Analysis

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Unbundling, untangling and recycling: Questioning director independence

Key take-aways

- When vetting candidates for Director positions, we have found that the Boards of many SA-listed companies have an inadequate number of truly independent non-executive directors (NEDs).
- There is a shortage of qualified candidates because few people have served on Boards previously, and “professional” NEDs often lack the operational experience necessary to help guide Board members in their decisions.
- We have found that Boards can be lax in conducting due diligences. Some have failed to uncover conflicting connections between NED candidates and their companies.

Unfortunately, a common theme for M&G Investments in our role as a responsible steward of our clients’ investments has been the presence on listed companies’ Boards of non-executive directors with questionable status as “independent”. Even as this article is being written, Business Day’s front page features an article about a former CEO of international retailer Spar becoming an “independent non-executive director” amid reported questions over his independence.

The role of independent non-executive directors (INEDs) is critical to the functioning of an entity. INEDs on a properly functioning board are a source of experienced, deep independent insights, mentoring, discerning questioning and guidance for management.

We have highlighted this issue in our latest 2021 Stewardship Report using the example of MultiChoice, whose lack of independent directors forced some complex choices for shareholders, including ourselves. Here we explain our decision on MultiChoice and delve into our concerns around the independence of non-executive directors (NEDs) in South Africa.

MultiChoice: A lack of independent directors

MultiChoice was spun out of Naspers in March 2019, a transaction that happened relatively quickly and, in retrospect, without the amount of time necessary for it to put in place sound governance structures. This resulted in the rapid appointment of Board directors, particularly non-executive directors (NEDs), including a former executive as lead independent director (LID). This was not ideal, and the individual was replaced in April 2020. However, his successor unfortunately passed away in June 2021. This in turn resulted in the current LID appointment also being a former company executive, leaving this position “compromised” under sound governance guidelines. Together with the current Chairman of MultiChoice being a former CEO, this left governance at MultiChoice lead by NEDs with very close ties to management.

MultiChoice shareholders collectively have a dim view of governance at the company, demonstrated by the Board having failed in its remuneration vote with possibly one of the lowest levels of support seen on the JSE. Our stance against the 2021 remuneration vote was based partly on insufficient disclosure and an excessive fee arrangement with the current Chairman/ former CEO, who was paid R58 million in FY2021 and R17 million in FY2022 under a five-year restraint of trade agreement.

In our view, important governance fundamentals are clearly not yet in place at MultiChoice, making it very difficult to see the Board as being truly independent. This has been exacerbated by the complexity of the Chair and the CEO both residing in Dubai, a city with no corporate operations. These issues raise questions as to whether the Chair is not essentially remaining as an executive. With governance discussions ongoing into 2022, these developments resulted in extensive remuneration changes at the company.

We addressed these issues, along with other governance concerns, in formal correspondence to MultiChoice in late 2021, followed by meetings with Board in early 2022. While being one of their most outspoken critics on the lack of independence, we sought a compromise with the Board. This was after having received undertakings that new additional NED's would be appointed to balance the Board, and the LID would relinquish his position as LID (though not as a NED) within the next 24 months.

We also received sufficient information to temper our shorter-term governance concerns around the impact on the group's strategy. This, in our view, enables an appropriate transition to better governance, while leaving sufficient support for the executives in the interim.

Our compromise with Multichoice highlighted a complexity in the role of monitoring issues of true independence. Although it would be easy to oppose directors who are deemed not sufficiently independent, MultiChoice's NEDs do offer years of critical experience unique to both the company and the industry in which it operates, and have played a role in its ongoing success. Responsible investors must sometimes balance requirements of independence against taking actions that could harm shareholder value in the short term, deciding where exceptions to guiding principles can be made, and then closely monitoring them.

A scarcity of candidates

The most common explanation we hear from companies for nominating individuals with some type of connection to the company itself is a lack of suitable candidates in South Africa. Consequently, they say, NED's must be sourced from former company executives because their experience is very valuable. This is also the case when NED's remain on Boards for lengthy periods of time.

Most Boards will insist on some prior listed-company Board experience, or experience at a large sub-Board of a listed entity. This leaves few available NED candidates, and those that are

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young and available may be "professional" NEDs, but they are likely to have never worked in any serious capacity on an operational level. We have reviewed many without genuine accounting, IT or ESG skills or background, or operational experience.

In fact, many have the sole experience of simply having been on other Boards. The reality, however, is that many professional 'Board sitters' often do not have the depth of expertise, or insights, into what management are facing as challenges, or ignoring as risks. As an example, one NED candidate we reviewed famously had attended over 100 meetings during the 2019 period, yet the Boards she sat on claimed she was an "excellent voice" in meetings.

The difficulty Boards face is that without proper due diligence of a candidate, an 'excellent voice' could simply be a well-resonating echo chamber of the rest of the Board. Behind the scenes, candidates for an NED's role need to be those who can genuinely question and guide management with critical thought and an experienced and "removed" perspective.

Due diligence?

When existing candidates are challenged by shareholders, the most common answer we receive is that the Boards themselves undertake a rigorous assessment of the individuals as a "selfcertification”. This it is hardly appropriate for a company’s most senior level of oversight on a personal level – there is a fairly evident conflict of interest if the candidate is well known to Board members.

And while some Boards are at least obtaining third-party due diligences of their members from outside companies, these entities can also be conflicted themselves; they are hardly incentivised to declare the Board members that hired them as needing removal.

The way forward

A potential, but not ideal, solution for some of the above concerns is for “experienced” hands to come onto Boards as non-executives, but for them not be classified as independent, and to ensure there are sufficient independent non-executive directors to counter them. Or better yet, to bring these qualified individuals in as consulting, but non-voting, invitees.

Specialised training for INEDs – supplementing that offered by the Institute of Directors where necessary – should also be offered to increase the talent pool in South Africa, and a limit set on the number of Boards an individual can belong to.

Some governance issues can also be resolved through better shareholder collaboration. South Africa has a sufficiently concentrated set of shareholders that, while ensuring regulations on change in control are not overstepped in law or in spirit, directors not meeting appropriate standards can be opposed through votes or collaborative engagement.

South African shareholders need to collaborate more frequently, question more deeply, and challenge more adequately. This should encompass not only resolving conflicts of interest and director independence issues, but also assisting in finding and pushing appropriately experienced and independent talent to Boards, and supporting these directors. And for those Boards where there are no obvious conflicts, but clearly best practice is not yet instituted, such as MultiChoice, it can simply mean requesting a transition to best practice in set time periods.

At M&G Investments, we have a long history of conducting strict due diligences on Board nominees, and our latest Stewardship Report relates some examples of our work in this area. We have made quite a few director appointments in past years with the support of other shareholders. The task of due diligence, stewardship and ensuring appropriate Board composition is an incredibly important function for shareholders, more so because some South African companies are falling short in these areas. □

Anthony has been our liaison with the UN PRI since 2007 and played a leading role in drafting our Responsible Investment Policy and inaugural Stewardship Report. Anthony has taken on ESG as a full time role from early 2019, and is currently working out of the Governance Risk and Compliance department. His key areas are supporting or initiating engagements, legal and regulatory support for the investment team on corporate actions, and policy development. He has been in the financial services industry since 2003, having worked with Prudential since January 2007. Anthony's qualifications include Bachelor of Commerce and Post-Graduate Law degrees.