ROLES AND RESPONSIBILITIES OF BOARD OF DIRECTORS: PAVING NEW PATH TOWARD CORPORATE GOVERNANCE IN THAILAND

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Abstract

Board of directors is one of the most essential elements of a corporation. Board members function as representatives of shareholders to monitor the management's performance. Therefore, the board of directors is directly concerned with corporate governance development. However, it is generally found that the roles and responsibilities of board of directors are often ignored. The Asian financial crisis that first started in Thailand in 1997 triggered the interest in the structure and roles of the board of directors as an attempt to improve corporate governance. As a result, several measures have been set up to strengthen the functions of the board after incidences of corporate disasters resulting from the failure of monitoring systems of the board. This includes both regulatory and voluntary measures to improve corporate governance through board of directors. Recommendations for future development of board of directors are also discussed.

Keywords: board of directors, fiduciary duty, corporate governance, business ethics corporate control, monitoring, Asian financial crisis

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Introduction

In a corporation, shareholders are the ultimate owners while they delegate the management to run the business for them. This is why it is necessary to have a group of people to monitor the management functions of the company. This group of people is the board of directors. Even though the board of directors is considered one of the most significant components of a corporation, the roles of the board of directors are often neglected. In today's education, there was almost no formal training about the roles and responsibilities of the board of directors, nor attempt to educate future board members.

It is therefore necessary to review the roles and responsibilities of the board of directors. The most important role of the board is to monitor the management functions on behalf of shareholders. In doing so, the board of directors must fulfill their fiduciary duties i.e. protecting the best interest for shareholders. In fact directors owe to its shareholders two types of duties which are considered fiduciary duties:

1. Duty of Loyalty. It is the responsibilities of the directors to be loyal to the shareholders and act honestly to protect the company's interest without personal gain and try to avoid conflict of interest.
2. Duty of Care. Directors should make decision with consideration of all possible alternatives and information with reasonable business judgment.

I. The Roles and Responsibilities of the Board of Directors

In recent years, the emphasis on corporate governance has resulted in an increasing number of studies on the roles and responsibilities of the board of directors and its roles in enhancing good corporate governance practices in a corporation. Several studies have outlined the roles and responsibilities of the board of directors. According to Conger, Lawler & Finegold (2001), Monks & Minow (2004), Colley, Doyle & Stettinius (2003) and Millstein (2002), the responsibilities of the board of directors can be summed up as follows:

1. Overall direction and mission of the organization. The board along with the management determines the direction and mission that would most benefit for the shareholders through the company's activities.

2. Senior management and CEO recruitment. The board also selects and recruits senior level managers and Chief Executive Officers of the company. In certain instances, the board prepares the succession of CEO in advance.

3. Senior management and CEO motivation, evaluation and compensation. Besides recruitment, the board continuously monitors the work of these senior managers and CEO, motivates and gives advice in their work, evaluates regularly and compensates the management accordingly.

4. Strategic planning of the corporation. The board and the management engage in long-term planning of the corporation in every step the company needs to move forward.

5. Financial plan review and approval. The board, like the members of parliament in politics, reviews the financial plan and budget that the management proposes and approves or disapproves it. This normally goes through several rounds of revisions before approval. After the approval, the board constantly monitors the use of the budget and checks whether the budget is used according to its purposes. Moreover, the board also approves decisions to search for source of fund for the company. This could be from loans, capital increase, debt instrument issuance, etc.

6. Compliance with business ethics. It is absolutely necessary that the board must perform their duty with business ethics. Chances to stray from the business ethics are high for both the management and the board. Thus, the board must keep in mind all the time that their existence depends on the trust the shareholders give them, and the level of trust is based upon their own ethical standards. The directors should know what is right and wrong and must protect the shareholders through their conscience.

7. Compliance with laws and regulations. At present, the board is bounded to comply with laws and regulations. More laws and regulations are coming up as a result of previous incomplete functions of the board and the public's need to strengthen the fiduciary duty of the board. As a result, the board must regularly follow the development of these laws and regulations and comply with them.

