

CORPORATE GOVERNANCE – THE SHAPE OF THINGS TO COME

1st MARCH, 2019

NEW DELHI

SUMMARY OF DISCUSSIONS

CONTEXT SETTING

Based on the recommendations of the Kotak Committee on Corporate Governance, SEBI has introduced a number of changes in the SEBI (LODR) Regulations. Many of these will take effect on April 1, 2019, with the remaining expected to come into force on April 1, 2020. The implementation of these recommendations will involve fundamental changes in the structure of the Board as well as several other important aspects of the functioning of corporate Boards. At the same time, corporates will also have to contend with the changes recently made by the Ministry of Corporate Affairs through an Ordinance amending some provisions of the Companies Act, 2013. Further changes are expected to be announced, after a final view is taken by the Ministry on the basis of the consultations that have recently taken place.

Briefly speaking, the regulatory regime has undergone, and will undergo, several significant changes. While a ticking-the-box approach might ensure compliance with these regulations, it will be necessary for progressive companies to extract value therefrom, and to reflect to policymakers and regulators, the impact that these changes have made, and are making, in the process of carrying on business.

DISCUSSIONS

- Message of Corporate Governance should reach a wider audience.
- Governance practices have improved in the corporate world. Earlier, there was complete lack of transparency around the proceedings of the Board and committee meetings.
- Most companies only respond to law and regulations, since the value of good Corporate Governance is not known to them.

LAW AND CORPORATE GOVERNANCE

- Laws are made keeping in mind the bad companies, and not the good ones.
 - Regulation is a response to ground realities.
 - The assumptions/ root causes analysis on the basis of which laws are written are sometimes not correct, leading to excessive lawmaking.
- The quality of language in the laws is not upto the mark.
 - On a number of occasions, the intent / objective behind law does not get translated to enacted law.
- Legislative processes are lengthy.
 - There are enough laws in India, enforcement of these laws should be improved.
- Corporate Governance should not, and does not, depend on law. It flows from culture.
- While governance framework is important since it helps *inter alia* in role clarity of the Board and Directors, over-regulation is never a good idea.
- Most companies do not travel beyond the minimum prescription of law.
- Spirit of law is at least as important as the letter of law. However, most companies consider the letter of law, forgetting the spirit behind it.
 - Some of the areas where the spirit of law is not considered by Boards are -
 - Executive pay
 - Succession planning

- Composition of Board
- Functioning of Audit Committee (AC)
- Self-governance is important.
 - There are a number of Boards which are doing good work and are making perceptible changes.
- In Public Sector Undertakings (PSUs), the process of promoting Corporate Governance has started, but at a slow pace.

NIFTY 50 COMPANIES VERSUS SMALLER COMPANIES

- Nifty 50 companies have better processes than the smaller companies.
 - For smaller companies, there are several constraints such as compliance and manpower costs.
- According to SEBI (LODR) (Amendment), the governance / compliance content is the same, only the timelines given to smaller companies are different. However, given the size, the content too should have been phased in.
 - The outcome of the same regulations being applicable on companies irrespective of their size is not yet known.
- There is an urgent need to carry out a Regulatory Impact Assessment (RIA), especially having regard to the compliance burden on smaller companies.
 - The cost of compliance is very high at present.

CULTURE

- The practices and processes followed by a company depend on its culture.
- The intention of both the promoter and the management is important. Equally important are the intentions of the Directors, especially the Independent Directors (IDs).
- There should be transparency in sharing information with the Board.
- Trust will beget trust among the regulator, promoters, management and IDs.

PROMOTER RUN COMPANIES

- Processes followed in a promoter run company and a company run by professionals are very different.
 - PSUs are also often treated like a promoter run companies.
- Promoters should see value in Corporate Governance.
- Quality of Board depends on the promoter and her intention of extracting value from Board members.
 - There should be efforts to appoint Directors for their experience and expertise, instead of appointing only family members to the Board.
 - Family's wealth can be reduced if the promoter family/ family member is not competent in running the business.
- The quality of deliberations in the Board and committee meetings is dependent on the tone that the promoter sets at the top.
- While the proposed split in the positions of Chairperson and the Managing Director (MD) is positive, the condition that the persons occupying the two positions should not be related is harsh.
 - In promoter companies, for continuity, the promoter may want a relative to be appointed as MD. The intention may be good, but in times to come, law will prohibit this.
 - There is a huge pushback from promoter companies on the split in the two posts.
 - If a promoter desires, she can bring a person who maybe nominally independent (on paper) as Chairperson.
- If a promoter wants to promote her interest and her family's interest at the cost of minority shareholders' interest, she will do so irrespective of a professional management and IDs on Board. The intention of the promoter is important.

