

Conversations on Corporate Governance

Dialogue 3: Instruments of Corporate Governance



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Corporate Governance helps build a healthy and transparent relationship among different sets of stakeholders of a company and enables the building of sustainable businesses. In this context, Corporate Governance is extremely essential for a company to achieve its goals and foster a culture of integrity and accountability amongst its stakeholders. While Corporate Governance will always be work in progress, it is necessary to recognise that there has been considerable improvement over the years in the practice of Corporate Governance in India.

Regulation is the primary instrument of Corporate Governance. The Corporate Governance framework has evolved over time, through changes and amendments in law and regulations, based on the recommendations of various committees. Board independence, oversight by Board committees, Board evaluation, Proxy Advisory, Stewardship Code and Prohibition of Insider Trading (PIT) Regulations, to name a few, have been helpful in ensuring acceptable standards of Corporate Governance. The framing of proper policies aids in ensuring Corporate Governance and accountability and protecting stakeholder interests. The interest of the investor community in Corporate Governance is also reflected by the increasing focus on ESG, while taking investment decisions. The Stock Exchanges, as first-level Regulators, have an important role in ensuring Corporate Governance. Towards this end, the Exchanges encourage conversations among the stakeholders.

There are any number of instruments of Corporate Governance. Their existence is not good enough. Execution and implementation are important. In this context, NSE, jointly with Excellence Enablers - a corporate governance **advisory firm, had organized a webinar on “Instruments of Corporate Governance”** – the third dialogue in the three-part Corporate Governance Webinar Series on October 21st, 2020.¹ How can companies work on the instruments of Corporate Governance? What are these instruments? What is their role? How can companies use these instruments? And how can they improve Corporate Governance? These were some of the questions that were addressed during the discussion with our expert panel comprising Mr. M. Damodaran, Former SEBI Chairman and Founder, Excellence Enablers, Mr. T. V. Mohandas Pai, Chairman, Manipal Global and Aarin Capital and Mr. M. K. Sharma, Former Non-executive Chairman, ICICI Bank and Former Vice Chairman, HUL. In this report, we summarise the key highlights from the deliberations.

- The tone at the top is important for adoption of Corporate Governance principles in an organization. Almost everyone claims to believe in the value that Corporate Governance contributes to companies. The instruments available to ensure Corporate Governance are many and varied. There is no shortage of issues in the area of Corporate Governance. One of the most important issues is the tone at the top. It is for the Chair of the Board to set the tone, and to ensure the adoption of the principles of Corporate Governance, and their practice. The actions of the Chair ought to demonstrate sincerity of purpose, and at the same time signal that there is no conflict of interest that will be tolerated.

Transactions have to be at arms-length. There must be a culture of transparency, openness and adherence to norms, and for this to exist, the information flow has to be proper. There should be a well-defined Code of Conduct to which all persons in the company, not limited to Board members and senior management, should strictly adhere. Within the boardroom and outside, there must be healthy discussions and debate, and an openness to question one another. Once these are in place, an appropriate culture will be developed, and will enable the protection of the interest of the company and its stakeholders.

Please click [here](#) to listen to the recording of the webinar.

¹ The first dialogue held on August 19th, 2020 was on the topic “Crisis Management: The Lessons Learnt. Please click on the link to watch the recording of the first dialogue on [YouTube](#) and read the summary report on [NSE’s website](#). The second dialogue held on September 22nd, 2020 was on the topic “Corporate Governance and Financial Sector Regulations”, Please click on the link to watch the recording of the second dialogue on [YouTube](#) and read the summary report on [NSE’s website](#).

- Processes are important. It must be recognised that substance is more important than form. A well-constituted Board is a major instrument of Corporate Governance. This would involve choosing the correct Independent Directors (IDs), encouraging them to speak freely, and making sure that they get all relevant information within time. Auditors are equally important instruments. They must be independent and should have the courage to point out anything that is wrong. Trust among investors, society and Regulators is critical and this can be ensured only if there is transparency. The relationship between the Chair and the CEO is important and this can remain healthy if each of them understands her role and the role of the other person. Demarcation of responsibilities is important to ensure a constructive relationship. Over the years, shareholders have not discharged their roles satisfactorily. They often look to the Government or SEBI to protect their interests.

In the Public Sector Undertakings (PSUs), the majority shareholder sometimes tends to be overbearing, and sees the Board only as an agency to execute its decisions. At the same time, other shareholders remain relatively indifferent and do not serve their cause well. In the case of MNCs, with Indian subsidiaries, there is a tendency on the part of the parent, to take decisions which has an impact on the functioning of the Indian entity, thereby placing constraints on the Indian Boards, as also giving rise to the possibility of conflict. It is necessary for Corporate Governance norms to address this satisfactorily. The culture of Corporate Governance has to percolate throughout the organisation. This would involve assessment of qualitative aspects of Corporate Governance, a matter that the Board should talk about increasingly.

