excellence enablers CORPORATE GOVERNANCE SPECIALISTS
(AN M. DAMODARAN INITIATIVE)

Expert Expressions
Corporate Governance Demystified

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# GATEKEEPERS OF GOVERNANCE

**M. Damodaran**
*Chairperson, Excellence Enablers*
*Former Chairman, SEBI, UTI and IDBI*

The sixth annual two-day Corporate Governance Summit, Gatekeepers of Governance, took place in Mumbai on 21st and 22nd November, 2019. It was truly a congregation of the cognoscenti, comparing notes on concerns and issues in the area of Corporate Governance. For the relatively less informed proponents and protagonists of Corporate Governance, the Summit was a clearing house where experience lent expression to itself in dispelling doubts and difficulties.

SEBI's, and indeed India's, formal journey of Corporate Governance commenced with the setting up of the Kumar Mangalam Birla Committee in 1999. 20 years later, the Summit, with Mr. Birla setting the tone in his inaugural address, took a look at the hits and misses in the regulatory space. Some of the issues that surfaced during the conversations are discussed hereinbelow.

There was all round recognition that a properly constituted Board of Directors is a sine qua non for good Corporate Governance. The contemporary issue of separation of the roles of Chairman and Managing Director (MD), witnessed support for separation as well as for combining the two roles. The related question whether the Chairman should be non-executive, and should not be related to the MD also had takers on both sides. Mr. Birla's contention that so long as there was separation, the non-executive character of the Chairperson's position should not be insisted on, found reasonable broad-based support. An equally significant point that emerged during the inaugural session was the crying need for increased professionalization of management at the highest levels in the company.

The expectations from Independent Directors (IDs), and the recently prescribed proficiency test, also came up for animated discussions. There was widespread support for the proposition that the proficiency test was not the best method for ascertaining the suitability of an ID. It was felt that the track record of the person concerned, and boardroom experience, would be far better indicators of fitness. To a suggestion that IDs should have x-ray vision to ascertain what was being held back from the Board, one response was that, to begin with, they should keep their eyes open.

Trust and transparency figured significantly in the discussions. The approach "When in doubt, disclose" was accepted as non-negotiable. It was felt that the time had come, in the interest of all stakeholders, to move from a situation of "distrust and terrify", to "trust and verify". Non-Executive Directors (NEDs), most of whom were categorised as independent, were expected to function on the "trust but verify" principle, and to resort to a smell test if things were suspected to be going wrong.

The on-off debate whether auditors were bloodhounds or watchdogs surfaced yet again. The fact that they did not pick up signals which, in hindsight could be described as obvious, did not cover the auditing community with glory. Now that the chips were down, it was time for the auditing profession to pull up its socks and to help shareholders understand the nature and extent of irregularities in companies that they were invested in.

The belief that well governed companies attract a governance premium in the market was subjected to scrutiny. It was noticed that several of the largest companies in the United States had governance issues which did not seem to deflect the enthusiasm of the investors. The other view which was canvassed was that companies without good governance were unlikely to survive in the long run, and in any case, should not be allowed to survive, unless, going forward, stakeholder concerns are effectively addressed by good governance practices.

The overarching issue, which is the mother-question of whether regulations are excessive, also came in for animated discussions. The view of corporate leaders, who had created wealth, was that excessive regulation stood in the way of proper attention being paid to the conduct of business. It was felt that the disproportionate time and energy, invested by top management in dealing with compliance issues, led to inadequate time being devoted to strategy, risk management and such other business concerns. Regulatory Impact Assessment was mentioned as a possible response to the perception of excessive regulations. Better regulation, rather than more regulations, was identified as an immediate necessity.

The related question of treating every mistake as one deserving of penal consequences was also addressed. It was noted, with considerable relief, that a committee constituted by the Ministry of Corporate Affairs (MCA) had submitted a report recommending decriminalisation of a large number of offences under the Companies Act, 2013 (the Act). The view that emerged was that urgent decisions needed to be taken on these recommendations so that managements and Boards would be encouraged to grapple with contentious issues, without fear of being held responsible for malafide intent being attributed to errors of judgement.