INDEPENDENT DIRECTORS

- IDs are important.
 - At times, the regulator may ask IDs about the company, rather than asking only the management.
- Quality of IDs, and not their number on the Board, is important.
- The process of selection of IDs is very important.
 - PSUs should have Nomination and Remuneration Committees (NRCs) to help them select their own IDs.
- IDs too should undertake due diligence of the company before joining its Board since their reputation is at stake. They should consider factors such as comfort with the Board and company, respect for other Board members and qualitative deliberations at the Board.
- IDs should undergo training, and this should go beyond the prescription of law.
- Separate meeting of IDs is a very good forum that can be used by IDs to bring about a difference to the Board.
 - The number of such meetings should go beyond the prescribed minimum of one. Ideally, there should be such a meeting before every Board meeting. The minutes of this meeting can be given to the Board/ Management/ Executive Chairman / MD, if needed, for appropriate action.
 - These meetings should normally be unstructured. If there are issues, they can be listed and discussed.
 - In some companies, these meetings are followed by impromptu meetings with Executive Directors (EDs) so that there can be a deliberation on the agenda and decisions can be taken. IDs should follow up with EDs / management on action taken on decisions.
- IDs have the right to ask for information, if it is not forthcoming from the management.
- They should drive the change. Law cannot be made for every aspect. They should consider the smell test to check if the company is on the right path. They should travel beyond compliance based on the company's requirement.
- IDs should speak in one voice on governance matters. On business matters, it is healthy to have a difference of opinion so that discussions can take place. If this is not the case, the promoter, if she is not well intentioned, can use this situation to her advantage.
- How much an ID contributes, and her true independence of thought depends on the ID and not on the promoter.
 - Their contribution should be respected.
- If a Board has an Executive Chairperson, Lead ID can help bring consensus, lead the deliberations among IDs and communicate the decisions of IDs.
- For IDs to be effective, there should be -
 - Role clarity – should not get into management's territory
 - Objective behind their appointment
 - Protection of interest of minority shareholders
 - Furthering the interest of the company
- IDs should know what questions to ask.
- They should suggest agenda items, especially if any important item is not coming to the Board.

BOARD PROCESSES

- Board composition is very important for a collegial Board and constructive Board deliberations.
 - Diversity in composition should move beyond gender to diversity of thoughts.
 - Equally important is attendance, or time commitment of Directors.
- Since compliance related agenda items are sent out as pre-reads, they should be taken as read, and only if any Board member has an issue with any item, it should be discussed.
 - This can also be discussed in separate meeting of IDs, before coming to the Board.
 - Compliance should be driven by both IDs and management.
- Each agenda item should have an executive summary.

- There should be at least one separate meeting of the Board to focus on strategy.
- Executive actions should not come to the Board since *inter alia* it reduces the accountability of management towards executive action (which is part of their job).
- Board evaluation – should be a meaningful exercise.
 - Questionnaires, if used for Board evaluation, should not be very long. The questions should focus on
 - What should the board start doing (which it is not doing at present)?
 - What should the board do better?
 - What should the board stop doing?
 - Feedback loop is very important.
 - So far no Director has been asked to leave on the basis of evaluation (as envisaged by law).
 - In Public Sector Banks, evaluation of Whole-Time Directors by Board members is starting now.
- Technology can be used constructively, such as for Board portals etc.

NON-EXECUTIVE CHAIRPERSON

- The role of the Non-Executive Chairperson has not been defined in law, or in the Articles of Association of most companies.
- The Chairperson should empower herself and not wait for anyone to empower her.
- A Non-Executive Chairperson is envisaged by SEBI (LODR) (Amendment). It will not increase the cost of compliance since Boards already have IDs, and one of them can be appointed as Chairperson.

COMMITTEES OF THE BOARD

- Most Boards have only the mandatory committees.
 - Very few companies set up committees which are not mandatory.
- Role and accountability of each committee should be defined and documented.
 - Most companies do not derive value from their committees.
- Action taken report is equally important for committees as it is for the Board.
- AC should devote qualitative time to its proceedings.
 - The interactions with statutory and internal auditors are very important.
- Every company should have an effective NRC.
 - The presence of the promoter on the committee makes a difference to the deliberations.
 - Succession planning, which the committee should focus on, is often ignored and should be given priority.
- Risk Management Committee (RMC)
 - Even though risk is important for each company, the committee is not mandated for all companies.
 - The composition does not mandate the presence of an ID.
 - Risk management and mitigation is not understood in India.
 - Risk identification, including cyber security, itself is faulty/ inadequate.
 - Risk register is either missing, or not updated / resisted at periodic intervals.

TWO-TIER BOARDS

- Two-tier Boards work well in companies where there are a large number of executives on the Board.
- A Board comprising no executives (Supervisory Board) is in a perfect position to hold the management accountable.
- In two-tier Boards, since the management is not on the Board, and since accountability is clearly established, the behaviour of management is more professional.
- In India, with Key Managerial Personnel (KMPs) and officer-in-default being defined by law, it is akin to a two-tier Board structure.

- In Dutch Boards,
 - Diversity of thought, rather than diversity of gender, is given importance.
 - Supervisory Board is encouraged to have discussions and debate. The information shared promotes discussion of topics such as strategy.
 - More time is spent in strategy/business and not on compliance.
 - Discussions on succession planning of Chairperson, Chief Executive Officer and Chief Financial Officer is led by the Supervisory Board.

EXCELLENCE ENABLERS

CORPORATE GOVERNANCE SPECIALISTS
ADDING VALUE, NOT TICKING BOXES

EXCELLENCE ENABLERS PRIVATE LIMITED

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.

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