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Conference Paper

The Nomination Committee in Maltese Listed Companies

Provided in Cooperation with:

Governance Research and Development Centre (CIRU), Zagreb

Suggested Citation: Baldacchino, Peter J.; Gatt, Jessica; Tabone, Norbert; Bezzina, Frank (2018) : The Nomination Committee in Maltese Listed Companies, In: Tipurić, Darko Labaš, Davor (Ed.): 6th International OFEL Conference on Governance, Management and Entrepreneurship. New Business Models and Institutional Entrepreneurs: Leading Disruptive Change. April 13th - 14th, 2018, Dubrovnik, Croatia, Governance Research and Development Centre (CIRU), Zagreb, pp. 125-139

This Version is available at:

<https://hdl.handle.net/10419/179987>

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The Nomination Committee in Maltese Listed Companies

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Abstract

This aim of this study is to examine the Nomination Committee (NC) in Maltese listed companies. The study achieves this by assessing the Maltese regulatory framework relating to this Committee, as well as its roles, status and effectiveness. A predominantly qualitative mixed methodology was employed to achieve these objectives. Twenty-five semi-structured interviews were held with two financial analysts, two MFSA representatives, eight audit firm representatives and 13 representatives of Maltese Listed Companies (MLCs) Research findings show that the NC is not as yet not well established among MLCs. There is a particular lack of insistence on the part of local regulatory authorities, as well as substantial resistance from listed companies, with regard to the adoption of this committee. Furthermore, most NCs in such companies are not performing all of the roles listed in their Code while the roles currently performed may need to be carried out in a more structured manner. Yet it is highly worthwhile for such companies to devote more attention to the NC, this being one of the best possible bastions of appropriate corporate governance. The change in the status of the NC from being merely recommended by the Code of Principles of Good Corporate Governance to becoming mandatory by the Listing Rules is increasingly called for. In this way, Maltese listed companies will need to embrace such a change. It is hoped that this study will contribute towards fostering more awareness about the NC and the corporate governance of Maltese listed companies.

Keywords: Board of Directors, Corporate Governance, Listed Companies, Malta, Nomination Committee

Track: Governance

Word count: 7.518

1. Introduction

The board of directors ('Board') may delegate, totally or partially, various roles and responsibilities to its committees (Mallin, 2004). According to Kim, Nofsinger and Mohr (2010), a substantial amount of Board work is carried out by these committees so as to improve efficiency in view of the more specialised nature of the committees.

For the purpose of this study, the Nomination Committee ('NC') is studied in greater depth. The NC is a committee appointed by the Board to which it delegates the key responsibility of identifying candidates qualified for Board membership (Mallin, 2004). Such a committee ensures that director appointments are made on "*merit rather than by patronage*" (McKnight and Weir, 2009, p.143).

In Malta, the appointment of the NC is included as a provision in the Code of Principles of Good Corporate Governance 2010 ('Code'). The Code was issued by the Malta Financial Services Authority ('MFSA'), and it lists the principles and provisions relating to good corporate governance ('CG'). Along with the MFSA Listing Rules 2016, the Code recommends that Maltese listed companies ('MLCs') adopt such principles and provisions in order to contribute towards enhanced CG (MFSA, 2016).

The NC is the "*bona fide working unit of the Board*" (Murphy, 2008, p.147). However, despite its significance, the NC has been paid scant attention and has not been subject to ample research (Kaczmarek, Kimino and Pye, 2012; EY, 2016). This study is therefore aimed at contributing towards bridging this literature gap, by assessing the Maltese regulatory framework relating to the NC, and the NC's roles, status and effectiveness. The research is conducted in Malta, a small island state economy.

The rest of this paper is divided into five main sections. The second section provides a summary of the relevant literature on the NC, followed by the third section which discusses the methodology employed in this study. The fourth section presents the findings, while the fifth section discusses such findings. Finally, the concluding section summarises the findings and presents the limitations of the study.

2. Literature Review

2.1 The Maltese Regulatory Framework

The Code stipulates that the company's shareholders have the jurisdiction to appoint and elect directors (MFSA, 2010). Similarly, the Companies Act requires that company directors, other than the first directors, are elected by the shareholders at the annual general meeting (AGM), unless otherwise indicated in the company's Memorandum and Articles of Association. However, Bezzina, Baldacchino and Azzopardi (2014) found that a number of MLCs have a tendency to be dominated by an absolute controlling shareholder, who holds more than half the company's shares in the aggregate. In such companies, the controlling shareholder has the right to directly appoint directors to the Board, and to thus control most of the Board's composition.

