NUS National University of Singapore

**Source:** *The Business Times,* p31
**Date:** 24 May 2019

# Hyflux's board ticked boxes but let down stakeholders

Many companies fail to recognise weaknesses in their boards and how they can affect board culture, behaviour and dynamics. **BY MAK YUEN TEEN**


**The Hyflux debacle is a warning to other founder-controlled and managed companies, where founders who may be excellent entrepreneurs fail to recognise that they may not make good CEOs as the company grows.** BT FILE PHOTO

IN ITS reply to questions raised by the Securities Investors Association (Singapore) and shareholders at its townhall meetings, Hyflux said:

*"The current challenges facing the Group are driven by market conditions of the Singapore power sector, and not a result of corporate governance issues. All investments into any particular project recommended by management are reviewed and approved at Board level. None of the directors have any self interest in the Group's investment into any project, including the Tuaspring project."*

While Hyflux's board may not have been guilty of the kinds of egregious behaviour we have seen in some other companies here, a closer scrutiny reveals weaknesses that arguably could have contributed significantly to the company's predicament.

## LEADERSHIP, SIZE AND INDEPENDENCE

Prior to FY2011, Hyflux disclosed that it did not have a board chairman, with Olivia Lum serving as group president and CEO. In FY2011, Ms Lum became executive chairman and group CEO.

The Board had between seven and eight directors over the last 10 years, arguably adequate for most companies. During this period, Ms Lum was the only executive director. Of the remaining six to seven non-executive directors (NEDs), at most one was non-independent.

On paper, Hyflux far exceeded the rules and guidelines on the number and proportion of independent directors, even based on the standards set by the latest 2018 Code of Corporate Governance. But the substance may be rather different from the appearance.

## LONG TENURE AND RELATIONSHIPS

While there was some board renewal, it was largely due to changes in circumstances of directors rather than careful succession planning. Four independent non-executive directors (INEDs) have remained on the board for more than 14 years, with one serving more than 17 years and two for more than 18 years – or since Hyflux's listing. These longstanding directors also had various types of relationships with the company which raise further questions about their independence.

Gay Chee Cheong, who was appointed as a non-independent non-executive director (NINED) in August 2001, was deemed a substantial shareholder following a 5 per cent placement by Hyflux to 2G Capital in June 2001, five months after Hyflux's listing. Mr Gay was at the time deputy chairman and CEO of 2G Capital. 2G ceased being a substantial shareholder in September 2005 and sold off its remaining stake in 2006. Mr Gay continued to directly hold between 450,000 and 3 million shares, and at the time of suspension of trading in Hyflux's shares held 3 million ordinary shares.

In 2005 – the same year that 2G ceased being a substantial shareholder – Mr Gay was re-designated from NINED to independent non-executive director (INED) and became chairman of the Remuneration Committee, while remaining a member of the Audit Committee and Nominating Committee. In 2006, he became chairman of both the Nominating Committee and Remuneration Committee, while remaining as a member of the Audit Committee.

Hyflux was re-designating directors from non-independent to independent, or vice versa and then back again, as if independence was an on-off switch, and was not transparent when doing such re-designations.

Christopher Murugasu, appointed to the board in February 2005, was formerly senior vice-president of corporate services at Hyflux. He first joined the board as an NINED, but was re-designated to an INED in 2010. His sister, Dr Deirdre Murugasu, was a long-time employee of Hyflux, having joined the company in 1996, and proceeding to hold positions of chief operating officer, deputy CEO and senior advisor to Ms Lum, before leaving the company in 2006. Dr Murugasu held as much as 3.13 per cent of the shares of Hyflux shortly after its listing. Given the close relationships between the Murugasus and the company, it's a valid question to ask if Christopher Murugasu is truly independent, regardless of how long ago he was a senior executive of Hyflux.

Two other INEDs – Lee Joo Hai and Teo Kiang Kok – have been on the board since December 2000, with Mr Teo serving as the lead independent director.

Over the years, there were other relationships between Hyflux and both Mr Teo and Mr Lee. Mr Teo's brother, Teo Yuan Cheng Casey, was vice-president of business development from May 2005 and was disclosed as an immediate family member of Teo Kiang Kok earning remuneration below S$250,000 until the 2008 annual report.

Mr Teo, who was classified as an INED and was chairman of the Nominating Committee, was re-designated as an NINED in FY2006 and remained so until FY2008. During this period, he stepped down as chairman of the Nominating Committee but remained as a member, while Mr Gay took over as chairman. The company did not announce the re-designation, mention the relationship between Mr Teo and his brother in the discussion of the assessment of independence in the Corporate Governance Statement, or explain why he was re-designated to NINED. However, since the period when Mr Teo was re-designated to NINED coincided with the time when his brother was an executive, it seems likely that the family relationship was the reason.

In FY2009, Mr Teo was re-designated back to an INED, again without any announcement or explanation. In FY2011, he took back the chair of the Nominating Committee and was appointed lead independent director.

Mr Teo was a senior partner at the law firm, ShookLin & Bok, and remains a senior consultant. Between FY2005 and FY2010, Hyflux disclosed under interested person transactions that ShookLin & Bok had provided legal services amounting to a total of S$364,000.

## CONFLICTS

In the case of Mr Lee – a partner at BDO LLP from 1986 to 2013 – BDO Raffles provided internal audit services to the company amounting to S$186,000 between FY2005 and FY2008. While the amounts may not have crossed the annual S$200,000 threshold for payments for professional services under the Code, there is nevertheless at least perception of a conflict when a director or his firm is providing other services to the company.