8. Board's assessment. The evaluation of the board is often difficult to administer. However, the board may assess its overall performance through full board evaluation. Since the management and shareholders do not often engage in board selection and evaluation, the board can do self-evaluation or peer-evaluation to determine whether the board members are fulfilling their duties. Details can be found on the evaluation of board members section.

Since the board is working closely with the management, there are many levels of board's involvement, Nadler (2004) has classified different levels of engagement in management by board of directors:

1. The passive board. The board follows traditional roles with limited accountabilities. This is mainly to justify management's decision.

2. The certify board. The board certifies to the shareholders that the management is doing properly.

3. The engaged board. The board of directors supports CEO in key decision, engages in useful discussion, and gives advice to CEO. The boundary between CEO and board responsibilities is clearly defined.

4. The intervening board. The type of board is intensely involved in management. The intervening board likes to hold frequent meetings.

5. The operating board. The board makes decision for management to implement and tries to fill in for inexperienced managers.

The levels of involvement by directors are not definitely divided as such but the board may involve in one of the levels above depending on the situations and environment.

Characteristics of Board Members: Board Selection

Generally, board of directors is chosen with consent from the shareholders. Therefore, the board appointment must be approved in the annual shareholder's meeting. However, the names of the board members are proposed by the management and the existing board members. Main characteristics of board members that need to be considered include:

1. Ethical standard: Integrity and accountability. This is the most important characteristics of the directors. They must be selected according to the ethical standards that are witnessed by the public. The directors should be a person of integrity and are ready to protect shareholder's interest.

2. Competence. Directors must be competent in the business of the company and the criteria to choose one is the proven record of success in business management. Therefore, it is found that most directors are often selected from the previous CEO or senior level managers of the company or the related industry.

3. Independent. Directors should be independent in their business judgment. The best practices and codes of conducts normally try to define the meanings of independence in terms of family and business relationships of the director. However, what considers as independence is the directors' own judgment to protect shareholder's interests.

4. Financial Literacy. This characteristic should be the easiest of all, since directors can be trained and

updated on their financial capability. However, most directors are often chosen from people in the business world, financial literacy should not be the problem. Nevertheless, it is occasionally found that there are some directors who feel that they are not well equipped in understanding and making decisions with financial information, especially if they serve as audit committee members.

In addition, the directors must possess other beneficial characteristics to the company. This might include functional expertise e.g. operations, finance, marketing, human resources or accounting management. In some cases, the board might need directors who have in-depth experience in the related industry. For example, Continental Airlines' board searched for directors who had in-depth understanding of the airline industry (Nadler, 2004). Some boards try to cover demographic diversity (such as gender, race, etc.) by recruiting minority candidates. Others might look for candidates with knowledge of geographical markets so that they can bring diverse understandings of customers in several regions to the board's sight. Distinct professionals and CEO experiences are also in need for their valuable business insights.

Evaluation of Board Members

With the roles and responsibilities of the board, it is necessary to evaluate the performance of board members. Evaluation is the most ignored process of the board. This would require the establishment of evaluation processes and objectives. Currently, there are many evaluation tools and models for board evaluation. The adaptation of the model to the environment and culture of the company and each board individually is an issue that the board needs to agree in advance. Generally, there are three types of board evaluation that can be done by board members and senior management in the board.

1. Full board evaluation. All members of the board assess their performance on a regular basis. This is done to evaluate teamwork for the whole board.
2. Self-evaluation. Several models and self-evaluation kits are available for directors to rate themselves in various issues. The board of directors may agree with certain types of evaluation before implementing one. Through self-evaluation, certain abstract characteristics of an individual can be rated e.g. honesty, integrity, motivation, self-confidence, etc.
3. Peer-evaluation. To avoid biases in self-evaluation, peer-evaluation can be used so that a board member can receive overall opinions from his or her peers.

The board should review the evaluation processes and its objectives regularly. Sometimes, an evaluation process might not be suitable for corporate and board culture and needs to be revised. After the evaluation, the board should inform the shareholders about the evaluation results along with the processes and criteria.