The Code recommends MLCs to appoint a NC to recommend director candidates to the Board (MFSA, 2010). However, the appointment of the NC is still not mandatory as at the date of this study. Nevertheless, such a committee has been made mandatory for significant credit institutions and investment companies, pursuant to the issue of the Fourth Capital Requirement Directive and Regulation in June 2013. As from January 2014, each Member State was obliged to adopt the requirements set out by this regulation and to transpose this directive into national law (European Parliament and the Council of the European Union, 2013).

2.2 The Roles of the Nomination Committee

A common misconception is that the role of the NC is simply to nominate director candidates (KPMG, 2012). However, as recommended by the Code, the roles of the NC should also include the following: determining director independence and advising the Board regarding any issues that may affect director independence (KPMG, 2012); reviewing Board composition through an assessment of the size, composition and membership of the Board (Higgs, 2003); reviewing Board performance through annual self-evaluations (KPMG, 2012); considering succession planning via an assessment of the possible gaps in the skills and

expertise of the Board and senior management (EY and ICSA, 2016); and selecting competent candidates to fulfil senior management positions and recommending them to the Board and chief executive officer (EY and ICSA, 2016).

2.3 The Status of the Nomination Committee

The roles of the NC tend to be less clearly defined than those of the Audit and the Remuneration committees, even though *“it is arguably the most important of the three”* (EY and ICSA, 2016, p.4). It has also been noted that *“in recent years the NC has been portrayed as the poor relation of the main BCs”* (EY and ICSA, 2016, p.4). In fact, the appointment of the NC has been much slower in comparison with the appointment of the Audit and Remuneration Committees (McKnight and Weir, 2009). A probable cause for such a delay may be attributed to this lack of clarity regarding the roles of the NC (Kaczmarek, Kimino and Pye, 2012). In addition, the NC has not been afforded the same amount of guidance as the other BCs (EY and ICSA, 2016), and the attention provided to it *“seems to have fallen off the radar”* (KPMG, 2012, p.70). The CG codes of various jurisdictions particularly insist on the appointment of the Audit and Remuneration Committees, yet the NC receives much less attention. This lack of insistence may also be another cause for the delay in the appointment of the NC (Higgs, 2003; Kaczmarek, Kimino and Pye, 2012). However, Masulis (2012) argued that *“forward-looking corporations that are trying to maximise shareholder wealth should be in front of regulators, and should want to make the changes first”*.

The appropriate size of the NC depends on its own remit, the size of the Board, and the availability of independent NEDs on the Board (KPMG, 2012). Such a committee should ideally comprise a minimum of three members (ICSA, 2013). However, according to EY and ICSA (2016), an apparent disadvantage of having the Board members constituting the NC is the potential lack of challenge, lack of scepticism and of questioning from such members. In addition, this requirement may also lead to common committee membership, which is greatly opposed by Higgs (2003).

2.4 The Effectiveness of the Nomination Committee

In view of the delegation of the various roles of the Board to the NC, the NC effectiveness will have an impact on the Board's effectiveness (KPMG, 2012). In particular, an effective NC enhances the Board's ability to discharge its roles (Hillman and Dalziel, 2003). In fact, Vafeas (1999) found that a Board with a NC will ultimately vary in effectiveness from one that does not have such a committee. This is because having a NC will benefit from group screening of the director candidates, potentially diminishing any limitations in the director nomination and appointment processes (Vafeas, 1999; Petra, 2005; Masulis, 2012). This renders an effective NC a key component for an equally effective Board. Furthermore, as stated by Higgs (2003), the increased use of the NC plays a pivotal role in raising the standards of CG, owing to the added assurance that the most significant roles of the Board are being effectively discharged.

3. Research Methodology

A predominantly qualitative mixed methodology was implemented to achieve the objectives of this study. Data was collected through the use of 25 semi-structured interviews employing both closed-ended and open-ended questions. These interviews were carried out with two financial analysts, two MFSA representatives, eight audit firm representatives and 13 MLC representatives. Purposeful sampling was used, whereby the researcher selected those

participants with the ability of contributing, through their knowledge, to the various topics of this study. The interview schedule consisted of five sections. The first four sections elicited the interviewees' views on the Maltese regulatory framework and the NC's roles, status and effectiveness. The last section inquired about certain characteristics of the interviewees.

