



# GENERAL GUIDANCE NOTE

## Board Composition

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Board Composition is a significant contributing factor to the performance of a Board of Directors (“**Board**”). It is crucial for an organisation to get the right mix and balance of people to sit on its Board. It is important to note, however, that every company is different and therefore each Board needs to determine its composition based on its unique circumstances.

While there are a few legal requirements addressing the minimum size of an organisation’s Board, terms of office of members and who would be disqualified to act as a director, the requirements around Board composition are limited in terms of the Companies Act No.71 of 2008 (“Companies Act”). As such, organisations should look to good corporate governance practices for further guidance when considering what their optimal Board composition is.

In terms of good corporate governance practices, factors such as size, balance of power, independence, diversity, skills and attributes, and rotation should also be taken into account in determining the optimal Board composition. This general guidance note covers these factors in greater detail hereunder, with the primary source being the King IV Report™ on Corporate Governance for South Africa (“King IV™”).

### 1. Size

The Companies Act provides in section 66(2) the minimum number of directors required on a Board depending on the type of company incorporated, namely:

- (a) *“in the case of a private company or personal liability company at least one director; or*
- (b) *in the case of a public company or non-profit company at least three directors,*

*in addition to the minimum number of directors that the company must have to satisfy any requirement, whether in terms of this Act or its Memorandum of Incorporation, to appoint an audit committee, or a social and ethics committee as contemplated in section 72(4)”.*

The Companies Act defines a profit company to include state-owned companies and in terms of section 9 the provisions relating to public companies apply to state-owned companies.

For example, if a public company is required to have an audit committee, it would need 3 directors to serve thereon. The social and ethics committee also requires 3 directors or prescribed officers. But there is nothing precluding the same 3 directors from sitting on both committees, provided they have the necessary skills to adequately fulfil the duties of each respective committee. In this instance, a public company would require a minimum of 6 directors to serve on its Board to satisfy this legal requirement.

Principle 7 of King IV™ provides the following recommendations on Board size:

- *“The governing body should assume responsibility for its composition by setting the direction and approving the processes for it to attain the appropriate balance of knowledge, skills, experience, diversity and independence to objectively and effectively discharge its governance role and responsibilities.” and*
- *“As a minimum, the chief executive officer (CEO) and at least one other executive should be appointed to the governing body to ensure that it has more than one point of direct interaction with management. The executive other than the CEO appointed to the governing may be the chief finance officer (CFO) or another designated executive as is appropriate for the organisation.”*

When determining the requisite number of directors to be appointed/required on the Board, King IV™ further recommends that the following factors should be considered:

- a) *The appropriate mix of knowledge, skills and experience, including the business, commercial and industry experience, needed to govern the organisation.*

For example, a large listed company in the financial sector may need more specialised skills on its Board in order to fully understand the business and its environment. On the other hand, a smaller non-profit organisation which does not necessarily have as stringent legislative requirements, may also need a larger Board in order to raise funding and awareness/profiling. Another example is in certain industries/sectors, specialised industry/market knowledge may be required in addition to general governance knowledge/skills. In addition to the industry, the size and nature of the business itself would also impact the skills and knowledge needed on the Board.

- b) *The appropriate mix of executive, non-executive and independent non-executive members.*

For example, if a company has 3 executive directors on the Board (being the CEO, CFO and COO), since the Board should have a majority of non-executive directors, the majority of whom are independent, it would need an additional 4 independent non-executive directors to maintain a balance of power i.e. the minimum Board size would be 7. Should taking into account the nature, size and industry in which the organisation operates, there are paramount additional skills, knowledge or experience required (if the current 7 directors do not possess collectively all the required knowledge, skills, experience and resources required for conducting the business of the Board) and/or due to the number of Board committees required, the size of the Board may increase.