The results from the evaluation should be constructive for the directors. The process should allow directors to leave the board alternately, so that the board would have new people and ideas.

Compensation of Board Members

Besides evaluation, the concepts of compensation for board members are even more controversial. At least two concepts stand out for board compensation. One believes that a large portion of compensation should be in the form of stock ownership so that directors would pay more attention to the company that he or she owns. However, the stock ownership must follow the appropriate guidelines by the authority such as the stock exchange or the Securities and Exchange Commission (SEC). The other concept does not believe in stock ownership by directors and would like to separate the stock ownership and director's responsibilities completely, so that directors are completely independent and have no possible conflicts of interest. Those companies that follow the latter concept chooses to compensate the directors by other means e.g. salary, meeting allowances, etc.

With the knowledge of the roles and responsibilities of the board of directors, it is interesting to investigate the state of the board of directors in Thailand, the country that first experienced the Asian financial crisis in 1997. The comparison between the pre-crisis problems and post-crisis solutions would help us understand more about the significance of the board of directors in a corporation and how Thailand paves its ways toward strengthening corporate governance through the board of directors.

II. The Board of Directors of Listed Companies in Thailand Prior to the 1997 Asian Financial Crisis

The board of directors' roles in Thailand and most of the Asian economies are often not in focus until after the Asian financial crisis in 1997. It is widely agreed that the crisis happened as the private debt of corporations accumulated as a result of reckless lending and inappropriate capital spending by the management of corporations. It is obvious that the monitoring system of the corporations, for which the board of directors is responsible, was improper and inadequate.

It would be useful to analyze the history of modern corporations in Thailand to understand what the roles of the board are. The structure of a corporation as existed in the Western society, was adopted in Thailand about a century ago. In the beginning, it was European-owned companies, namely Berli Jucker, East Asiatic, etc., that introduced the modern corporation concept in Thailand. The Chinese in Thailand, who owned a majority of businesses during that time, had not adopted the modern corporation concept but still run their business as a family-owned business. As the modern concept diffused into the Thai society, the roles of the board of directors that function as a check-and-balance system, were not implemented, as family management often made decisions without any monitoring mechanisms, especially from outsiders. Thus, directorship was interpreted in various ways. Some companies treated their directors as consultants, they decided to choose experts or professors to serve as directors. Others believed that having high-ranking police officers, soldiers or politicians, etc, as directors would help them protect the interest and benefits of the company, etc.

The crisis in 1997 starting in Thailand was just a stepping stone that triggered several parties that intended to improve corporate governance to pay attention to the roles and responsibilities of board of directors, as people started to question who were responsible for the financial devastation. It is surprising to learn that, according to surveys done around 1996-1997, even the board of directors in Thailand had not known about the significance of their roles in protecting shareholder's interests.

In general, the Thai legislation outlines the qualifications for directors in a very broad way as follows:

1. 20 years or older
2. Be solvent and not incompetent or quasi-competent
3. Never been imprisoned based on final judgement for a fraudulent offence related to property
4. Never been dismissed or removed from government office due to dishonesty

When the Stock Exchange of Thailand required listed companies to appoint independent directors, the following qualifications were added:

1. Be independent from the major shareholders of the company or any shareholder in the group
2. Not be an employee, staff member or an adviser receiving a benefit from the company or its related entities
3. Have no shares in their own name, or in a related person's name, representing more than 0.5% of the respective paid-up capital of the company and its related entities
4. Be able to protect the interest of all shareholders equally
5. Be able to prevent conflicts of interest between the company and its management, major shareholders or other companies that have the same management group or major shareholders as the company
6. Be able to attend board meetings to make decisions on significant company activities

Committees of the Board of Directors

The board can appoint a group of people consisting of board members and senior managers to perform selected duties for the board. This group of people is executive committee. Moreover, the Stock Exchange of Thailand suggested listed companies to appoint the following committees:

1. Audit Committee: The committee that is responsible for verifying financial statement of the company
2. Remuneration Committee: The committee that is responsible for the remuneration of the staff and board members
3. Corporate Governance and Business Ethics Committee: The committee that is responsible for the corporate governance issues of the board

Realizing that setting up the audit committee is the key toward better corporate governance for the listed company in Thailand, the Stock Exchange of Thailand required the appointment of audit committee for all listed companies from 1998. From the experience of the 1997 financial crisis, it was found that most of the mistakes could have been avoidable if the audit committee had been established and monitored the financial status of listed companies.