The audio recordings of the interviews were transcribed shortly after the interviews were held, leading to the analysis and subsequent interpretation of the interviewees' responses. The quantitative data collected from Likert-type items (with responses ranging from 1=strongly disagree to 5=strongly agree scale) were analysed using IBM SPSS V22. To investigate differences in mean ranks across the Likert scales, the Friedman test was used with paired samples while the Kruskal Wallis test was used with independent samples. In the presence of a significant effect, post-hoc tests were conducted. Due to word count limitations, only statistically significant findings ($p < 0.05$), are being referred to in this paper.

On the other hand, the qualitative data was analysed by summarising the transcripts, allowing key themes to be identified from each open-ended question, which rendered the process of drawing up conclusions easier.

4. Results

4.1 Nomination Committee in the Interviewee Companies

Company interviewees (13/25) were asked whether or not their companies have an NC. Eight companies confirmed that they have a NC ('NC-including interviewees'), while five do not have an NC ('NC-excluding interviewees'). Most of the 13 companies interviewed (8/13) have a NC which is not standalone, having three independent NEDs and with a chairman who is also the chairman of the Board. Meetings are held at varying frequency, occurring up to once a month. All NCs have members who also hold positions in other BCs.

4.2 The Maltese Regulatory Framework

All interviewees maintained that the power to appoint and elect directors needs to remain vested solely in the shareholders. However, most of them (19/25) added that other parties, which they specified, are best to be involved in recommending such appointments. The most mentioned parties include the NC (9/25) and the MFSA (6/25). Interestingly, six interviewees argued that no other parties should be involved.

Almost all interviewees agreed (24/25) that Board members are generally biased when recommending new members to stand for election. They claimed that it is easier to recommend someone with whom one is acquainted and feels comfortable to work with, especially in a small state like Malta where people tend to know each other. Furthermore, interviewees identified the following barriers which may impair the engagement of the most suitable directors: bias of controlling shareholders towards persons of trust (7/25), shortage of competent individuals (6/25), inability of competent individuals to attract sufficient votes (5/25), inadequate remuneration (5/25), lack of interest (4/25) and insufficient time to devote to the Board (4/25).

Moreover, interviewees marginally agreed that an independent outside consultant should act as an advisor to the NC ($\bar{x}=3.60$). Two agreeing interviewees (2/14) commented that the NC "*has blank authority to appoint advisors, as the Board members do not know everything*". Therefore, appointing outside advisors to assist the NC will render its work more effective.

Interviewees expressed neutral views as to whether the appointment of the NC should be made mandatory by law ($\bar{x}=3.36$). Six of the agreeing interviewees (6/14) explained that the present 'comply or explain' Code provision is insufficient and tends to spur MLCs not to comply, but then to try to explain. On the other hand, six of the disagreeing interviewees (6/7) contended that imposition by law is not to be the way forward as each MLC has its own particular circumstances and it is best to leave it up to each company to decide whether or not to appoint an NC.

Additional comments were requested specifically in relation to how justifiable it is that the NC has become mandatory only in the case of significant credit institutions and investment companies. The interviewees who commented favourably (17/25) to this maintained that both the operations and systemic importance of these companies are of such a magnitude that such discrimination is rendered justifiable. Conversely, the interviewees whose comments were unfavourable (8/25) stated that companies should be regulated in a uniform manner irrespective of their size, industry and whether they are listed or otherwise.

Furthermore, interviewees disagreed with the statement that the recommendations of the NC are not to be circulated to the Board before being forwarded to the AGM ($\bar{x}=1.92$). Furthermore, the responses to this statement (based on mean ranks) were significantly lower ($p<0.01$) from the preceding two statements. Most of the disagreeing interviewees (13/20) emphasised that the NC is a committee of the Board and thus the Board is ultimately responsible for such committee's roles.

4.3 The Roles of the Nomination Committee

Interviewees strongly agreed with the role of the NC in reviewing Board composition ($\bar{x}=3.56$). They also agreed with three other NC roles: proposing director candidates to the Board ($\bar{x}=4.40$), considering issues related to succession planning ($\bar{x}=4.28$) and determining director independence ($\bar{x}=4.08$). However, as regards the last two roles, interviewees only marginally agreed that the NC should review the Board policy for the selection and appointment of senior management and that the NC shall evaluate the Board performance ($\bar{x}=3.60$). In fact, the interviewees' responses for the latter two statements were statistically different ($p<0.01$) from those of the former four statements.