- c) *The need for a sufficient number of members that qualify to serve on the committees of the governing body.*

Consideration should be given to the membership needs of the various Board committees, in terms of numbers as well as skills requirements. For example, at least 3 independent non-executive directors will be required on the Board if the company is required to have an audit committee – perhaps even more than 3 depending on the knowledge and skills of those directors, bearing in mind that it is recommended that an audit committee have quite a wide range of collective knowledge. In addition, specialist skills may be required to effectively fulfil the Board committee duties with regards to nominations, risk, remuneration and social and ethics.

d) *The need to secure a quorum at meetings*

For example, let's say the company's founding document or Board charter requires a quorum of the majority of members of the Board to be present at a meeting - if a Board only has 6 directors, it would need at least 4 of them to be present at every Board meeting - hence if only 3 directors are unable to attend, a quorum would not be reached. If, however a Board has 15 directors, it would need at least 8 present – so 7 would be able to drop off without affecting the quorum. This is however not a reason to have a unnecessarily large Board as every Board member should attend every meeting.

e) *Regulatory requirements*

Certain industries may have specific regulatory requirements which would impact on a Board size.

f) *Diversity targets relating to the composition of the governing body.*

If a company is striving towards 30% women on their Board, and already have 10 men who are adding value and they wish to retain, they may decide to increase their Board size to 14 or 15.

Some considerations with regards to the pros and cons to having a small versus large Board is tabulated below. It should however be noted that the size of the Board will always be relevant to the size and needs of the organisation.

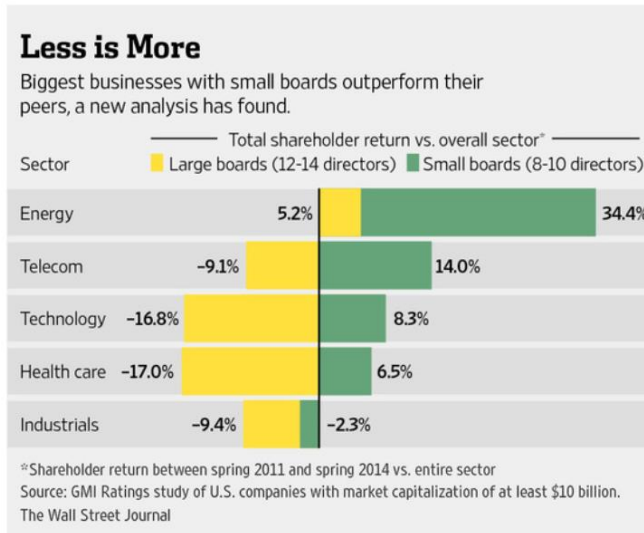
	Large Board	Small Board
Pros	<ul style="list-style-type: none"> <li>Provides enough people to manage the workload of the Board and to serve on the various Board committees</li> <li>More diverse views/perspectives are represented</li> <li>More space for different skills and experience</li> <li>Better continuity in times of leadership change</li> <li>Easier to raise a quorum</li> </ul>	<ul style="list-style-type: none"> <li>Communication and interaction is easier</li> <li>Constant and meaningful involvement by directors creates satisfaction</li> <li>Better feeling of unity, common purpose and ownership for the work</li> <li>Easier and less expensive to manage</li> <li>Meetings easier to schedule</li> <li>More effective in oversight,</li> <li>More swift in making decisions and responding to change.</li> <li>More engaged with no place to hide</li> </ul>
Cons	<ul style="list-style-type: none"> <li>Every Board member may not be engaged in meaningful activity and participation</li> <li>Meetings may be difficult to schedule</li> <li>Members may tend to defer to someone else to take on responsibility</li> <li>Difficult and expensive to manage</li> </ul>	<ul style="list-style-type: none"> <li>Workload may be too heavy for a few people</li> <li>There may not be adequate representation of all points of view</li> <li>Less collective skills and experience</li> <li>Less continuity in times of leadership change</li> <li>Potential difficulties in raising a quorum</li> </ul>

According to the [PwC Non-executive directors' Practices and fees trends report - January 2014](#), the majority of JSE Boards have between 3 and 11 Board members, with very few having more than 14 Board members.

In global news, Board size and composition are shifting to be more smaller and diverse. According to a study by governance researchers GMI Ratings prepared for The Wall Street Journal, the analysis of nearly 400 companies showed that, *“among companies with a market capitalization of at least \$10 billion, typically those with the smallest Boards produced substantially better shareholder returns over a three-year period when compared with companies with the biggest Boards”*.

“Companies with small Boards outperformed their peers by 8.5 percentage points, while those with large Boards underperformed peers by 10.85 percentage points. The smallest Board averaged 9.5 members, compared with 14 for the biggest. The average size was 11.2 directors for all companies studied.”