- Audit Committees (ACs) constitute an important instrument of Corporate Governance. It is, therefore, necessary to examine whether their performance is measuring up to expectations. It has been found that in some cases, ACs see themselves as agents of managements, negotiating with auditors to ensure that reports are clean. What they should be doing instead is to see themselves as agents of shareholders, asking tough questions on behalf of the shareholders, and in the process, protecting the legitimate interest of the company and its various stakeholders. AC should detach itself from management, but not from business. It should be willing to look at whatever needs to be done to improve the business, while not rubberstamping decisions taken by the management. Protection of auditors is an important function of the AC. If a management unreasonably prevents an auditor from expressing her views, it would be for the AC to protect the auditor and to ensure that the auditor is heard. ACs should also help to create a culture in which matters that have gone wrong, or are going wrong, are voluntarily disclosed, rather than their getting discovered in due course.
- There are very high expectations from Independent Directors (IDs). It is useful to examine whether the gap between expectations and performance is on account of unrealistic expectations that do no factor in the part-time role of the IDs, and the information asymmetry that they suffer from. Unfortunately, with rising expectations, the liabilities have also increased, and this deters otherwise qualified persons from accepting the position of IDs.

If IDs are to be reckoned as a significant instrument of Corporate Governance, it is important that they are fully appreciative of their role and are adequately compensated for the quality time that they devote to the affairs of the Board and the company. An honest Board evaluation process can help to establish whether the IDs, individually or collectively, measure up to what is expected of them. Presently, Board evaluation exercises amount to no more than ticking boxes. In the process of evaluation, some persons hold back for fear that their views might not be kept confidential.

- The fiduciary role of the Board is not understood by many. It is the loyalty to the job, and not to any person. With increasing irregularities coming to surface in the corporate arena, Regulators have considerably enhanced the responsibility placed on the Board and the Directors. With limited time, and with work that is increasing exponentially, it is unrealistic to expect the IDs and the ACs to do justice to their expanded roles.
- There has been a history of distrust of the business by both the Government as well as the man on the street. This has led to a situation in which the motives of wealth creators are always suspect, and they do not get the respect that they deserve. Good companies have several things in common, including the mutual respect and trust among all their stakeholders, as also a continuing constructive conversation where every opinion is heard, and decisions are taken based on what is in the best interest of the company and its stakeholders. Good companies are also those that have zero tolerance for actions that are inconsistent with law, regulations, company policy and good conscience.
- Regulators have to ensure that they develop the market, and protect the interest of investors, while not ignoring the legitimate concerns of issuers and intermediaries. It is useful to understand that regulatory organisations are not unidimensional, and do not serve only as policemen. Trust cannot arise from a situation in which the regulatory organisation persuades itself that if it is not watching, the regulated entity will necessarily do something that is irregular or even illegal. IDs, auditors and Proxy Advisory Firms exist to serve the cause of Corporate Governance and for this to happen, they should be professional and independent.
- Peaceful co-existence between the AMCs and the Trustees is a sure sign of an impending problem. When it comes to Mutual Funds, the expectation is that the Trustees who are first-level Regulators, will ensure that the AMCs do their job properly. The reality is that many Trustees do not know what is expected of them and are neither seen nor heard when things are going wrong. Just as Boards become centerstage when there is a crisis or any major impending action such as the sacking of the CEO, the Trustees should also come into their own at least in critical situations.
- Do institutional investors look into the quality of IDs on the Board, in addition to other factors while for making investment decisions? Until now, the experience seems to be that investors do not believe that Directors give quality time to the affairs of the company, leaving investment decisions to be based almost entirely on financial performance.

- Formal educational qualifications are not relevant for **assessing a person's** potential as an ID. Attributes such as collegiality, teamwork, appropriate boardroom behaviour and understanding Board dynamics are important attributes. Since the Board is the primary instrument of Corporate Governance, it is important that persons who are IDs, are not persons who hanker for positions, and are not afraid to speak their mind. They must also be appropriately compensated.
- Risk is inherent to any business and should not be seen as inconsistent with the doing of business. The question whether Boards understand risk is one that cannot be confidently answered in the affirmative. The financial sector is somewhat better off thanks to the interventions of Regulators. In the manufacturing sector, risk does not appear to get similar attention. Many Boards are reactive and wait for a crisis to materialise before scrambling to address what needs to be done.

All Directors are on the Board to aid the business of the company and therefore to believe that a focus on risk will deter a company from taking business decisions, seems to be a misplaced fear.

- Companies are for the long-term, and therefore it is imperative for the Boards to take a long-term view rather than focus on the present. In Covid times, managements have had to focus on the very short-term requirements, leaving it to the Boards not to lose sight of the necessity for looking into the future, identifying opportunities, and helping to take the tough decisions that the company's future demands.