When asked to comment about the roles which are currently performed by the NC in the companies of the NC-including interviewees, barely half of them (3/8) pointed out that their NC actually performed the roles recommended to it by the Code. Moreover, when comparing the responses of the NC-including interviewees regarding their agreement to the recommended NC roles with the actual roles such a committee plays in their companies, it was found that overall, not all the recommended roles were in fact actually being taken up by the NC in many MLCs. This indicates an inconsistency between what the interviewees agreed with, and what actually happened in real life in the respective NCs.

Furthermore, in the absence of the NC, NC-excluding interviewees commented that the parties responsible for the recommended roles usually assigned to the NC are mainly the shareholders, the Board and the chief executive officer.

4.4 The Status of the Nomination Committee

Interviewees expressed neutral views with respect to the statement that only members of the NC are to be permitted to attend the meetings of such committee ($\bar{x}=3.12$). Two of the agreeing interviewees (2/13) explained that the other Board members are not to attend such meetings as

they might influence the decision/s taken by the NC members. Conversely, almost all disagreeing interviewees (9/12) stated that other Board members may be invited to attend for specific meetings, at the NC chairman's discretion, to observe (without having a right to vote), and thus contribute with their knowledge and experience.

Interviewees also expressed mixed views as to whether the NC may successfully be combined with another committee ($\bar{x}=3.08$). Two of those who agreed (2/12) with this possibility stated that when nominating directors to the Board, remuneration needs to be taken into account, thus implying that it makes sense for the NC to be combined with the Remuneration Committee. In fact, most of the companies of the NC-including interviewees (5/8) have a combined NC-Remuneration Committee. However, three disagreeing interviewees (3/8) argued that it is best for the NC to be a separate committee because each committee has its own specific roles and focus.

Furthermore, interviewees were marginally neutral tending to disagree with the statement that the members of the NC are not to be members of other committees ($\bar{x}=2.68$). Six of these interviewees (6/13) commented that common committee membership is inevitable, especially when the Board is small and the company has quite a number of committees in existence. In fact, such common membership has been seen to be the case in the MLCs of the interviewed companies.

Interviewees mostly disagreed with the statement that the NC does not deserve the same amount of attention and guidance as other committees ($\bar{x}=2.24$) with ratings to this statement differing significantly between interviewees ($p=0.04$). Seven of these interviewees (7/17) emphasised that the NC plays a crucial role in proposing candidates for Board and senior management positions, which parties are responsible for the direction of the company; also that, given such importance, the NC should deserve the same amount of attention and guidance as other committees.

Furthermore, NC-including interviewees were asked whether another independent NED would be more appropriate to chair the NC than the chairman of the Board. Most of them (6/8) disagreed, adding that the chairman of the Board is more than capable of chairing the NC as well. In fact, most of the NCs in the companies of the NC-including interviewees (5/8) are chaired by the chairman of the Board. Conversely, the other interviewees (2/8) agreed, stating that if the same chairman chairs both the Board and the NC, then such chairman is more likely to unduly influence the final decision.

NC-including interviewees were also asked whether the report of the NC in the annual report provides enough assurance to the users that relevant issues are being addressed. Some (3/8) maintained that such a report is quite transparent, however others (2/8) stated that the disclosures on the work performed by the NC in the annual report are quite limited in view of the sensitivity and confidentiality of such work.

In addition, all interviewees agreed that the setting up of the NC is relatively delayed owing to various barriers. The following barriers were identified by interviewees: the appointment of the NC not yet being mandatory by law (10/25), the lack of awareness by MLCs of the use and importance of the NC (8/25), the appointment of the Audit Committee being given precedence (3/25), the fact that controlling shareholders are commonly not very willing to promote such a committee (2/25), the reluctance by the Board to delegate the responsibility of nominating directors to the NC (2/25) and the perception that such a committee might be "*too much of a burden*" (1/25).

4.5 The Effectiveness of the Nomination Committee

Interviewees were neutral as to whether the NC reduces the likelihood of appointing new directors based on personal connections ($\bar{x}=2.96$). A few of them (4/19) remarked that the appointment of the NC made up of independent members would convey a more transparent and objective view and ensure that they are not biased for improper reasons when nominating directors to the Board.

