Is Corporate Governance still relevant during the Pandemic?

While the Novel Coronavirus is a humanitarian catastrophe its crippling effect on the world economy has, and will continue to, disrupt the way business is being conducted globally.

Amongst a host of business re-structuring exercises that we will no doubt see in the near future, it is critical that corporate leaders come to grips and re-invent themselves as to how they are going to react, and what they are going to do, when faced with hard decisions. While choosing their options, they will need to act with compassion and keep to the highest levels of governance – for they will be under immense scrutiny and pressure both during and after the pandemic. There is no doubt that boards, their conduct, actions and inaction will be analyzed threadbare, through the lens of hindsight, by various stakeholders, when the dust settles. Conduct of the board should be able to demonstrate a balancing act between a number of opposing forces and arrive at a result which is good for the company, satisfies regulators, pacifies workmen, presents a positive image to the society and builds shareholder value.

This article explores this evolving landscape in two parts. The first part outlines some tough choices that boards will have to make, while the second one sees whether the board is equipped to make these decisions and, if not, what it needs to do to make that happen.

Part I - Choices

» Revenues vs. Safety

The immediate dilemma for decision makers is whether to completely re-start operations at the first opportunity or to wait it out until things are "safer". The former may be very tempting, given the compelling financial reasons, but more so because even the world's top scientists are unable to predict the timelines for when it will get "safer".

However, operating while under the threat of COVID – 19 has its own risks and potential liability – mainly to the health and safety of employees and other personnel. The recent PIL – against the management of Jubilant Generics – may be the first of many such cases. Boards and management have to be clear about the risks they are willing to take, and the mitigation measures they are adopting. Following the guidance released by the government is the starting point, but boards should not hesitate to bring in more best practices if needed. Not to forget, mitigation measures cost money and that may be hard to find in an already crunched situation.

» Get Leaner vs. Remain Loyal

The one thing that the virus and the ensuing lockdown has shown to employers is– that it may be possible (and indeed better in the medium term) to operate with a leaner and more agile work force. This is not applicable in all cases but certainly is the case in the services industry.

Therefore, the more medium-term dilemma is whether to reduce workforce, scale back investments and become a leaner organization or whether to go back to the earlier ways of working. This crisis will make boards and founders re-evaluate their business philosophy and core operating principles. Whichever option one chooses, it will have costs (economic, people, reputational and operational).

» Globalize vs. Localize

The impact of COVID – 19 is more profound than anything that we have faced because of the scale and reach of the infection in a very short period of time. Because supply chain and markets of the world are intrinsically interconnected, the ensuing localized chaos and, disparate government reactions have had an asymmetric domino effect on supply chains and customer management in different parts of the world.

Today, you have US customers refusing to recognize force majeure in India, German industries restarting production this week to find that their Indian suppliers are still shut down, essential goods manufacturers finding that ports are not open for import/export of those goods and numerous other similar instances, which will tempt boards of large companies to seriously consider localized supply chain and maybe even in-source certain critical components. A lot of global companies will probably consider moving out of "high risk" countries such as China and "high risk" zones such as urban population centers.

» Executive Pay vs. Workmen Pay

In India, there is much clamor about the legally questionable requirements from the Government mandating employees to not reduce wages and other benefits, not terminate the employment of personnel. Needless to say, without providing any meaningful economic relief to the industry, the government is being accused of a lopsided approach as far as the employers are concerned. On the flip side, it is equally true that in a highly unequal society such as India, such measures may be required to mitigate economic ruin of the vast majority of workmen on the bottom rung of the economic ladder.

In light of this, boards should seriously consider their response in a holistic manner keeping in mind not only economic necessities and legal compliance, but also humanitarian and reputational fall outs. We have seen a number of companies announce pay cuts at the top level while continuing to pay at the middle and the lowers levels without any abatement for the time being. This period will test the resolve of the board and force them to choose priorities. Each such choice will come with its pros and cons – none perhaps starker than redundancies and wage cuts.

» Shareholder Value vs. Social Responsibility

The age-old tussle of creating shareholder value while at the same time contributing to societal welfare is heightened in the present scenario. Questions such as COVID -19 relief measures outside the organization, contributions to funds and re-aligning assembly lines to produce COVID-19 relief material are only some examples where the cost of corporate responsibility will add to the already burgeoning cost base.

Boards will have to weigh all considerations, including what their long-term goal in India is, and then decide their immediate spending and cost control measures.

» Maintain Status Quo vs. Issue Revised Guidance

In many instances during this crisis, boards are faced with classic force majeure calls. Despite well documented SOPs on 'Business Continuity' and 'Disaster Management', there is very little they can do to "control" this crisis. This in itself will be a very unique situation. As most of us in the professional world know, most boards probably haven't faced a situation that they cannot control. There are umpteen number of processes and people to ensure that the board is presented with a controlled situation. This crisis is a major and stark exception. Given this lack of control, when everything is said and done, boards will be measured as to how they reacted to the crisis in terms of communication, planning and mitigation – while always keeping to the highest standards of governance.

Did they assess, well in advance, revenue impact, impairment of assets, loan covenants and contractual defaults? Did they take corrective measures such revised guidance, provisioning, re-negotiating loan terms, mitigating contractual defaults and if required, recasting the balance sheet? Did they plan and war game different scenarios taking inputs from industry experts on recovery trends? .

Part II - Tools

These decisions should be taken keeping in mind that the legal standard of care, skill and judgment under the Companies Act and various other regulations that place a fiduciary duty on board members continue to apply in their undiluted form.