Board size influences Board effectiveness, as such, each Board needs to consider its optimum size taking into account the above guidance in order to ensure effective and efficient functioning of the Board.



## 2. Balance of Power

In terms of the recommended practice No.8 in Principle 7 of King IV™ “The governing body should comprise a majority of non-executive members, most of whom should be independent.”

The balance of power within the Board allows for a positive interaction between the Board members and also ensures the diversity of views within the Board. Ensuring a mix of executive and non-executive directors on Boards, ensures that decisions made by the Board takes into account both operational views and affects as well as independent views and judgement.

For further information on the different types of/terminology used for directors as well as their different roles see the IoDSA [General Guidance Note: Frequently used Terms for Directors and Governance Role Players](#).<sup>1</sup>

In accordance with the JSE Listing Requirements, section 2.84 also speaks to the balance of power and other factors as set out below:



**Section 3.84(b):** There must be a policy evidencing a clear balance of power and authority at board of directors’ level, to ensure that no one director has unfettered power of decision-making.

**Section 3.84(c)** The issuer [company] must have an appointed chief executive officer and a chairman and these positions must not be held by the same person. The chairman must either ban independent director, or the issuer [company] must appoint a lead independent director

<sup>1</sup> [http://c.ymcdn.com/sites/www.iodsa.co.za/resource/collection/49D62EF3-F749-403C-BE47-73C50F27F30F/General\\_guidance\\_note\\_on\\_frequently\\_used\\_terms\\_for\\_directors\\_and\\_Governance\\_role\\_players\\_.pdf](http://c.ymcdn.com/sites/www.iodsa.co.za/resource/collection/49D62EF3-F749-403C-BE47-73C50F27F30F/General_guidance_note_on_frequently_used_terms_for_directors_and_Governance_role_players_.pdf)

### 3. Independence and conflicts of interest

The concept of independence on a Board often brings with it some confusion and misunderstanding. King IV™ provides that: *“The governing body should comprise a majority of non-executive members, most of whom should be independent.”*

The query that often emanates thereafter is: “What does independence entail?” Is there a checklist with which an organisation may use to measure a director’s level of independence?

King IV™ provides the following practice recommendations in this respect:

- *“Non-executive members of the governing body may be categorised by the governing body as independent if it concludes that there is no interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making in the best interests of the organisation.”*
- *The governing body should consider the following and other indicators holistically, and on a substance-over-form basis, when assessing the independence of a member of the governing body for purposes of categorisation. The member of the governing body:*
  - *is a significant provider of financial capital, or ongoing funding to the organisation; or is an officer, employee or a representative of such provider of financial capital or funding;*
  - *if the organisation is a company, participates in a share-based incentive scheme offered by the company;*
  - *if the organisation is a company, owns securities in the company, the value of which is material to the personal wealth of the director;*
  - *has been in the employ of the organisation as an executive manager during the preceding three financial years, or is a related party to such executive manager;*
  - *has been designated external auditor responsible for performing the statutory audit for the organisation, or a key member of the audit team of the external audit firm, during the preceding three financial years.*
  - *Is a significant or ongoing professional advisor to the organisation, other than as a member of the governing body;*
  - *Is a member of the governing body or the executive management of a significant customer of, or supplier to, the organisation;*
  - *Is a member of the governing body or the executive management of another organisation which is a related party to the organisation; or*
  - *Is entitled to remuneration contingent on the performance of the organisation.*

It is further recommended that an independent non-executive directors should be independent in fact and in the perception of a reasonably informed outsider. Although independence of mind is essential, perceptions of independence are also important.

With regards to conflicts of interests King IV™ recommends the following practices:

- a) each member should submit to the governing body, at least once a year or whenever there are significant changes, a declaration of all financial, economic and other interests held by the member and related parties; and

- b) all members should be required at the beginning of each meeting (i.e. governing body/committee) to declare whether any of them has any conflict of interest in respect of a matter on the agenda.

It is for this reason that King IV™ recommends that: “A non-executive member of the governing body may continue to serve, in a independent capacity, for longer than nine years if, upon an assessment by the governing body conducted every year after nine years, it is concluded that the member exercises objective judgement and there is no interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making.”