Interviewees were also marginally neutral as to whether that the Board having the NC will ultimately differ in effectiveness from one not having such a committee ($\bar{x}=2.92$). A few of them (3/19) emphasised that having a dedicated committee entrusted to actively filter and nominate the most suitable directors and to ensure that there is appropriate synergy around the table would contribute to the Board's effectiveness. Moreover, they added that a NC composed of independent NEDs would result in more objectivity, independence and less bias in the execution of its roles, thus enhancing the effectiveness of the Board.

However, interviewees expressed mixed views with respect to whether the Board can effectively perform the roles of the NC and therefore replace the NC ($\bar{x}=2.96$). A few of the agreeing interviewees (4/10) commented that disagreeing with this statement would in effect be implying a lack of confidence in the Boards of most companies in Malta to perform these roles, given that in practice, such companies did not have an NC. A further four interviewees commented that since there are no legal distinctions between the duties and liabilities of executives and NEDs, and since the NC is composed of Board members, then its roles may effectively be replaced by the main Board. On the other hand, most of the disagreeing interviewees (7/10) argued that the NC is composed of independent members having the required qualities, has fewer roles than the Board, and may therefore focus more effectively on performing such roles.

Overall, it was found that a common viewpoint of the interviewees was that in order for the NC to reduce Board bias, enhance Board effectiveness and enhance CG, such a committee needs to be composed of independent outside consultants.

In addition, interviewees specified the following benefits of appointing a NC: greater scrutiny of candidates for directorship positions (10/24), a more transparent director nomination process (7/24) (since the NC is composed of independent members), more time for the NC to conduct an effective discussion (6/24), a higher probability of reaching consensus given that the NC has fewer members than the main Board (5/24), a more dedicated focus on the director nomination process (5/24), the possibility of benefitting from external independent perspectives (4/24), and the additional comfort provided to the shareholders arising from the fact that the recommendations of the Board would have been substantiated by the NC (2/24).

On the other hand, interviewees also identified the following limitations: limited scope of a NC in MLCs having controlling shareholders with the right to appoint the majority of the directors (7/20), the lack of experience of Board members with regard to the operations of the NC (6/20), the limited available pool of independent NEDs given Malta's small size (5/20) and the possibility of conflicts of interest owing to the NC members also being part of the main Board itself (5/20).

5. Discussion

5.1 Who Needs to Be Involved in the Engagement of Directors?

In Malta, the power of appointing and electing directors is conferred on the shareholders of the company, pursuant to the Code and the Companies Act. However, as also stated by most interviewees, other parties may be involved to provide guidance to the shareholders in appointing the most suitable and competent directors. These parties mainly include the NC and the Board. The positive input that such parties can contribute arises from the fact that they hold a position that makes them most cognisant of the needs of the company. As a result of this, they are able to properly guide shareholders in appointing the most suitable directors.

In addition, independent outside consultants are also to be involved since, owing to their independence, they are in a better position to guide the shareholders in appointing the most competent directors. One suggestion that was mooted by one interviewee was to go a step further and even involve the company's creditors and employees in the appointment of directors on the basis that they too have an interest to appoint the most suitable directors to ensure the continued smooth running of the company. Nonetheless, owing to the tendency for most MLCs to be dominated by controlling shareholders (Bezzina, Baldacchino and Azzopardi, 2014), the controlling shareholders would wish to retain the power to appoint directors, and would therefore be reluctant to permit any interference from other parties in this regard. In particular, controlling shareholders are biased towards their persons of trust and might want to appoint Board directors who they are confident will ensure that the shareholders' interests are promoted and pursued. This may occur irrespective of whether or not such directors are competent enough to give a fair contribution to all the stakeholders of the company.

The possibility of such resistance from the controlling shareholders renders the role of the MFSA, as the regulator, much more significant. The MFSA requires candidates to undergo a due diligence process so that it may establish whether they are 'fit and proper'. Therefore, as emphasised by an MFSA representative, *"irrespective of whom the shareholders would like to appoint, if any candidate is not deemed 'fit and proper' by the regulator, then such candidate will in any case not be appointed."* However, this does not mean that the Board may rely on the checks being placed by the MFSA. The responsibility of the Board should probably extend towards the appointment of the appropriate directors in the first place, if there is to be a proper first line of defence with regard to CG.

