35

A Good Nominating Committee Can Save a Company

Junie Foo

It seems that corporate scandals in Japan are almost as common as the typhoons that lash the country each year.

This past July, the venerable Toshiba was right in the eye of the storm when it transpired that it had overstated its operating profits by 151.8 billion yen (S$1.8 billion) over several years. The accounting irregularities involved top-ranking management.

Independent investigators it hired said that since 2008, the three most recent chief executives had played active roles in inflating the numbers.

The Toshiba scandal is the latest in a string of high-profile financial imbroglios in corporate Japan. In the past decade alone, these have included:

- **Kanebo Ltd:** The cosmetics maker inflated earnings by about 210 billion yen (S$2.4 billion) over five years;
- **Livedoor Co:** The fast-growing Internet company used stock splits, swaps and share purchases to fraudulently boost its share price;
- **IHI Corp:** Japan's third-largest maker of heavy machinery corrected earnings to a 4.6 billion yen (S$54 million) loss from a previously reported 15.8 billion yen or S$185 million profit;
- **Olympus:** The maker of optics and reprography products concealed more than 117.7 billion yen (S$1.3 billion) of investment losses and other dubious fees and payments for nearly three decades.

ROOT CAUSE

Certainly, Japan is not alone in what appears to be systemic accounting fraud – the shadows of Enron and WorldCom in the United States loom large – but it appears that the country's corporate traditions have contributed to this sorry state of affairs.

Some observers are convinced that one root cause of the problem is the immense pressure management exerts on the company to meet unrealistic targets. This is, in turn, exacerbated by a culture of obedience and unquestioning deference.

In Toshiba's case, the lawyers and accountants investigating the fraud found "organised involvement including top executives", and that the chief executive officer (CEO)'s instructions were to use "every conceivable means" to achieve profitability. To add fuel to the fire, Toshiba's non-executive directors, who ought to have been a check on management, failed miserably because most were either company or industry insiders with no incentives to question the practices to which they were party; or they were former government bureaucrats who did not know enough to spot the problems.

NOMINATING COMMITTEE'S KEY ROLE

The Toshiba scandal is a timely reminder about the crucial role of the nominating committee to identify individuals with the right sets of skills, talents and attributes that are best suited for the needs of the board in discharging its duties. In Toshiba's case, there were too many senior executives either approaching or past retirement age, hanging around in ill-defined "advisor" or "consultant" positions and exercising undue influence.

It is important for directors to act without self-interest and avoid exerting undue pressure on the staff to obey. Good directors are those who should be both supportive as well as challenging of management decisions and actions when appropriate. They should have the independence of mind and moral courage to ask the uncomfortable questions and vote according to their conscience.

Collectively, a board should have an appropriate balance and diversity of skills, experience, gender and knowledge of the company. They should comprise a good mix of core competencies such as legal, accounting and finance, business and management experience, industry knowledge, strategic planning experience as well as customer-based experience and knowledge.

There should be a continual renewal of directors on the board. This, of course, needs to be balanced with continuity, where existing directors can continue to apply their knowledge of the company. This results in a more effective contribution to shareholders' value while providing for a more stable corporate direction and culture.

GUIDE FOR NOMINATING COMMITTEE

In the end, if management is tasked to run the business, then governance is about seeing that it is run properly. This requires the board to play a strategic role in the corporate governance of a company by safeguarding shareholders' interests and creating value. To avoid dark clouds forming, the nominating committee is the first line of defence in ensuring that the board's composition, structure, practices and processes are well established.

How then does the nominating committee go about ensuring all these? Help is on hand, at least in Singapore, with the launch of the *Nominating Committee Guide* by Minister Grace Fu on 28 August 2015.

The guide provides comprehensive coverage on the regulatory and practical aspects of the responsibilities and common issues faced by chairmen and members of nominating committees. These include challenging areas such as director independence, board diversity and succession planning.

The guide is the first in a series of corporate governance guidebooks for boards and board committees produced by the SID with the support of the regulators and the corporate community. It is no accident that this is the first of the guidebooks to be launched.

After all, good boards begin with good directors, and making sure that good directors get appointed to the board is one of the principal roles of the nominating committee. ■