The responsibilities of the audit committees are:

1. To monitor the financial reporting system of the listed companies and disclose all financial information to the public.
2. To establish and supervise an effective internal control and internal audit systems
3. To comply with relevant laws and regulations regarding financial disclosure
4. To avoid conflict of interests in the activities that the company may engage in

Even though the SET has required the establishment of audit committee, it was found later that some of the audit committee members were financially illiterate. Thus, the Securities and Exchange Commission (SEC) involved in the recruitment of audit committee by setting up a criteria that at least one member must have literacy on financial statement. The SEC also interviews all audit committees of Initial Public offering (IPO) companies.

Problems of Board of Directors: Surveys on Board of Directors and Business Ethics in Thailand: 1996-1999

To understand the state of board of directors in Thailand, the Stock Exchange of Thailand had commissioned three survey studies of listed companies in Thailand during 1996-1999. The objective of the survey was to understand corporate governance and business ethics of the listed companies in Thailand. Important results regarding board of directors and business ethics can be summarized as follows,

1. Board meetings were convened regularly on the quarterly basis
2. Most boards consisted of 10 or more members with the required two independent directors
3. In 1996, (before the enforcement of audit committee establishment), there were about 30 organizations which set up an audit committee
4. Only 10 companies had a formal code of business ethics, several intended to have one published.

Problems of the Roles of Directors

In an in-depth interview by the Stock Exchange of Thailand in 1997, participants who were board of directors admitted that

1. Independent directors do not know the actual reason why they were invited to be in the board.
2. They do not know their roles and action.
3. They do not know their responsibilities under the law.
4. They do not know the industry and business of the company well.
5. They do not know their expectations from shareholders.

Problems of the Roles of Audit Committee

The scope of responsibilities between the audit committee, the internal audit and independent directors were not clear and some audit committee admitted that their financial literacy was insufficient.

III. Improvement of Good Corporate Governance Practices through the Board of Directors

Realizing the significance of board of directors in improving corporate governance in Thailand, the government together with related agencies such as the SEC and the Stock Exchange of Thailand strengthened legal enforcement to prevent common violations by board of directors and initiated voluntary programs to enhance good corporate governance practices through board of directors.

Regulatory Approach toward Improving the Roles and Responsibilities of the Board of Directors

The regulatory approach aims at strengthening legal enforcement for violators of good corporate governance practices. Several new laws and regulations were passed to ensure that violators would be punished. Moreover, it can be served as a warning for the board as a whole to be more prudent and responsible for their fiduciary duty.

The common violations that could seriously affect directors are insider trading and connected transaction. Insider trading occurs when a person engages in the trading of any securities of a listed company and uses inside information for his or her own benefits. Insider trading is a violation that is very difficult to prove. In Thailand, insider trading is strictly prohibited with imprisonment of up to 2 years and/or a fine of up to twice the amount of benefit received or should have been received by an insider trader (This fine is a minimum amount of 500,000 Baht, which is approximately USD12,000 per case). The Securities and Exchange Commission (SEC) has continuously monitored for insider trading. Normally, the case ends up with settlement with a fine of up to USD5 million per case.

Connected Transaction is any transaction that creates a conflict of interest between a listed company and its management or connected persons (management, major shareholders or related persons) of that listed company. Directors must monitor all possible connected transaction of the listed companies they involve, since a director must protect the interests of all shareholders. The director normally knows their own interests and possible conflict of interests with the shareholders. All Connected transactions are required to be disclosed to the public and in the annual financial statements.