5.2 Should the Nomination Committee Be Made Mandatory?

With the NC not being mandatory, in their annual report most companies tend to neither comply nor explain sufficiently and reasonably the reasons for their non-compliance. Boards may be using different tactics – such as delaying or dominating ones – to retain their say about who will ultimately be appointed. Given such resistance, it is also not surprising that only eight of the 22 MLCs have a NC as at the date of this study. This is in line with the findings of Muscat (2012), Bezzina, Baldacchino and Azzopardi (2014), as well as Deguara (2014), all of which confirmed that the appointment of the NC was still not common practice among most MLCs as at the date of their studies. Therefore, within this context, more vigilance needs to be exercised by the regulator. On the one hand, this committee may not need to be enforced on MLCs. In line with Masulis (2012) and some of the interviewees' responses, companies should not wait on the regulators to enforce the appointment of the NC on them; instead, they should adopt a more pro-active approach and voluntarily set it up. On the other hand, if the objective is to have more companies appoint a NC over the short term, the NC is best made mandatory by law, possibly in the Listing Rules in the same manner as the Audit Committee.

5.3 To Whom Should the Nomination Committee Report?

In line with most interviewee responses and Prasad (2011), the Board should retain responsibility for and make the final decisions relating to the roles delegated to the NC. Therefore, the recommendations of the NC are to be approved by the Board before being forwarded to the AGM. Nevertheless, as the owners of the company, shareholders constitute the party that is most interested in the Board composition and any recommendations related to it. Thus, the question arises as to whether the NC should be empowered to report directly to the shareholders at the AGM. This would avoid the possibility of any NC recommendations being rejected by the Board which, on their part, shareholders could find valid. With such direct reporting, it will be up to the shareholders to decide whether or not to accept the recommendations of the NC, without any material influence on such a decision by the members of the Board. While it remains questionable whether the Board would be ready to accept that it is bypassed in such an important decision, it is probable that such an arrangement would do away with undue Board politics.

5.4 Are the Recommended Roles Sufficient?

According to the majority of the interviewees, the roles designated for the NC as required by the Code are quite sufficient, particularly for those NCs which are operating effectively. The Board need not delegate more roles to it because, as also remarked by an interviewee, *“this would overburden such committee and render more difficult the fulfilment of its roles.”*

5.5 Do Companies Practise What They Preach?

For most of the recommended NC roles, it was difficult for the NC-including interviewees to practise what they preach within their NC. The indications are that a high level of resistance relates to the role of the NC to evaluate Board performance. Perhaps such apparent resistance to the evaluation of Board performance emanates from the idea that each of the existing Board members is to be assessed directly by the other Board members. Therefore, in line with Barlow (2016), the role of an independent outside consultant to help the NC in such evaluations might prove to be particularly important. Such outside views may help ensure that the appropriate picture is drawn of each director, irrespective of their acceptance or otherwise within the Board. Surprisingly, the NC in most MLCs rarely has a role in proposing director candidates to the Board, even though their representatives agreed to it and identified it as being *“its key role”*. This is because, as most of the NC-including interviewees explained, most directors are directly nominated and appointed by the controlling shareholders, and that therefore the NC has a limited role in such nominations.

Moreover, with regard to the other recommended roles of the NC, particularly the review of Board composition, these may need to be carried out in a more structured manner than at present. For example, the use of a ‘board skills matrix’ as explained by Clune, Hermanson, Tompkins and Ye (2014), which none of the interviewees actually referred to, would probably help ensure a more thorough review than that being performed at present, which too often is performed in a very unstructured manner.

Furthermore, as stated in the findings, in the absence of a NC, the parties responsible for such roles are the Board, the chief executive officer and the shareholders. However, all parties would probably be unable to supplant the NC roles successfully in view of insufficient focus and lack of specialisation. A properly structured NC with skilled NEDs should go a long way to fulfil such roles.

5.6 What About Combining the Nomination Committee?

From the findings of this study, it emerged that most NCs in Malta are combined with the Remuneration Committee. As indicated by Higgs (2003) and some interviewees' responses, in order to be in a position to propose director candidates to the Board, the NC requires feedback from the Remuneration Committee to enlighten it about the remuneration of such candidates once these have been appointed to the Board. This is because the NC needs to be assured that the minimum level of director remuneration is sufficient to be attractive to the right calibre of candidates with the appropriate qualifications and experience. Nevertheless, as also indicated by the interviewees and Higgs (2003), such a link does not mean that the NC has to be combined with the Remuneration Committee. Both committees have separate and distinct roles to fulfil, and combining them would probably give rise to the disadvantage of overburdening those directors involved in these committees.

