Splitting CEO & MD roles should have come many, many years ago: M Damodaran

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*In an exclusive interview with ET Now, **M Damodaran**, Former **SEBI Chairman**, says to believe that independent directors are the solution to all problems is to expect much more than will happen at this point of time.*

Edited excerpts:

How important is the Uday Kotak Panel report which intends to improve corporate governance standards in listed companies?

It is important to state at the outset that this committee worked within certain constraints. Firstly as you know, The Companies Act 2013 as well as SEBI's LODR regulations provide for corporate governance -- that is the framework.

SEBI set up this committee and tasked it to look at the LODR regulations and what needed to be done to improve those to see that they met the requirements. I do not think this committee had the express mandate to suggest changes to the Companies Act 2013. Therefore, that clearly is a handicap.

Secondly as happens, often committees are set up because of certain episodes that take place even though revisiting corporate governance regulations is a requirement. But what happened in the Tata and Infosys matters in some sense must have -- and I am only guessing -- led to the urgency in setting up the committee.

Given that both these constraints exist and in the terms of reference -- if I remember right -- there were seven terms of reference, the committee should only use or could have only used the seventh term which is any other item to deal with a large number of issues which were not set out in the other six.

Let us talk about the recommendation relating to information sharing. One can safely assume that the recent corporate governance scandals which erupted at Infosys and the Tata Group could have been case studies during the meetings of this panel. It is in this respect that the very important proposal has been made wherein the information rights of certain promoters and significant shareholders have been specified. The panel has proposed that an agreement has to be signed between the company and promoters when it comes to having access to sensitive information. Your take on this because at the end of the day the intention of the panel was to ensure that no unpublished price sensitive information moves from one safe container to an unsafe container?

Honestly, I am a little uncomfortable with this recommendation. I know what has occasioned the committee to look at this. Clearly it was a Tata matter but the recommendation seems to suggest that this is a matter that will be resolved by an agreement between the two parties and I do not think that is necessarily the best solution.

What you need to look at, in all of this is you operate on a need to know basis. Does that person or does that group need to know the information that they are seeking and if so for what purpose? Is it likely to lead to any disadvantage being suffered by those that do not have information at the same point of time because information asymmetry is one of the major issues in the corporate governance space along with conflict of interest.

I called them the terrible twins in the governance space and you cannot skirt information asymmetry related regulations like PIT by saying let them enter into an agreement and deal with this. I am uncomfortable. I would like to see how this plays out.

Thematically, if you look at the panels proposals, they have highlighted three main aspects -- succession planning, strategy and risk management. The panel has proposed that ideally the boards of listed companies should discuss all these three aspects at least once a year if not more. What do you think was the rationale behind this suggestion?

The way we got to this was that a large number of boards do only four meetings a year and these are accounts related meetings where you spend a little time looking at the accounts and the recommendations of the audit committee. You do not get really have too much time to look at strategy and to look at non-accounting issues which are board level items. Therefore, they have suggested that all of this needs to be considered separately in a meeting which will be the fifth meeting.

But if you look at the three items that they talked about, clearly succession planning is something that the nomination remuneration committee is supposed to look at. It is a board committee, it is an important committee and they are supposed to look at the succession planning as well as remuneration of people at senior levels in the organisation.

It is for them to bring it up and you cannot wait for one year for succession planning to be discussed with the board level. If it is important, it should be discussed in one of the quarterly meetings.

I am a little more surprised that risk management has been consigned to what I call meeting number five whenever that takes place because risk management is something which is critical and risk is really top of the mind concerned for most boards, it should be. I was disappointed that the Companies Act did not specify that there should be a board committee on risk management. LODR says that everybody should appoint set up risk management committee but it does not say it is a board committee, it should have been elevated to a board committee and the board should have looked at risks on a continuing basis.

The audit committee certainly should own the process and look at it so a fifth meeting, a sixth meeting is fine but you should not leave these to only the non-accounts meeting as and when these assume importance you need to address them.

Now let us talk about a proposal which is likely to impact at least six of the Nifty companies if accepted and these include the likes of RIL, Hero MotoCorp and United Phosphorus. This is a proposal wherein, interestingly, the Uday Kotak panel has proposed a split in the role of chairperson and the CEO/MD in those listed companies where the public stake is 40% or more. This they believe should ideally be ushered in by April 2020. Now the panel has also said that this is a growing concern worldwide as well in other corporates. What do you think was the driver behind this proposal and what is the panel trying to avoid in terms of any unintended consequences or conflict of interest?

I have for several years maintained that if the same person is the chairman and the chief executive -- call him or her MD, CEO -- whatever you will, it is the ultimate negation of corporate governance. And the reason I am saying this is because it is the responsibility of the board to ask questions of the management. The responsibility of the management is to answer those questions. The board on behalf of shareholders and other stakeholders is to hold the management to account for running the company properly in the interest of all stakeholders. So, there is a relationship between the board and the management in terms of one holding or the other accountable.