Conflict of interest was identified as the elephant in the room. Related party transactions (RPTs) which best manifest the possibility of conflict of interest, was discussed threadbare. It was noted that there were major inconsistencies between the Act and the SEBI LODR Regulations, and these needed to be reconciled without further loss of time. Apprehension was expressed that the continuation of a large number of RPTs would lead to foreign investors, as also some domestic investors, staying away from the concerned corporate entities. While Audit Committees have been tasked with approving RPTs, it was noticed that they did not have adequate time, and in many cases, adequate information to conclude that an RPT was completely above board. The setting up of subsidiaries in large number, and having an increasing number of RPTs with them, was identified as one of the problem areas. It was felt that more and more companies should, over time, and in a non-disruptive manner, reduce the dependence on related parties, so that conflict of interest could be gradually phased out of corporate entities.

Asymmetry of information which along with conflict of interest, constitutes the biggest danger to sound Corporate Governance was also gone into, especially with reference to SEBI's Prohibition of Insider Trading (PIT) Regulations. It was noticed that unlike in many other jurisdictions, it was not necessary for trading to be done based on unpublished price sensitive information (UPSI), to complete the concerned offence. The mere enabling of passing on of UPSI, to persons who did not need to know, itself completes the offence. The preventive and procedural steps to eliminate the unauthorised passing of UPSI, to unconcerned persons was stressed, even as it was recognised that there could be situations in which an offence could be committed without anyone intending to do so. While guardrails and guidelines were necessary, there was some doubt whether they were sufficient to prevent the scourge of insider trading.

Concerns were aired and discussed. Solutions were proffered. The time has clearly come to walk the talk. As someone observed, perhaps in a cynical fashion, "When all is said and done, more will be said than done." It is time for regulators and regulated entities to prove the cynic wrong.

## Readerspeak – Egress and Ingress

***Reena Ramachandran, Former CMD, Hindustan Organic Chemicals***
*"Every step in the regulatory system needs careful consideration and a well designed consultative mechanism with relevant stakeholders."*

***S Vishvanathan, Former MD, SBI***
*"It has now become imperative for us on the Boards to not only know "what to do" and "what not to do" but also do what is required of us "in the prescribed manner" in "good time"."*

***Nawshir Mirza, Former Senior Partner, M/s S. R. Batliboi & Co.***
*"One angle on the auditor resignation issue that most commentary does not address: the auditor and the company are bound by a contract under the Indian Contract Act. Either side wanting to renege needs to have a reason that the Act permits, else, they have to deliver on what they committed to do."*

## Readerspeak – Gaps, Overlaps, Traps and Mishaps

***S Hajara, Former CMD, Shipping Corporation of India***
*"A brilliant piece indeed giving account of so many inter regulatory conflicts over the decades. Your example of a case of murder on a football field is really apt and clearly supports your argument that for jurisdiction of regulatory bodies, it's the function which should take precedence over the structure or the entity. "*

***RK Nair, Former Member, IRDA and Former ED, SEBI***
*"The recent PMC Urban Cooperative Bank is another example of Regulatory overlap, underlap or chasm. Chit funds are another area that has been a pain point between different agencies of the Government."*

***V. A. George, Managing Director, Thejo Engineering***
*"You have been able to lucidly bring out the 'core issue' (whether it is a proposed entity to be regulated, or its function or activity). If all concerned look at conflicts amongst regulators with the above objective in mind; all the issues can be resolved very fast."*

***Govind Sankaranarayanan, Vice Chairman, ECube Investment Advisors and Former COO, Tata Capital***
*"Very pertinent. The need for better governance only increases."*

Do let us know of any specific issues you would like to see addressed in subsequent issues.