Voluntary Approach toward Improving the Roles and Responsibilities of the Board of Directors

As it normally takes longer time to prosecute the violators of corporate governance, it is more efficient to rely on the voluntary approach to cultivate the new breed of directors. The voluntary approach includes:

Education for Board of Directors

From the survey of the Stock Exchange of Thailand, it could be concluded that directors did not have sufficient knowledge to perform their duties effectively. Many seminars and training programs were arranged. However, they were not formal and cannot guarantee long-term effectiveness in providing director's training.

In 1999, Bank of Thailand, SEC, SET, with the assistance of the World Bank and Capital Market Foundation established Thai Institute of Directors (Thai IOD). Thai Institute of Directors provides training for directors and executives. The curriculum of Thai IOD was designed with the assistance of the Australian Institute of Corporate Directors (AICD). The followings are the training programs of the Thai IOD.

1. Director Certification Program (DCP). This program was started in December 1999. It intends to provide a 5-day program to train the directors and executives so that they under the roles and responsibilities of directors. Thai IOD has trained more than 1,000 persons since inception.
2. "Chairman 2000" is another program designed specifically for Chairpersons and high-ranking executives. The objectives are to enhance good corporate governance practices and clarify roles and responsibilities of presidents, board members, corporate secretaries and executive directors of the company (Thai IOD, 2001).
3. Director Accreditation Program (DAP) is a 1-day program which is intended to be a compulsory program for directors of listed companies. The program provides fundamental knowledge on good corporate governance and roles of directors in a corporation.
4. Company Secretary Program. This program gives an overview of the role of a company secretary who deals specifically with the board of directors, so that he or she would aware of the roles of the board and good corporate governance rules and regulations.
5. Effective Audit Committees and Best Practices. It is designed for directors who are on the audit committee.
6. Finance for Non-Finance Director. This program teaches essential finance for directors who are not equipped with sufficient knowledge in finance and accounting so that he or she can improve financial skills.

The Stock Exchange of Thailand has subsidized the training cost of directors of listed companies in Thailand as a support for good corporate governance endeavor. The Securities and Exchange Commission also provided training materials and lecturers for DAP

Establishing a Guideline of Ethical Standards for Directors

One of the most difficult tasks in the issue of board of directors is the ethical standards. It is the responsibilities of several parties including the government, the companies and the public to establish a guideline of ethical standards for directors. Many institutions have attempted to raise the ethical standards so that the directors and the public understand the roles and responsibilities of the board of directors.

1. Codes of Best Practices. The best way to enhance ethical standards is to encourage the organization to initiate the project by itself, as organizations have very different needs. After careful assessment of the needs, they can arrange proper ways to reach the objectives. In this case, we found that many organizations in Thailand have realized the needs to raise the ethical standards of directors and executives. They started by drafting codes of best practices for directors and management even before the financial crisis happened. Although not guaranteeing the results, the codes of best practices serve as guidelines that directors must follow and assessment can be made along with the written best practices. Among the organizations that have codes of best practices include Federation of Thai Industries, Council of Industries of Thailand, Siam Cement Public Company Limited, the largest building and construction conglomerate in Thailand, to name a few. Almost 30 companies had some forms of best practices for their directors in 1996 and several said they intended to create one. This prompted the Stock Exchange of Thailand to issue publications as guidelines for directors including "Best Practice Guidelines for the Audit Committee" (Stock Exchange of Thailand, 1999) and "The Roles, Duties and Responsibilities of the Directors of Listed Companies" (Stock Exchange of Thailand, 1998). These best practice guidelines are constantly revised and updated.

2. Education for Board of Directors. We can raise ethical standards through the education for board of directors, demonstrating best and worst cases in the duties of the directors and the results that could happen to the company. Moreover, shared values among groups of directors can be gathered after going through all these cases, providing understanding of the solutions that the directors agree and sharing these updated findings with other directors through publications.