Key speakers

Welcome address

Mr. Vikram Limaye, *MD and CEO, NSE*

Introductory remarks

Dr. Tirthankar Patnaik, *Chief Economist, NSE*

Panel Discussion



T. V. Mohandas Pai
Chairman, Manipal Global and Aarin Capital

Mr. T. V. Mohandas Pai is the Chairman of Board of Manipal Global and of Aarin Capital. He is a Former Board member and CFO of Infosys. He was an integral part of the Infosys team that enabled the first listing of an India-registered company on NASDAQ. He has been the Chairman/member of several committees, taskforces and panels set up by the Government of India and SEBI. He is a Trustee of International Accounting Standards Committee Foundation, the body that oversees the International Accounting Standards Board. He works with the Union and State Governments in the fields of education, availability of skilled manpower, entrepreneurship, IT and business. He has won several awards and recognitions, including the Padma Shri.



M. K. Sharma
Former Non-Executive Chairman, ICICI Bank and Former Vice Chairman, HUL

Mr. M. K. Sharma is the Former non-executive Chairman of ICICI Bank. He retired in May 2007 as the Vice Chairman of Hindustan Unilever Limited (HUL). In HUL, he was responsible inter alia for Human Resources, Legal and Secretarial, M&A activities relating to acquisition of companies in food and beverages and disposal of some businesses, Corporate Affairs, Corporate Communications, Corporate Real Estate functions and New Ventures, Plantations and Export businesses of the company. He has also served as the non-executive Chairman of Unilever Nepal Limited. Prior to joining HUL, he worked with DCM Limited. He has served on a seven-member committee constituted by the Government of India for redrafting the Companies Act. He was also a member of the Naresh Chandra Committee, which formulated the norms for Corporate Governance. He is actively involved in various industry associations, particularly CII and Bombay Chamber of Commerce



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

Mr. M. Damodaran is Chairperson, Excellence Enablers Private Limited and Former Chairman of SEBI, UTI and IDBI. He serves on Boards of Directors, including as Non-Executive Chairperson of InterGlobe Aviation, and on Advisory Boards of several companies. He successfully led the revival efforts of UTI and IDBI. He created the unique Stressed Assets Stabilisation Fund (SASF) which helped clean IDBI's books. He was also the Former elected Chairman of the International Organization of Securities Commissions (IOSCO)'s 80-member Emerging Markets Committee for two years. He has chaired several committees of the Government of India, RBI and some chambers of commerce. He was Former Chief Secretary of the Government of Tripura. He is a recipient of several awards and recognitions.

About National Stock Exchange of India Limited

National Stock Exchange of India Ltd. (NSE) is the world's largest derivatives exchange by trading volume as per the statistics published by Futures Industry Association (FIA) for 2019 and ranked 3rd in the world in the cash equities segment by number of trades as per the statistics published by the World Federation of Exchanges (WFE). NSE was the first exchange in India to implement electronic or screen-based trading. It began operations in 1994 and is ranked as the largest stock exchange in India in terms of total and average daily turnover for equity shares every year since 1995, based on SEBI data. NSE has a fully-integrated business model comprising exchange listings, trading services, clearing and settlement services, indices, market data feeds, technology solutions and financial education offerings. NSE also oversees compliance by trading and clearing members with the rules and regulations of the exchange. NSE is a pioneer in technology and ensures the reliability and performance of its systems through a culture of innovation and investment in technology. NSE believes that the scale and breadth of its products and services, sustained leadership positions across multiple asset classes in India and globally enable it to be highly reactive to market demands and changes and deliver innovation in both trading and non-trading businesses to provide high-quality data and services to market participants and clients.

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About Excellence Enablers Private Limited (EEPL)

Excellence Enablers Private Limited (EEPL) is an initiative that focuses on implementation of better corporate governance practices, improvement of Board performance, including audit and evaluation, training of directors and engagement with stakeholders of governance. It is founded on the firm belief that the gap between performance and potential can, and must, be bridged. Consistent with that belief, all our offerings are tailor-made to the specific needs of the organisation or the individuals concerned.

Given that our founder, Mr. M. Damodaran, introduced Clause 49 of the Listing Agreement, dealing with corporate governance in India, and has been a part of both public sector and private sector Boards, as well as performing and underperforming Boards, we offer experience based consultancy and courses on the journey from compliance through governance to performance. Further, given his success in turning around organisations that had been written off, we are uniquely positioned to offer courses on leadership, organisational transformation, and building winning teams.

EEPL has a number of highly experienced and renowned consultants and faculty members who have helped, and continue to help, us deliver programmes that have been well received.

For more information, please visit: www.excellenceenablers.com

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