There therefore needs to be a careful qualitative consideration of this, as opposed to approaching independence in a tick-box/checklist fashion. For further guidance on this refer to the IoDSA’s [General Guidance Note: Independence of non-executive directors.](#)<sup>2</sup>

#### 4. Diversity

King IV™ provides that:

- “The governing body should promote diversity in its membership across a variety of attributes relevant for promoting better decision-making and effective governance, including field of knowledge, skills and experience as well as age, culture, race and gender.” and
- “The governing body should set targets for race and gender representation in its membership.”

Ensuring you have a diversified Board is highly beneficial and favourable for the organisation. Diversified Boards allows for different perspectives and input into the organisation and therefore impacts on its strategic direction through diversified leadership.

#### 5. Skills and Attributes

The Companies Act does not have any specific requirements in relation to the skills, qualifications or attributes required of a director, but rather provides for what may disqualify or render a person ineligible from serving as director.

As such consideration should be given to the guidance provided in best corporate governance practices, such as for example that:

- Directors should be individuals of integrity and courage, and have the relevant knowledge, skills and experience to bring judgement to bear on the business of the company.
- In situations where directors may lack experience, detailed induction and formal mentoring and support programmes should be implemented.
- Boards should ascertain whether potential candidates are competent to be appointed as directors and can contribute to the business judgement calls to be made by the Board.

The [IoDSA Director Competency Framework](#)™ sets out the key competencies expected of a director and that which a director should aim to possess. The [Chartered Director \(South Africa\)](#)® (“CD(SA)”) designation uses this Director Competency Framework™ as the benchmark to assess an applicant’s competency and

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<sup>2</sup> [http://c.ymcdn.com/sites/www.iodsa.co.za/resource/collection/49D62EF3-F749-403C-BE47-73C50F27F30F/General\\_guidance\\_note\\_on\\_independence\\_of\\_non-executive\\_directors.pdf](http://c.ymcdn.com/sites/www.iodsa.co.za/resource/collection/49D62EF3-F749-403C-BE47-73C50F27F30F/General_guidance_note_on_independence_of_non-executive_directors.pdf)



experience as a director in order to determine whether the applicant should be awarded the prestigious designation. All directors and/or budding directors should aim to use the Director Competency Framework™ as a basis to assess their competency to act and serve as a director and progress therein. In addition, Boards should consider ensuring they have CD(SA)s on the Board and should encourage its directors to follow the path of CD(SA).

Before nominating an individual or when looking at the skills and suitability of a proposed candidate, the Board/governing body should consider the following factors:

- a) the collective knowledge, skills and experience required by/on the Board and/or to fill the gap on the Board;
- b) the apparent integrity of the individual;
- c) the diversity of the Board;
- d) the skills and capacity of the individual to discharge his duties on the Board;
- e) the competency of the individual to serve as a director (i.e. against the IoDSA Director Competency Framework™);
- f) whether the individual is a CD(SA); and
- g) whether the proposed candidate meets the appropriate fit and proper criteria.

It is of great significance and impact to the organisation to have the right directors sitting on the Board i.e. directors who are aligned to the organisations ethical standards and values as well as directors with suitable skills and knowledge. As much as there is an objective test (i.e. the disqualification/ineligibility rules found in the Companies Act) the subjective elements above cannot be ignored.

## 6. Terms of Office & Rotation

In terms of section 68(1) of the Companies Act, directors are elected to serve for an indefinite term or for the term as set out in the companies Memorandum of Incorporation (“MOI”). In terms of best corporate governance practices, it is however not recommended that directors serve for an indefinite terms. It is thus important to ensure that appointment letters/contracts or the MOI of the organisation clearly stipulates the term/period of office of the director and whether or not such director shall be eligible for re-appointment at the end of his/her term.

An organisation via its Board should implement a programme ensuring the staggered rotation of its non-executive directors on its Board. King IV™ recommends that: *“The governing body should establish arrangements for periodic, staggered rotation of its members so as to invigorate its capabilities by introducing members with new expertise and perspectives while retaining valuable knowledge, skills and experience and maintaining continuity.”* An organisation does not want to become stale – as such growth and forward thinking is fundamental in order to ensure the longevity of the organisation.

King IV™ further recommends that:

- *“The governing body should establish a succession plan for its membership which should include the identification, mentorship and development of future candidates.” and*
- *“Nomination for re-election of an incumbent of the governing body should be considered by the governing body on the basis of that member’s performance, including attendance at meetings of the governing body and its committees.”*