

CORPORATE GOVERNANCE – WALKING THE TALK

28TH APRIL, 2018 | MUMBAI

RATIONALE

In recent times, increasing evidence has surfaced that a number of companies are merely paying lip service to Corporate Governance. Either on account of not understanding their role, or arising out of the unwillingness to act, Boards of Directors have reduced themselves to passive spectators. The unseemly rush to endorse management action, or inaction, has given rise to legitimate apprehension that the interests of the stakeholders are being given short shrift. It is time to restore the balance in the boardroom and to ensure that Boards are either pressurised or persuaded to discharge their fundamental duty, which is to keep management honest. The clearly unsatisfactory situation that obtains at present will need to be addressed by concerted action, consequent on informed discussion and debate.

SUMMARY OF DISCUSSIONS

- There is a near-complete mess in Corporate Governance across sectors. It is wrong to assume that private sector is better than public sector, or that so called professionally managed companies are better than promoter run companies. Governance standards depend on the tone at the top and the commitment to Corporate Governance by senior leadership.
- Discussions on Corporate Governance seem to surface only when there is a problem or a scam.
- Conflict of interest is present across large number of transactions in the corporate world.
- A major part of the problem is that Corporate Governance systems in India are not consistent with our Indian culture and ethos, and are imported from outside. This becomes important since the culture is the sub-structure on which Corporate Governance is premised. Further, Corporate Governance systems should be put in place keeping in mind the ground realities such as the shareholding patterns.
- A huge cultural change is required for better Corporate Governance systems. A shock to the system is also necessary. Post the Satyam episode, a number of Directors sat up and started taking their role seriously.

Legislation

- Legislation cannot be the solution to all problems. They only provide the threshold requirements.
- Good companies do the right things without their being mandated. Behaviour cannot be legislated.

Composition

- Composition of Boards is the starting point for strengthening Corporate Governance. If good IDs join only good Boards, then there would only be good and bad Boards which is not ideal for the system. Instead IDs should join or create Boards which have a backbone.
- Earlier, and to some extent even now, there was a tendency to choose those persons as IDs, who the promoter or the management was comfortable with. This was because promoters and managements like to avoid Directors who ask the tough questions. Gradually, word spreads and such Directors are not chosen by a number of companies who do not want “difficult” Directors.
- The basic underlying principle of Board composition was *you scratch my back, I scratch your back*.
- A number of boards choose “comfortable” and “eminent” Directors. Eminent Directors cannot be expected to go through a formal process of selection since they believe that they are beyond such processes.
- Interdependent Directors, sitting on each other’s Board as IDs, is yet another problem. Such “Interdependent” Directors should not be treated as Independent Directors.
- With the selection of the Director, the process, the remuneration and the removal of IDs decided by the promoters, how truly independent are IDs? While various legal provisions have, from time to time, toyed with the idea of curtailing these powers of the promoters, they have decided against it. As a

result, a lot of times, appointment of new Directors is entirely as per the whims of the promoter or management (in professionally run companies).

- While most Boards have NRCs, proper process for selection of a Director is not followed. The process should ideally start by first determining the quality and attributes that are required in the potential Director. In the absence of this, the process, however rigorous, will not yield productive results.
- While getting a new Director, the criteria should not be a formal qualification because it is completely possible that the context has changed.
- Boards get the kind of Directors that they want. With a huge majority of companies not being completely honest, but requiring IDs since it is a legal requirement, they get IDs who do not want too much information coming to the Board so that they can certify that nothing inconvenient was brought to their notice.
- Indian Boards also do not have diversity. Diversity should *inter alia* include age diversity since younger persons have a lot to offer. There should be a distinction made between the person and the job that she does so that age is not considered to be a negative. Young persons are not afraid of asking the tough question, and this is slowly becoming a part of the corporate culture in India.
- Usually, Indian Directors believe in consensus in decision making while foreign directors ask the tougher questions and ask to record their dissent in the minutes. This could prevent Indian Directors from asking questions. Some Boards do view questions as a disruption, which may not be the correct approach.
- Ultimately, rigour, diversity, candour, courage and backbone, and maintaining the right decorum are all essential for a Director and for proper value-adding boardroom deliberations.

Intention

- Purity of intention of promoters, Directors and managements is very important. If they have the right intention, they would want to improve.
- This is however often missing in both promoter and professionally run companies.