5.7 How Wise is Common Committee Membership?

One problem of BCs is perceived to lie in the fact that most Boards appoint the same directors on such committees (KPMG, 2012). This is in line with most of the interviewees' responses, who claimed that common committee membership is inevitable owing to the size of the Board and the numerous BCs. In fact, it was found that common committee membership is the case for the Boards of all MLCs included in this study. Directors who are highly involved in such committees may be overloaded, leading to a lack of balance in Board deliberations. Therefore, while for the sake of cooperation and continuity, links may need to be maintained, on the other hand, indulging in too many committees would probably turn out to be detrimental to the CG of the company.

5.8 Is the Board Chairman to Chair the Nomination Committee?

As stated by most of the NC-including interviewees, the chairman of the Board may be sufficiently competent to also chair the NC. In fact, it was found to be common practice for most NCs in MLCs to be chaired by the Board chairman. However, normally it is considered best practice for both positions to be segregated. This would ensure that the Board chairman, who is also typically the most powerful Board member, does not treat Board and NC matters as one and the same. Additionally, it ensures that the NC is composed of members who are most detached from the Board.

5.9 What Constitutes the Nomination Committee Report?

In line with EY and ICSA (2016) and interviewees' responses, it may be the case that the report of the NC contained in the company's annual report is not adequately transparent, owing to the sensitivity of the matters discussed by such committee and the general lack of regulation relating to it. While it may be clear that in view of such sensitivity involved, transparency at shareholder level is not always attainable, the NC may attempt to compensate for this by lodging regular reports – including the more confidential matters – to the Board. These may be further supported by the written viewpoints of independent outside advisors.

5.10 What Barriers Hinder the Nomination Committee Appointment?

McKnight and Weir (2009), as well as Kaczmarek, Kimino and Pye (2012), maintained that the lack of awareness on the scope and benefits of the NC has resulted in the slower rate of the setting up of the NC. This has also been found to be the case in Malta. Furthermore, as also pointed out by the interviewees, the Audit Committee is given much more importance than the NC, even though as argued by EY and ICSA (2016), the NC is considered more important than the Audit and the Remuneration committees in view of the roles assigned to it. This is indicative, therefore, of the need to make the NC mandatory. Interviewees also

pointed out that a small Board commonly bars the appointment of the NC. However, all these 'barriers' could merely be betraying a hidden resistance to the appointment of the NC. Moreover, such reasons are hard to justify given the public interest nature of the listed companies involved.

5.11 Should More Attention Be Given to the Nomination Committee?

The NC does not receive the attention and guidance it requires for its effective functioning (KPMG, 2012; EY and ICSA, 2016). In particular, there is a general lack of insistence on its appointment (Higgs, 2003; Kaczmarek, Kimino and Pye, 2012). As indicated by the interviewees' responses, the NC deserves the same amount of attention and guidance. This is because, as explained by such interviewees and in accordance with EY and ICSA (2016), the roles of the NC are crucial ones and therefore the NC requires more guidance, especially from the regulator. In this context, the need for such a committee to be made mandatory is heavily implied.

5.12 Does the Nomination Committee Reduce Board Bias?

One may agree with most interviewees who claimed that Board members seem generally biased when recommending new members, because they would rather recommend someone they are familiar with and trust rather than someone they barely know. However, being composed of independent NEDs, the NC helps reduce bias by ensuring that the Board nominees are not recommended for illicit reasons. This is in line with the findings of Vafeas (1999), Petra (2005) and Masulis (2012), which indicate that having a NC will benefit from better screening of the director candidates, potentially diminishing the bias in director appointments and working towards the effective functioning of the Board.

5.13 Can the Board Replace the Nomination Committee?

A further controversy lies in whether the Board can replace the NC. It is true that the Board can in theory perform all roles delegated to the NC, as well as those assigned to any other BC. However, in practice, the question arises as to whether the Board is in a position to carry out such roles effectively. In line with Dalton, Daily, Ellstrand and Johnson (1998), most of the key decisions are primarily derived from BCs. As pointed out by some interviewees, without such committees, there would definitely be less room for proper discussions and examinations, as well as possibly the need to hold numerous meetings. This was confirmed by Hillman and Dalziel (2003), who claimed that an effective NC enhances the Board's ability to discharge its roles more effectively.

