ILLUSTRATION BY AJAY MOHANTY

The task of the board

What is the role of the board?

There is fresh interest in the role and function of the board of directors. Some features of the board are common across a private corporation or a government agency. The function of the board is to hold the management accountable, both at a black box level and at the level of strategy and structure. In the government setting, four aspects of the board process have to be modified.

If an organisation is controlled by its management, there is the danger that the management will be lazy, corrupt or non-strategic. For this reason, the sound design is one where an organisation is governed by a board. The words "governance" and "management" are distinct. The management runs the shop on a day-to-day basis, but this is done under the oversight of the board.

We often see the board as a homogeneous unit, but it is actually two very different groups of people. There are the management directors: The members of the board of directors who are whole time managers of the organisation. And there are non-management directors (NMDs) who are outsiders. The board process is about NMDs influencing the management to foster better performance.

The board exists because of three problems. The management always claims that things are good and nothing needs to change. The management is in love with its own decisions, which are often taken in a way that fits in their comfort zone. The management is lost in detail, mopping the floor and not turning off the faucet. The management suffers from the pride of the field operative, and claims that you have to be a hen to know about eggs.

The NMDs have three levers through which these problems are addressed. They establish sound methods of reporting, which portray the true performance of the organisation. They conduct reviews and hold the management accountable for performance. They directly participate in developing the strategy of the organisation and the organisation design through which that strategy is pursued.

For these levers to work, NMDs must make up a majority of the board, and the chairman must not be chief executive officer (CEO). A nice board structure has a CEO, three deputies, and at least five NMDs. This adds up to a board of nine persons. Or we can have a CEO with two deputies, and at least four NMDs, which adds up to a board of seven persons.

SNAKES & LADDERS

AJAY SHAH

A primitive country is ruled by a dictator. The essence of a sophisticated liberal democracy is the dispersion of power into a large number of minds. This delivers better results when compared with concentrated power. In similar fashion, the dispersion of power from one autocratic CEO to seven or nine members of the board yields superior results. Seven or nine minds that think, debate and collaborate yield better results than one unchecked mind. The hallmark of a sound organisation is a CEO who does not use the word "I" when talking about the actions of the organisation.

It takes decades for a country to learn the soft infrastructure of sharing power. In similar fashion, it is hard for an organisation to learn the soft infrastructure of dispersion of power, through which many minds participate in all decisions.

All these ideas apply in a government organisation, with four fascinating twists.

First, it is hard for NMDs to hold the management accountable in a government setting, absent the simple metrics of financial performance. It was easy for the board of IL&FS to see failure as measured by revenue, market share, profit, return on equity and share price. In contrast, it is difficult for the board to judge the performance of the Securities and Exchange Board of India (Sebi). Therefore, the board of Sebi must work much harder in establishing procedures for quantitative and qualitative evaluation of the organisation's performance.

If the RBI only did monetary policy, it would be possible to judge its performance as the extent to which inflation diverged from the target of 4 per cent. An organisation can be accountable only if its objective is simple and well understood. A sprawling, confusing, conflicting objective is not conducive to accountability, and requires greater activism by the board.

Second, in a private organisation, the profit motive forces organisation redesign. The board holds the CEO accountable for profit growth, and the CEO does the work of cost minimisation. In a government organisation, the lack of a profit motive and the human lust for arbitrary power create bad organisational design. The board must take an active interest in the organisation diagram, the mandate and accountability of each department, and the process manuals. Cost minimisation, and the rule of law, will be championed only by the board.

Third, there is the unique problem of delegated legislation. In a constitutional democracy, the power to coerce private persons can only flow from law, and law can only come from the elected legislature. But regulators have the powers to write law ("regulations"), which coerce private persons. This is a unique situation, where the coercive power of the State is handed over to unelected officials. It is all too easy for these unelected officials to become politicians (dispensing patronage between rivals in the market), and to drift into corruption, laziness and central planning.

To solve this problem, all regulation making must start and end at the board. A board resolution must be required before a regulation-making project commences. The staff must run a formal, transparent, consultative process through which the regulation is drafted. This documentation packet must come back to the board for discussion, and only the board should be able to approve the release of regulation.

Fourth is the problem of nominee directors. Many government organisations have nominee directors. By and large, this has not worked well. Nominee directors are mostly silent and passive, and only speak up to exert veto powers for the interests of their parent organisations. This does not add value and this should change. As an example, the Sebi board should have 'n' management-members, one representative of the Department of Economic Affairs and 'n+2' NMDs.

The writer is a professor at National Institute of Public Finance and Policy, New Delhi