and question their own roles and assumptions.

Directors must be involved in the management of the company's affairs. They must be given specific tasks and ask to be informed about the strategic and operational issues involved.

This may involve collecting external data, meeting customers, anonymously visiting plants and stores in the field, and developing relationships with external stakeholders. These steps will go a long way in imposing individual accountability on the directors.

In the 1980s and 1990s, shareholder activists, accountants, lawyers, and analysts highlighted the importance of independent directors, audit committees, ethical guidelines, and other structural elements that can help ensure that a board does its job.

Undoubtedly, these guidelines have helped companies avoid problems, big and small. They are necessary but not sufficient conditions for good corporate governance.

If a board is to truly fulfill its mission to monitor performance, advise the CEO, and facilitate effective stakeholder management, it must become a robust team whose members speak the truth and challenge one another in a constructive manner and allow hidden assumptions to come to the surface.

All companies talk about the importance of teamwork. The right place to start is the board. For good governance, the board should be a team where members have complete trust in each other.

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