MINORITY SHAREHOLDERS WATCH GROUP
BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD
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- **Can** a director be kicked out for also being on the board of a company with competing business interests?
- **The** market can punish a company for having such a director by selling down its shares
- **Boards** must demonstrate higher standards of self-discipline

Of undivided attention and conflicts of interest

by **Devanesan Evanson**

Shareholders and other investors must protest against company directors with conflict of interests

Public listed companies (PLCs) are governed by the Bursa Malaysia Listing Requirements. However, the Companies Act 2016 is the bigger umbrella law detailing how the affairs of companies are to be conducted. This includes the directors' duties and responsibilities.

The Listing Requirements allow a director to sit on the boards of up to five PLCs with the proviso that it is incumbent upon the director to decide if he can spare the time to fulfil his fiduciary duties to the PLCs on whose boards he sits.

This makes sense as different PLCs, depending on their size, structure, geographical locations and nature of business, demand different time commitments.

Should executive directors also hold board positions in unrelated PLCs?

One can therefore debate whether it is good governance for executive directors to sit on the boards of unrelated PLCs as independent directors.

Being an executive director (including managing director) is a full-time job. The company in whose board you sit in an executive position demands your undivided attention and focus – more so if the company is facing challenges and headwinds.

As such, sitting on other PLC boards at the same time could result in divided attention and focus. When executive directors sit on other boards, there is also a possibility that they will also be sitting on some of the subcommittees of these boards – further draining the undivided attention which the executive director position demands.

Sitting on the board of a PLC demands a higher degree of vigilance as there are the Listing Requirements and the Malaysian Code on Corporate Governance (MCCG) that would apply to PLCs.

While the MCCG does not prohibit directors from sitting on the boards of competitors per se, the Companies Act does provide some guidance and prohibitions.

Sitting on rival companies' boards is an important matter. For instance, if one is sitting on the board of another PLC which happens to be a bank, there are potentials for conflicts of interest; e.g. there may be a perception that you will favour that bank compared to the other banks.

Given the demanding role of being a director, especially an executive director, we are of the view that it is preferable for an executive director to refrain from sitting on the boards of other PLCs so that he or she can give full value to the company in which he or she has an executive position.

It would be good if the board or the senior independent director can counsel these executive directors against sitting on the boards of other PLCs.

At the very least, boards must conscientiously evaluate and come up with a policy on executive directors sitting on the boards of other PLCs. There are a handful of PLCs on Bursa Malaysia where such a situation occurs.

Should independent directors also sit on the boards of companies involved in substantially similar business?

The fiduciary duty imposed by the Companies Act requires the directors to act in the best interest of the company, which is the collective interest of all shareholders.

When directors sit on the boards of PLCs which are involved in a competing business, it will be difficult for them to argue that they can act in the best interest of the two PLCs.

The same holds true for independent directors who sit on the boards of companies which have competing business interests.

As an example, should independent directors of property companies sit on the boards of other property companies as independent directors?

Given the current property overhang, an independent director of one property company may unwittingly "share" the strategy and tactics of that property company with the board of the other property company where he also sits.

Or what about the case of an independent director who sits on the board of a telecommunication company and a power utility company and later, the power utility company decides to diversify into the telecommunication business in a big way. Is not the independent director in a conflict of interest position?

Sometime ago, there was a director who was sitting on the board of a glove-making company and a condom-making company. After some time, the glove maker decided to diversify into condom making – a perfectly logical and synergistic diversification as the common denominator is latex.

Sometime later, the director of the glove-making company stepped down. There must have been a realisation that that the director was truly in a conflict of interest situation.

A laudable move in the interests of good corporate governance.

Saying that you will excuse yourself whenever a "conflicted" subject matter is brought up is untenable as, apart from board meetings, information that has the potential for conflict abounds elsewhere e.g. board papers, management reports, conversations with staff and fellow directors or even a chat over lunch, where sometimes discussions may involve the matter related to the said conflict-of-interest subject.

In fact, more often than not, the board meetings would likely deliberate extensively on "conflicted" or sensitive subject matters as the companies are substantially in similar business.

One must be pragmatic when alluding to the concept of the "stepping out when conflicted" approach.

These are generally for one-off ad hoc instances of conflicts of interest. Where a conflict of interest situation is pervasive or continuing or is likely to rear its head every now and then, the better approach is to avoid the conflict of interest situation completely.

It is impractical and untenable to adopt the "stepping in and out" approach.

It would be good if the board or the senior independent director can counsel such independent directors to not sit on the boards of other PLCs with competing business interests. This is called self-discipline.

There is a Biblical saying that "no man can serve two masters. For either he will hate the one, and love the other..."

Where independent directors sit on boards of two PLCs which have competing interests, the independent director is serving two masters.

When directors play hardball

Sometimes directors in such situations may decide to play hardball and refuse to vacate their other directorships. They will adopt the legalistically (and technically correct) approach that the shareholders appointed them and only the shareholders can remove them.

This is where both institutional and minority shareholders will have to play their part to ensure that such directors do not continue in their compromised positions.

This is the type of shareholder discipline that the regulators would expect.

Sometimes, the PLCs have the patronage of a major shareholder who acts as a "protector" of the independent director and condones the position of the independent director in a competing business, and when it comes to a vote, the major shareholder will vote this director in.

However, under such circumstances, the other shareholders, including other substantial shareholders, may express their displeasure by opting to sell down the shares of the involved PLCs. This can be painful as the share prices tend to tumble. This is market discipline ... where the market disciplines the PLC.

The triune approach to capital market discipline

There are three kinds of discipline in the capital market: self-discipline, regulatory discipline and market discipline.

The preferred discipline is self-discipline. If boards discipline themselves, there would be no need for regulatory discipline or for even the market to discipline them.

Where self-discipline goes awry, the regulators move in to discipline the PLC when there is a breach of law and/or rules.

This is often followed by market discipline where the investors show their displeasure by selling down the stock.

Markets (investors) also discipline PLCs by selling down the stock if they do not like what they see, regardless of whether there is a breach of laws or rules or codes.

Every institutional shareholder of repute will have its own internal mandates on what is acceptable behaviour which is often over and above the requirements of laws, rules and codes.

Boards are therefore expected to subject themselves to higher standards of self-discipline, higher than that expected from the laws, rules and codes.

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