3. Education for the Public. The education of directors and management may provide solutions for the issue of corporate governance on a short-term basis. For the long-term, the public needs to understand the roles and responsibilities of the board of directors. Higher educational institutions play a role in fulfilling this need by educating upcoming directors and executives who will become a change agent in the society. Mass media can also have a role in publicizing information about good and bad directors and monitor their roles in corporations.

4. Denouncing bad directors in public. As a preventive method for future violation of corporate governance, the SEC and stock exchanges should

publicize their legal enforcement for directors who have violated good corporate governance practices. This would provide understanding for the public about the consequences of corporate governance violators. Using fear as an instrument to inhibit future offences by directors can be effective.

In approximately three years after the survey of the Stock Exchange of Thailand, the board structure of listed companies in the SET is much more impressive. According to the Mckinsey survey (April 2002) of the top 234 listed companies in the Stock Exchange of Thailand, 85% of the listed companies have fewer than 50% non-executive directors in the board; 69% have 20-25% of independent directors in the board; 78% have separate chairman & CEO; and13% have independent chairman.

IV. Recommendations

Thailand has initiated a lot of measures to enhance good corporate governance practices through the improvement of board of directors. However, there are still many rooms for further improvement, especially on the ethical perspectives.

Several measures that would help improve the roles and responsibilities of the board of directors are still needed. First, education for board of directors and public should be expanded to formal educational institutions. The Thai Institute of Directors has been doing a fabulous job on director training. However, higher educational institutions that produce future leaders and directors are still novice in corporate governance issues, since the curriculum of business education still emphasizes on producing executives and managers. At least, future managers need to learn the roles and responsibilities of the directors in order to react appropriately to the monitoring system the board is intended to provide. Second, the regulations for board selection and responsibilities must be tightened. The SEC and SET must draft a definite guideline on the qualifications of independent directors and should be more involved in overseeing board selection processes. Currently, the SEC interviews directors of new IPO companies but does not involve directly in the board selection of existing listed companies. Moreover, the selection process of the company itself should be improved by using information from board evaluation, so that the company can recruit the qualified persons to serve on the board. Thirdly, with the significance of evaluation processes in selecting qualified board members, listed companies in Thailand should adopt a director's evaluation processes, so that the board would receive a feedback to improve itself. Even though self and peer evaluations are very foreign in Eastern culture, gradual adoption of director evaluation would enhance board member's responsibilities and enable the company to select better directors in the future and know how to compensate the current directors with proper criteria. Finally, the legal enforcement on corporate governance in Thailand still needs improvement so that we can eliminate directors who fail to perform their duty of care and duty of loyalty. Previously, the SEC and SET blacklisted several directors from directorship and the SEC imposed heavy fines on violators. These results must be publicized in the mass media so that public understands the significance of corporate governance in regard to directors.

As Sonnenfeld (2002) suggested that rules and regulations do not lead a board to become an effective board but how to manage a social system of the board is a more important issue. He suggested the company have board members who create a climate of trust and candor, foster a culture of open dissent, utilize a fluid portfolio of roles, ensure individual accountability and evaluate the board's performance. These suggestions are valuable to improve the performance of the board. However, they need to be cultivated in the Eastern culture as certain traits, e.g. a culture of open dissent and a fluid portfolio of roles, etc., are not traditionally accepted in Asia. They are not totally impossible. However, it requires time to cultivate.

Improvement of roles and responsibilities of board of directors is the key toward the success of good corporate governance practices. Thailand has been successful in implementing education for the board of directors, issuing codes of best practices on many levels and strengthening legal enforcement for violators of good corporate governance. However, what needs to be done is the process of board evaluation, a social system of the board that would allow an effective board to evolve through director's self-governing and the educational system that would bring the roles of the board to public attention. The measures proposed in this paper may be difficult to implement and it would take a long time to be successful. However, it would not be too late to start the process of building up new roles of directors. The new roles would enhance the work of management and would bring strategic results for a corporation through proper monitoring system. Board of Directors is a place where a new path toward good corporate governance starts.

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