If both are led by the same person at one level. it is the chairman asking questions and the managing director answering the questions and the rest of the board having ringside seats in that theatre which is not good enough. You must split both these positions. Otherwise you are negating the fundamentals of corporate governance. This is the recommendation that should have come many, many years ago. It has not happened, I am glad it has come now.

Now let us talk about the entire focus on the independent directors and the panel has gone into great detail regarding the accountability of independent directors regarding their selection, regarding the reasons for their resignation. There is a proposal wherein the panel has said that ideally at least 50% of the board must be independent. This of course applies to listed companies. If you look at the current provision or the existing provision, the number of independent directors depends on the chairperson's status. How do you look at this proposal wherein they want half the board to be independent? Clearly this is a move towards avoiding any conflict of interest and of course there was a lot of chatter around independent directors and their role, especially during the recent impasse between the Tata Group and Cyrus Mistry. Your take on this?

I think where the chairman is related to the promoter or is holding an executive position, clearly you must have 50% of the board as independent directors. This recommendation travels a little further and says you must have independent directors to the extent of 50% on board. It does not say that where the chairman is an executive chairman. It is a good thing to do that but to believe that independent directors are the solution to all problems is to expect much more than will happen at this point of time.

I think underlying all of this there is a fallacy which we need to look at. There is a feeling that independent directors are supposed to look after just the interest of the minority stakeholders, whereas Section 164 (2) of the Companies Act says clearly that it is to look after the interests of the company as a whole, all stakeholders and to act in a manner which promotes the interests of all stakeholders.

Of course, elsewhere it has said that you also need to focus on the requirement of minority shareholders. Now the minute you say that it is independent directors that are going to drive this entire process, are you in some sense negatively impacting the role of the management because independent directors and audit committees do not run companies, it is managements that run companies and answer the board. So you can have 50% I have no problem with that but you must get the right people, I think that is more important.

At least in certain quarters of India Inc and in certain companies, there is a widely held perception about independent directors that they are mere rubber stamps of the promoters. They act based on the promoters' wishes, they attend board meetings as a mere formality, have the tea and snacks and then they go back home. Now that is the perception in certain quarters and I think this is a

perception which the Uday Kotak panel has tried to address and here is the proposal. The proposal is that they want boards to list the competencies that they believe its members should possess. In fact, they have also said that the boards should disclose the skills that its directors possess. How important would these disclosures be?

This is a half-way house. It is important to have competencies, it is important to have skills, it is important to have the right people in the boardrooms and in fact the Companies Act provides that the nomination and remuneration committee should identify what are the missing pieces in the boardroom and get the right kind of people to come by.

Clearly, this is a good thing to say that you are bringing on board directors whose qualifications, competencies, expertise etc you will state to the shareholders and allow them to judge but is that a complete solution, no it is not. I might have competency, I might have skill sets and if I keep quiet in the boardroom because I do not want to rock the boat, clearly that competency and skill set is not only not contributing but is actually lulling the stakeholders into a sense of complacency they think that oh we have this guy on the board and he is definitely going to ask the right questions on our behalf and it might not happen.

At the end of the day, the individuals that come to boardrooms must come for the right reasons, must ask the tough questions, must leave their friendships with promoters and chairpersons and management outside the boardrooms and resume that friendship after the boardroom because it is a constructive tension that ought to drive the relationship between the board and the management. Qualifications are fine You can have excellent qualifications which means that you are really looking at the past of the director, you are looking at somebody who has acquitted himself or herself very well in some other theatre and might be a flop show in the boardroom unless the person gets involved. I think involvement is more critical.

Let us move on to another interesting proposal, this is the proposal where in the Uday Kotal panel has proposed that detailed reasons should be disclosed to the stock exchanges and these reasons should be also mentioned in the governance report when it comes to resignations of independent directors. If you look at the current provision, the detailed reasons have to be given only to the registrar. Now I am tempted to again go back to the entire Tata, Infosys saga wherein we did see scenarios where a lot of independent directors came under the scanner and there was a war of words and a few of them resigned because they were disgruntled. But of course, that whole concept of resigning on personal grounds the panel wants to throw out of the window. Do you think that is the intention?

It all depends. Theoretically, it is a very good proposition but it all depends on that director stating honestly what the reason is for his or her leaving the board. I will give you an example. If somebody says I am resigning for personal reasons and you say that is not good enough, tell us what those personal reasons are, it could vary from, let us say, a physical threat to his existence in the boardroom, not unlikely in some cases, to just saying I do not have the time or maybe I got into the board by mistake and the earlier I leave the better. All of that can be subsumed under personal reasons because all of them are personal reasons.

You must expect people over time to make an honest statement. You have to report to the ROC why you resigned and my best guess is not that I have facts at my disposal but if you take the resignations that have happened since the Companies Act came into being, I do not think you will see too many who have said I am unhappy with the way the company is being run, I am unhappy with the management, I am not getting information when I ask for it. I do not think you will see too many of that kind of cases. So, that has to happen, people must be more honest with themselves and therefore with the stakeholders on why they are not staying.