Further, Mr Lee was, and remains, the chairman of the Audit Committee which is supposed to oversee the internal audit function. Since the internal audit is supposed to report directly to the Audit Committee and the committee is supposed to oversee the internal audit function, there is clearly a conflict. The internal audit is supposed to provide independent assurance over Hyflux's internal control and risk management, and the conflict could have hampered its effectiveness.

But this is not the only company where Mr Lee was in such a compromised position. In an article published in *Today* on 20 April 2009 ( "*Kian Ho AGM one to watch*"), I took issue with Mr Lee serving on 10 listed boards at that time when he was director and Audit Committee chairman of Kian Ho Bearings. BDO Raffles was also providing internal audit services to Kian Ho.

## INTERLOCKING DIRECTORSHIPS

Mr Lee and Mr Teo also served together on at least two other boards. One was the former SGX-listed Adampak Ltd and the other is the currently-listed IPC Corporation. At IPC, Mr Lee retired from the board in April 2017 as independent director after serving 21 years. Together with two other directors, Mr Lee withdrew from seeking re-election just before the April 2017 AGM. Mr Teo then joined the board in July 2017 and was appointed lead independent director and chairman of the Nominating Committee. In October 2018, Mr Lee rejoined the board as INED.

While the Code in Singapore is silent on such interlocking relationships, they have been identified as a possible threat to independence in codes in some other countries and in the academic literature. Such interlocking directorships across several companies suggest that Mr Lee and Mr Teo are close to each other, which may raise questions as to whether they will bring diverse perspectives to boardroom discussions.

Would these long-serving directors with various relationships with the company be in a position to objectively review decisions that they have made which may need to be changed or modified? Would they be inclined to constructively challenge management's decisions?

## BUSY DIRECTORS

Most of the directors also have many other commitments, which raises questions about their ability to commit sufficient time to the affairs of Hyflux. Ms Lum herself served on the boards of organisations such as International Enterprise Singapore and the National University of Singapore, and was a director of other listed companies such as Matex, ST Engineering, Yeo Hiap Seng and Singapore Exchange. At one time, she served on as many as three other listed boards. Was she able to dedicate sufficient time to managing Hyflux?

Would such a collectively busy board be able to effectively govern the company?

## SKILL GAPS

The board has the usual diversity of skills and experience on paper, such as accounting, finance and law, but was it an effective sounding board for Ms Lum and did it complement her where she lacked the necessary expertise?

What appears to be lacking among the NEDs include deep knowledge of the water and power industries and countries where Hyflux was operating (particularly China, Middle East and North Africa). Further, there was a lack of highly successful ex-CEOs and/or other experienced C-level executives who had the exposure and skills that Ms Lum did not have.

That Ms Lum was the executive chairman did not help as the roles of a CEO and chairman are quite different.

Were the Board and committees providing active and independent oversight?

Hyflux has five board committees – audit, nominating, remuneration, risk management and investment.

Neither the board nor the committees were particularly active. The board met four times a year throughout the period from 2008 to 2017, except for 2011 when it met five times. Given the growth in the business and the challenges in recent years, one might have expected the board getting more engaged and meeting more frequently. The same could be said about the Audit Committee, which met four times every year – presumably in sync with the quarterly and annual reporting requirements.

For a company like Hyflux operating in the water and power industries, expanding aggressively into new markets and with increasing indebtedness, sound risk management is fundamental. The establishment of the risk management committee in 2005 was therefore a right step, taken before the Code had recommended that companies consider having them.

The committee which initially met once a year, became more active in FY2007 when it started meeting three times, and met as much as nine times in FY2009. The increased activity of the Risk Management Committee coincided with Rajsekar Kuppuswami Mitta joining the board and assuming the chairmanship of the committee. However, from 2013 – the same year that Mr Mitta ceased being an INED citing family commitments – the risk committee became far less active, meeting at most twice. In FY2017, the committee met only once.

The Investment Committee, formed in FY2014, is chaired by Ms Lum herself. It is supposed to assist the board in overseeing the investment policy and strategy for Hyflux, including reviewing proposals on major investments and making recommendations to the board for approval. Given the role of Ms Lum as founder, controlling shareholder, executive chairman and CEO – plus chairman of the Investment Committee – she is likely to call the shots in investment decisions. It is of even greater concern that she may not have the expertise and experience in finance and investment.

Ms Lum is also a member of the Nominating Committee. While this is permitted under the Code, it may affect the ability of the committee to exercise independent judgement on critical matters such as board appointments, renewal and succession planning.

In FY2008, Ms Lum started attended all committee meetings by invitation (except on a few rare occasions when presumably she was unable to do so). While this is not an uncommon practice among listed companies, it is an unhealthy practice as it defeats the purpose of committees being made up predominantly of independent directors. While committees may invite relevant management to part of their meetings to hear their views, they should ensure that their participation does not undermine the ability of these committees to have frank discussions on matters in which management may have an interest.

## TICKING TIME BOMBS

The Hyflux debacle is in my view a warning to other founder-controlled and managed companies, where founders who may be excellent entrepreneurs fail to recognise that they may not make good CEOs as the company grows.

Like Hyflux, many companies also fail to recognise flaws in their boards and how these flaws can affect board culture, behaviour and dynamics, in turn adversely affecting board effectiveness. Proper selection of directors, board renewal and succession planning are ignored, and threats to independence or conflicts of interests dismissed, until the company reaches a "Hyflux" moment – and then shareholders and stakeholders are left to count the cost.

The writer is an associate professor in the NUS Business School where he specialises in corporate governance. This commentary is part of a comprehensive case study he is currently writing on Hyflux.