Role clarity

- While more Directors understand the increase in their responsibility, and fear legal consequences for inaction, they do not fully understand their role.
- Boards often forget that they exist to protect the interests of shareholders. Duty of care and candour is missing. Board members start thinking of their appointment as an entitlement.
- Most Board members forget that they have fiduciary responsibilities which they should not forget. They are not invited to join a board only for their technical know-how, for which the company can always hire an external expert. A Board is a Board of Directors and not a Board of consultants.
- An intensive and well designed induction programme for new Directors is very important. It helps them tremendously in performing their Board level commitments. In addition to business related items, this should also include interaction with senior management. The programme should focus on familiarising the Directors with the domain so that they can apply the basic principles of right or wrong.
- For a number of IDs, their role as a Director is their second career. They may require training, including training on soft skills, for this transition from an executive to a non-executive role.
- Mandating training for role clarity will not help in the absence of seriousness from the Director.
- Nominee directors need to understand their role better and play their part effectively.
- IDs should know when to say yes or no. While Boards might work on the basis of majority, the right points must be raised with conviction. IDs should record their dissent if they feel about a matter strongly. If required, they also have the option of seeking an external opinion. IDs who take their role seriously are taken seriously by others on the board.
- Shareholder activism should be understood by directors and not frowned upon.
- While there could be some merit in having a global institution for Directors to make them understand their role as Board members, it could degrade to yet another institution since soft skills cannot be imparted by any institute. A well-qualified Director and a good Director are different things.

Role of Promoter

- Many promoters do not differentiate between their money and the money that they have raised from the market. They believe in doing the best that they can for their company, for themselves and their families, and their employees. As long as lenders and shareholders are paid their dues, they do not worry/ care about them. In fact, everyone treats the promoter as the owner. It is part of the Indian ethos.
- The concept of RPTs is not looked into in the right spirit and the definition of relatives is too narrow, and so both of these can be, and are often, misused. However, expanding the list to make it very long is not advisable.
- Promoter can set the tone and environment to encourage IDs to ask questions.
- After some time, the “professionals” in professionally run companies also start behaving like promoters. But unlike most promoters, they do not like Directors asking what they perceive to be too many questions.
- Promoters, including new entrepreneurs, too need help for improving the governance standards in their companies. With their companies expanding, their focus has been on business related items. By constant dialogue, and not fighting, IDs can bring about a change by engaging with the promoter and making her aware of good practices. At the end of the day, most promoters are open to such conversations.
- Next-gen promoters are changing faster than the corporate world would like to believe and they too are realising that the world is changing. Small changes like calling the promoter family by first name is happening.
- Many promoter companies have a good culture, only ethos has to be changed.

Role of Chairperson

- The role of Chairperson is very important. She can keep the Board on track and the management honest.
- No one is born a professional Chairperson. As a result, orientation of a Chairperson, especially first time Chairperson, too should be given importance.
- In the absence of the right tone at the top, good Directors too can start pulling their punches.
- A good Chairperson also continually reminds the Board that their ultimate responsibility is to the stakeholders of business, especially minority shareholders.
- Chairperson also has to manage egos and insecurities of the Board and its members.

Role of Management

- Managements, especially in professionally run companies, set the tone of boardroom deliberations.
- A number of managements are not open to hearing a “no” from IDs.
- In a number of companies, management creates facts that are presented to the Board. Sadly, this is increasing, especially in the private sector.
- While internally colleagues ask a number of tough questions, the dynamics changes in the boardroom since the boardroom itself has its own dynamics. However to think that all managements are averse to questioning is not correct.

Board-management interface

- Even well intentioned IDs can discuss only what comes to the Board. Not every material information comes to the Board.
- If the management wants to keep the Board engaged and informed in between meetings, it can take proactive steps. Proper agenda, complete flow and access to relevant information, and keeping the Board informed goes a long way in constructive dialogue.
- Board and management should have mutual trust which can only be created overtime.

Board Evaluation

- Even though Board evaluation has been mandated, it has become yet another annual compliance process in most companies.
- The process of board evaluation should be improved so that it contributes to enhanced Board performance. A mere questionnaire approach cannot be expected to add value. One on one interactions are essential to the process.

Benchmarking best practices of Corporate Governance

- If good Directors and Boards set standards, which can be benchmarked, and lead by example, group behaviour of corporates can be improved since others would want to follow.
- Positive changes should be celebrated so that companies who practice governance create peer pressure, and those which do not practice it are frowned upon and they feel the need to improve their standards. This will promote compliance with substance.
- Companies should become role models, and with market rewarding them for governance, should exist so that they can lead by example.
- Good companies should strive to continuously go higher.
- Companies should consider total return to shareholders.
- If feasible, balance sheet, through regulation or valuation, should capture some kind of governance score.

International Boards

- While looking for a new Director, international Boards first determine the quality and attributes that they require and then look for potential persons who can be approached to join as director(s).
- The process followed for selection of Directors is much more rigorous. On occasion, all Directors, and not just NRC members, meet the potential Director.
- Some Boards even ask for references from the potential Director.

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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.

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