excellence enablers | CORPORATE GOVERNANCE SPECIALISTS
[AN M. DAMODARAN INITIATIVE]

Expert Expressions
Corporate Governance Demystified

Excellence Enablers Private Limited March|2018

Neither a borrower nor a lender be
For loan oft loses both itself and friend;
And borrowing dulls the edge of husbandry
- Polonius to his son Laertes, in Hamlet

The behaviour of borrowers, especially those that do not know that "grief" is only a few pages after "greed" in the dictionary, cannot be predicted. However, it is safe to believe that public sector lenders will take Polonius seriously. With bona fide errors of judgement sometimes treated as ab initio mala fide decisions, sanctions will shrink and conditions precedent to disbursement will exponentially increase. Is Corporate Governance the answer to rooting out corruption while facilitating business decisions?

Editor

BANKING ON GOVERNANCE

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

One inevitable fallout of every negative development is that persons of all hues and views tend to join in the game of finger-pointing. Almost everyone would like to hold everyone else responsible for anything that might have gone wrong in an organization or a sector. The recent five digit banking scam involving the second largest Public Sector Bank (PSB) is no exception.

The LOU misadventure, and the panic induced in another large bank by the possible "flight" plans of a "paan to pen" entrepreneur have to be addressed having regard to context.

In the protracted discussions taking place, and the definitive pronouncements being made in the media, with the same persons often playing prosecutor, judge and jury, there has hardly been any mention of Corporate Governance. With breathless broadcasters baying for blood, bandaid solutions will surface, while systemic and substantive solutions endlessly await their turn.

Central to one's understanding of what has gone wrong, and what may go wrong in future, is the Corporate Governance philosophy and processes in PSBs. Both in 1970 and in 1980, while banks were nationalized, the Statements of Object and Reasons for introducing the respective Bills in Parliament visualized "that public ownership of these banks would help in more effective mobilization of savings and their channelizing for productive purposes." Behest lending and connected lending were proposed to be consigned to history. Creditworthiness of purpose was to replace creditworthiness of person. Branch expansion helped to mainstream the disadvantaged and the distanced.

While the gains were many, it was only a matter of time before the greedy began to game the system. Some acted on Omar Khayyam's advice: "Ah, take the cash and let the credit go". Others interpreted "directed lending" as lending on the basis of telephonic directions. In the process, the occidentalists, in whose dictionary privatization is a synonym for efficiency, productivity, honesty and transparency (and every other virtue of humankind), wanted, and continue to want, the public sector out of the banking space. The history of private sector banks that went belly up while impoverishing their depositors and minority shareholders has been conveniently forgotten. It is also useful to remember that Vijay Mallya, Nirav Modi, Mehul Choksi and Vikram Kothari are not from the public sector.

Therefore, what is at issue is not ownership but empowerment and role clarity. In listed entities, which is what PSBs are, the functions of superintendence, direction and control must vest in the Board of Directors. This must necessarily include at least the right to be consulted when a CEO/Managing Director is appointed or sought to be removed. Given its role at the top of the governance pyramid, it is incomprehensible why the Board of Directors of the bank did not meet as soon as the scam surfaced. While the mitigation of operational risk, arguably, is within the remit of management, the mitigation of reputational risk must necessarily reside in the Board.

It is time to get back to basics. The Banks Board Bureau, being a recommendatory and not an empowered body, is at best the fifth wheel of the coach, and must be wound up. With its recommendations not being acted on in time, accompanied with the perception that it is all powerful, all that it has achieved is to cause embarrassment to competent persons with a hitherto credible track record.

The Department of Financial Services must revisit its role. Performing the ownership function of PSBs should not translate to owning every credit decision. Periodic meetings with PSB Chieftains to tell them what to do, and when, should be a thing of the past.

Unfashionable as it may sound, good governance is premised on checks and balances. It is beyond belief that a couple of collusive employees drilled such a big hole in the bank's books while the rest of the workforce and the management were blissfully unaware.

Much has been made of the fact that one employee was in the same seat for seven years. While transfers after a period of three years constitute a sound administrative practice, good risk management lies in ensuring that persons in sensitive seats are forced to take at least two weeks off every year.

Bank branches often complain of internal, statutory, concurrent and other auditors being ever present at their premises. It is fair to ask why their professional skepticism did not help to smell something this fishy going on in a branch.

When things go wrong, a studied silence is suicidal. Keeping stakeholders informed, in a tone that is confident without being combative, is a non-negotiable requirement in a crisis. The statement of the Chief Executive, pointing to contributory negligence on the part of other banks did not help his bank's cause. With the Board being the custodian of the interest of stakeholders, a statement by the Chairperson would have helped considerably. Some news reports found a solution to this by describing the Chief Executive as CMD, presumably because he and his Chairperson answer to the name of Sunil Mehta!

In a land of continuing economic disparity, PSBs cannot and should not be wished away. They have problems. The solution clearly lies in the Tripod Theory of empowerment, incentivisation and accountability (The Tripod Theory is an intervention devised by Excellence Enablers).

PS – Diamonds aren't forever. Diamond LOUs are!

READERSPEAK – Alarm Bells or a Wake-up Call?

"Kiran Mazumdar Shaw, CMD, Biocon"
"Draconian measures akin to killing a fly with a bomb rather than a fly swatter. You should take this up to protect the interests of IDs, especially when they are professional."

"Srinivasan Kalambur, Former Member, IRDAI"
"Boards were becoming "buddy clubs". This is certainly a welcome wake up call."

"S. Hajara, Former Chairman, Shipping Corporation of India"
"Very well articulated indeed…. God bless the Independent Directors."

"Madhu Terdal, Group CFO, GMR Group"
"Excellent and insightful article."

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