If questions on the conduct of the board are raised in the future, the best defence that the board can raise will be that they acted with due care, skill and judgment with the information available with them at the time. Therein lies the catch – availability of information. The pandemic has restricted physical mobility and brought daily work to a standstill. In India, even today, vast amounts of information is exchanged in physical one on one meetings, office corridors, preparatory meetings, physical verifications, physical inventory taking, physical investigations, physical interviews and numerous other physical information gathering exercise which find their way into (hard copy) reports that are shared with board members as part of the agenda papers for physical board meetings. All of the above now have come to a near standstill.

In this scenario, it is very easy for boards to rely on outdated or incomplete information or misread information, miss information, not ask the right questions or not spot a developing crisis within the organization.

That is not to say that information is not available. Most modern companies have some variation of ERP tool which is used to run their supply chain, inventory, sales, production etc. However, there are still a number of physical interventions required to convert the raw data into formats that tie in to give the overall picture of the health of the company.

Then there are support functions such as HR, finance, legal, audit, tax, insurance, facilities etc., that may operate on different platforms. Very often these functions don't interact closely with production, sales, quality on a remote basis and they don't share common IT platforms.

Finally, there is the issue of incident management. Just because there is limited mobility does not mean there will not be any crises. In fact, risks of cyber breaches, corporate non – compliances, audit shortcomings etc., will become even more acute in this period.

Boards will need to have certain tools at their disposal and use these tools in an effective and efficient manner in order to mitigate the risks of lack of information flow, analysis and action based on that information. Some of these are provided below as "pointers".

- Work with the assumption that you have limited or no control over the COVID – 19 situation and that information flow is disrupted and what information you get may not be up to date or complete. This self-awareness is the first step which will help you heighten governance standards by asking more questions than usual and verifying information from various sources.

- Put in place a specialist cross functional team with the specific mandate to share information between departments, divisions, verticals. Ensure that one board member is overseeing this flow of information.

- Your IT systems and network will now play a disproportionately important role in your organization. Get your IT team to stress test the system, have a disaster recovery plan, ensure systems backup, ensure security measures are taken and train your employees to be sensitive to cyber threats.

- Get your IT head to report into a board member on a regular basis. He or she will be able to tell you how the IT systems are withstanding increased demands, whether the ERP is performing to scale, whether there have been any cyber threats and whether the information is being picked up by the relevant departments or verticals.

- Ensure your department heads are available in every board meeting and submit the cross functional report prior to every board meeting.

- Keep a close watch for developing situations and don't allow them to become crises. These could be harassment claims, wage payments, pollution control issues. Appoint a board member to each "high risk" department to regularly ask questions on whether there are any such situations developing.

- Be acutely aware that code of conduct rules (financial, HR and others) should be scrupulously followed by "approvers" and other system gate keepers. Any exceptions due to exigencies should be approved in a board meeting or by two or more board members.

- If you are an exempt industry or have restarted operations but the threat of infection is still present, put in place special safety measures to prevent, contain and mitigate the spread of infection. Have one or more board members monitor this on a daily basis with the safety officer submitting a daily report on the implementation of the safety measures.

- Engage with your workmen, suppliers and other key insiders on a regular basis and give them a realistic picture of the situation and what you are doing to monitor and mitigate risks.

- Engage with your internal auditors very closely to monitor treatment of assets and liabilities and take a call, at the right time, to revise provisioning, fair value etc. on an ongoing basis. This will become extremely critical when your external auditors start looking at your balance sheet when the dust settles.

- Engage with your lawyers and accountants on a pro-active basis where you see that contracts and other assets are under the threat of impairment.

- Be aware of opportunistic raids – employees, corporate, contracts – by competitors. Identify and keep a close watch on your "crown jewels".

- Engage with your top clients and customers on a regular basis. Have key account managers report to you on a regular basis and specifically highlight any concern areas.

- If due to unfortunate circumstances, you have to take certain hard decisions, ensure that you follow the letter of the law to the T.

- The steps you take in India might affect your obligations to customers and regulators in other jurisdictions. Be aware of this when you are making snap decisions.

- Do not forget that it is your responsibility to keep the company alive as a going concern.But for reasons beyond your control, if you see that this is not going to be possible, provide guidance in time, act in time and don't wait until the last minute. It is better to have a controlled exit than a chaotic one where workers arrive one day to find the gates closed.

- If you are in the enviable position of looking at this crisis as an opportunity, this might be the time to clean up house and look at restructuring with a view to emerge stronger at the tail end of this crisis. For example, with increased scrutiny over Chinese players investing in India and the US/EU going into deep recession, local investments may be available at a much more realistic valuation. Missing out on a once-in-a-blue-moon market opportunity will be as bad as under reacting.

- This is also a useful time to enforce fiscal and operational discipline on your partners/management. Additional fund infusions/new business plans can be tied to new standards of behaviour. Refocus (limited) resources on what is actually important (pension fund coverage vs. golf club memberships).

- When things reopen, management will get flooded with emails, calls and tasks. Each of these will appear time critical. It's useful to prepare a priority matrix that you and your officers can use to decide which matter is to be dealt with first.

Recovery from this pandemic and its after-effects is going to take some time. The complexity is acute because no one is able to predict how and when this recovery will happen. Those who claim they do, are probably guessing.

The only way corporate leaders can deal with this situation is to evolve a way of doing business that is agile and in keeping with the mantra– "change is the only constant"- which is more applicable than ever in the current scenario. This means, governance also has to evolve and decision making has to be accurate. This is easier said than done, but there is hardly any other choice.

BTG maintains material on the ongoing COVID-19 crisis and legal implications here. Please click to access.

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