EVOLVING THE ROLE OF THE COMPANY DIRECTOR

More than ever, investors value the role that directors play in ensuring companies are well governed and act in the long-term interests of their shareholders. However, today's rapidly changing environment means both shareholders and directors have to adapt continually. Building strong relationships between the two parties is an essential prerequisite for success, argues Amra Balic, head of corporate governance and responsible investing for Europe, the Middle East and Africa at BlackRock. This article provides an inside view on a global investor's expectations on boards.

An evolving role

The role of board director is a key position from the shareholder's perspective. Shareholders rely on directors to represent their interests and the right to nominate directors is a crucial element in the protection of shareholders' interests. Over the last decade, the importance of the role has continued to increase. The financial crisis and the rise of real time and social media mean that shareholders now require more regular engagement with board members. This presents a notable change as, traditionally, many boards of directors tended to communicate with shareholders only

ARTICLE BY AMRA BALIC
HEAD OF CORPORATE GOVERNANCE AND RESPONSIBLE INVESTING FOR EMEA
BLACKROCK

annually at shareholder meetings. While this requirement for greater accountability and pro-active engagement with shareholders may vary from market to market, it is only a matter of degree. Globally, the direction of travel is clear: shareholders are looking to establish better understanding and constructive relationships with individual directors and the wider board.

We view the changing and growing role of directors as a highly positive development. However, we recognise that it further increases the already substantial commitment required from the board directors in terms of time and intellectual focus. From a shareholder point of view, it requires a supportive approach and an appreciation that there are different ways to run a company well. After all, good corporate governance is a complex matter that requires thoughtful execution in line with local practices. It is important that investors understand the local market's culture and regulatory environment as well as the specific ownership structures. The board structure of companies with strong majority ownership will necessarily be different from that of a company with a highly dispersed shareholder base, but both may be as effective in protecting shareholders. Likewise no single governance model works best universally, and even when comparing major markets, such as Japan, the US and the UK, we find significant differences. In all instances, however, we expect boards to add meaningful value in a number of key governance areas as well as to engage pro-actively with shareholders.

Adding value

In our view directors add value in the following areas:

• establishing an appropriate corporate governance structure;
• setting the tone for the culture of the company;
• providing counsel/guidance to the management in the setting of the strategy and overseeing the execution of the agreed strategy;
• ensuring the integrity of financial statements and audit process;
• establishing a sound process regarding mergers, acquisitions and disposals;
• creating appropriate executive compensation structures that align interests of executives with shareholders; and
• addressing business critical issues – including social, ethical and environmental matters – that could affect corporate reputation and performance.

Establishing a clear and transparent governance structure

As a global investor, we respect regional differences and believe that governance structures need to reflect the markets in which a company operates. Nevertheless, we believe that it is important to have robust checks and balances as they significantly reduce the risk of negative financial consequences. This usually involves clearly defining the different roles of the board and management such that the responsibilities of each are well understood and accepted. It may also include the use of ad-hoc or more permanent sub-committees for areas where the board needs to consider certain aspects more closely (e.g. audit process, nominations etc.) or where certain board members face a potential conflict of interest.

In order for boards to act as an effective counsel to management they also need to represent a sufficient diversity of views and experience. In our view, companies that can muster a wide range of perspectives and experience at the most senior level are better placed to respond to changing risk and opportunities.

CORPORATE GOVERNANCE AT BLACKROCK

As an independent fiduciary of our clients, BlackRock devotes significant resources to corporate governance as we believe well-governed companies deliver better long-term outcomes for both shareholders and the companies in which we invest on behalf of our clients.

We are a member of more than 40 corporate governance, shareholder, and responsible investment-related organisations. We vote in more than 85 markets and engage with over 1500 public companies worldwide every year.

We believe good governance is about leadership. We focus our efforts on the board of directors because without board and executive leadership, companies may not have sound governance practices. These cover a range of critical business issues, including the environmental and social impact of companies.

Directors also have to communicate their corporate governance approach to shareholders and other stakeholders. This involves explaining the underlying rationale and why the chosen approach is in the interest of shareholders, particularly where it differs from standard market practice.

Supporting management in setting the culture of the company

'The tone from the top' is critically important in embedding corporate culture. Management has a primary role in establishing the corporate culture. However, the role of the board is to ensure that management's view and application of the company's culture is firmly rooted in clearly articulated ethical principles that a broad range of stakeholders can subscribe to.

Providing strategic direction and oversight

Company boards have a role to play in setting the strategic goals of the company, by providing management with insights and counsel to steer the development of a coherent and robust strategy that they can endorse. It is also incumbent on the board to oversee and monitor the successful implementation of the approved strategy and, where/if necessary, undertake corrective steps.

Integrity of financial statements and oversight of audit process

Financial statements should provide a complete and accurate picture of a company's financial condition. Directors play a vital role in ensuring that goal is met through appropriate oversight of the management of the audit function. We believe it is important that auditors are independent both in practice and perception. This involves putting in place appropriate procedures. These should include disclosure of any potential conflict of interest faced by the auditors that could affect the integrity of financial statements and, ultimately, the company's reputation.

Making decisions regarding mergers, acquisitions and disposals

Mergers, asset sales or other special transactions can have a material impact on the long-term economic interests of shareholders and other stakeholders. Boards therefore need to put in place a transparent decision making process, which takes into account the views and inputs from the entire board. We also believe it is important to have processes for managing any potential conflict of interest.

Establishing an appropriate executive compensation structure

Executive compensation has become a hot topic in most markets with much greater scrutiny around the potential misalignment of executive compensation with the long-term interests of shareholders and other stakeholders. While the way companies respond will differ from market to market, we believe that directors are best placed to put in place an appropriate compensation structure. This necessarily needs to take into account the specific circumstances of the company and the key individuals the board is trying to incentivise. As a rule, boards have to ensure that their compensation packages incorporate appropriate and challenging performance conditions consistent with corporate strategy and market practice.

Addressing business critical issues, including social, ethical and environmental

We see social, ethical and environmental ('SEE') matters as corporate governance issues that are integral to the successful management of companies. We believe companies that have robust governance structures and practices in place are much better positioned to identify and manage the risks and opportunities – including those relating to SEE issues – that are material to their company. This also extends to providing the necessary transparency to shareholders and other stakeholders on the adopted approach and how it compares to global and industry standards.

A constructive dialogue

Our starting position is to be supportive of boards in their oversight efforts on behalf of our clients. As a shareholder, we do not seek to micromanage companies but rather present our views as long-term shareholders and listen to companies' responses. Directors, along with shareholders, are critical in ensuring this dialogue is fruitful for both parties. While this dialogue has always been at the heart of good governance, a rapidly changing environment and greater scrutiny by regulators, media and broader stakeholders has added a new urgency. Directors and shareholders now need to be able to respond pro-actively to an ever wider range of issues. A crucial element in meeting this challenge is the strength of the relationship between shareholders and directors.