5.14 Does the Nomination Committee Enhance Corporate Governance?

The NC plays a crucial role in ensuring that the most suitable directors are appointed. As stated by Higgs (2003), Murphy (2008) and KPMG (2012), this has a significant impact on the quality of CG in the company. Furthermore, results clearly indicated that interviewees with a NC in place ($\bar{x}=1.25$) disagreed significantly more ($p<0.01$) than those without such a NC ($\bar{x}=2.40$) with the claim that, in practice, the increased use of the NC would hardly raise the standards of CG. This indicates that the practical experience of having a NC is one of positive enhancement and of changing preconceptions.

5.15 How Can the Nomination Committee Be Effective in Malta?

In accordance with Petra (2005) and Masulis (2012), as well as with the NC-including interviewees' responses, having an NC leads to the nomination of the most suitable and independent candidates. This is because key matters will have already been discussed

primarily at a committee level, in this manner deploying more focus and time for effective discussion, and resulting in a more formal and transparent nomination process. This indicates that the company interviewees with hands-on experience within the NC perceived the appointment of such a committee to be good CG practice. This also indicates that the perception of NC-excluding interviewees who commented that the NC is not effective in Malta stems from their lack of experience on such a committee.

Overall, most interviewees repeatedly maintained that in order for the NC to be effective in a small state like Malta, it would need to be composed of outside consultants rather than Board members. Indeed, as a tiny island Malta has “*close interweaving personal relationships*” (Magri and Baldacchino, 2004, p.956). As a result, the pool of independent NEDs is limited and, being composed of Board members, the NC may lead to potential conflicts of interest, as was also indicated by a number of interviewees. This also aligns with the findings of KPMG (2012), EY and ICSA (2016), which also suggest that having the NC composed of Board members may result in a lack of scepticism and objectivity on the part of its members. Within this context, while, as has already been referred to, there is a need for such a role for outside consultants, a NC composed of NEDs but supported by such outside consultants would probably be a more balanced solution.

6. Conclusion

This study revealed that at present, the NC is not well established within MLCs yet, both in terms of the regulatory framework and also in terms of the NC’s roles, status and effectiveness.

With regard to the Maltese regulatory framework, it is somewhat lacking, particularly in view of the ‘comply or explain’ provision of the Code. In addition to rendering such Code mandatory in the Listing Rules, the need arises for the regulator to issue more specific guidance to not only ensure that the NC is appointed in all listed companies, but that more significance is attached to it by those companies which already have a NC. Furthermore, better regulatory provisions relating to the engagement of new directors are called for, particularly to compensate for the potential or actual biased influence of existing Board members.

As regards the roles of the NC as already listed in the Code, they are in themselves sufficient. However, most NCs are not performing all of these roles. In particular, there seems to be a persistently strong resistance against the NC’s role of evaluating Board performance. In addition, even those roles currently performed by the committee may need to be carried out in a more structured manner if they are to be improved.

The status of the NC within MLCs needs further clarification. Examples of this relate to whether the said committee should stand alone or be combined; whether there should be common membership between committees; whether it is recommendable for the chairman of the Board to be the NC chairman; what qualities, such as experience and qualifications, NC members are to be expected to have; and what constitutes an appropriate NC report. Such clarifications should go a long way to ensure that the NC receives the status it properly deserves.

Finally, our findings show that, with regard to the effectiveness of the NC in the CG of MLCs, companies that have such a committee find it somewhat effective. Nonetheless, the NC reduces Board bias and enhances CG if it is composed of external consultants. Therefore,

in order for the NC to be effective in Malta, it needs to be supported by independent outside consultants.

The results of this study are subject to the following limitations. In spite of the efforts exerted to render the interview questions as clear as possible, the possibility of interviewee misunderstandings could not be fully eliminated. Furthermore, at times where comments on individual MLCs were requested, company interviewees refrained from giving specific information. This might have prevented the researchers from arriving at a complete picture of the overall situation of the NC in MLCs. Finally, although efforts were also made by the researchers to avoid bias and impartiality, the possibility of the presence of such factors cannot be discounted, particularly in view of the probing questions that needed to be placed in the open-ended sections of the interview schedule.

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