A provision that has been proposed by the Uday Kotak panel wherein they want a minimum of six directors as far as board size is concerned as compared to the existing provision of minimum three directors. They have also looked at gender diversity in a major manner where they want at least one of the independent directors on the board to be a woman. Now this will lead to a great demand for these directors both men and women, there will be a chase for attracting the right kind of talent. Do you think the right kind of talent exists in India Inc currently and do you not think this might be a challenge for companies in the long term?

I do not think it will be a challenge if you search for the people seriously. There are several untapped areas where you can get good directors but typically what happens and what happened as soon as gender diversity was introduced in the Companies Act everyone went to the same 10 or 15 women directors who had done very well on boards and said will you join my board. Clearly ,they had their limitations but if you look around, if you can find men to be on the board I do not see why you cannot look around and find women to be in the board. In this day and age, you will find as many women that are competent for board positions as you will find men.

I do not think that is a challenge at all but to stay with the subject, I personally believe you need to have a minimum of two women on the board of whom at least one should be independent. The reason I am saying this is that you do not want the first women director coming on the board because of tokenism to be referred to as a woman director because the men do not get referred to as men directors or male directors. She is a director first, the gender is a matter of detail. I think you do not want to slot somebody into a box for the sake of tokenism, it must be for talent, it must be because of the value they bring to the board.

Compensation and executive salaries are two huge issues for minority shareholders and there is an interesting proposal that has been made by the Kotak Corporate Governance Panel. This is the one relating to executive promoter director salaries. What has been proposed is that in cases wherein the executive promoter director salaries are in excess of Rs 5 crore or 2.5% of the net profits whichever is higher, then you mandatorily need a special resolution. You need a nod from the shareholders. What they have done is now they have come out with a cap and they have made it a little tighter. How important is this from a corporate governance standpoint?

There is no harm going to the shareholders. If you have a good case and it is not easy to get extraordinarily competent people now, if a promoter who has skin in the game, who has grown the business seeks to be paid higher, you should not see that necessarily as negative, but certainly you should get support of the shareholders.

In one case or so, in corporate India, shareholders rejected the proposed compensation and that too happened to executives and not to promoters. They felt that the compensation was high. But otherwise, go to the shareholders. At the end of the day, the shareholders who have written out the cheques, went to the market to raise money. What is the harm asking them for approvals which are matters of concern to them.

In the past, the conduct of auditors has come under the scanner in several corporate governance controversies both in listed as well as unlisted companies. What the panel has proposed is clear, that SEBI should in fact act against erring auditors and not only erring audit firms when it comes to cases of gross negligence. Now clearly there is a different note by the ICAI to this but nonetheless the panel wants more teeth for SEBI to act against auditors and audit firms. What sort of powers do you think SEBI should have in this regard?

This is a very welcome move. A lot of shareholders treat the auditor's report as gospel truth for good reasons because the auditor is looking at the accounts on behalf of the shareholders. It is a mistaken impression that the client is the management of the company. It is the shareholders on whose behalf the auditor has to ask the right questions. If that person has committed established gross negligence, clearly SEBI as the market regulator should have, in the interest of the integrity of the market, the ability and the powers to take action.

It is a 177-page report that has been submitted by the panel to SEBI and this panel was a rich panel, rich in terms of experience, rich in terms of variety. There were corporates on the panel, there were regulators on the panel, there were academicians on the panel. Are you satisfied with the breadth and scope of the recommendations that have been made or do you think there is anything missing?

India's corporate governance standards are not lesser than the standards in most other countries. We tend to be overtly critical of ourselves because we have had a few bad cases. Almost every jurisdiction had bad cases. This report functioned on the basis of one constraint which was that they were only looking at LODR and not at the Company's Act. I would have liked to see the committee given far more time and be in task to look at both of these.

I know that in case of Company's Act, it is the ministry that is the owner and not SEBI. But unless you look at both these together, you will not get a complete fix on it. Then there are incremental changes. Five meetings have been suggested instead of four, at least one meeting of independent directors. Now clearly companies that attach value to governance do much more than this.

Then there is one which I was a little disappointed with. It said that if there are regulatory changes, you must inform the directors once a year. It is just not good enough. Whenever the regulatory changes take place, do not wait for the next meeting, send out mails to the regulators if they are important enough and if they impact your business. There must be a monthly report to the directors and some companies do this, what are the material developments since the board met, between boards meetings what are the major developments.

I would have expected to see the frequency a little more than what the committee has recommended, once a year is just not good enough. If you look at the evaluation process, it could have been prescribed far more tightly not in terms of detailing a process but in terms of ensuring that it was done well and you make the company responsible for wholesome evaluation process and not the kind of box ticking response and thinking and politically correct response to some questions which does not translate to anything at all. I think it is like the curate's egg good in parts, bad in parts -- the direction is good, the intensions are good and if we can gain some ground in some of these, I think we would have travelled in the right direction.