

'Flower-vase directors will not take a stand'

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Meleveetil Damodaran - BL

M Damodaran, former SEBI chief and UTI's turnaround man, shares his views on the IL&FS crisis, corporate governance issues and his varied institutional experience

Feisty and fearless. That probably best describes Meleveetil Damodaran, Chairperson, Excellence Enablers, and former chairman of SEBI, UTI and IDBI. He helped restore the credibility of UTI and bring IDBI back from the brink. As SEBI chief, he was redoubtable. In a free-wheeling interview with *BusinessLine*, he shared his views on the IL&FS crisis and the governance landscape in India, drawing from the immense experience he has gained over an illustrious career.

Excerpts from the interview:

There were enough indicators of a crisis brewing in IL&FS -- gearing was high, there were cash flow problems, etc. Do you agree that the credit rating agencies and the auditors should have picked the signals much earlier?

I think India has more rating agencies than it needs; many mature economies do not have as many rating agencies as we do. I would not join the chorus which says that the rating agencies need to shut down their business. All the agencies that rated IL&FS are known to have good time-tested processes.

However, they have to revisit the matter to see what signals they did not pick up, and whether they were swayed by the optimism that the management expressed. To say that they looked at each vertical separately and did not consider the consolidated debt is like saying, 'we rate an instrument and don't look at the institution'. With the benefit of

hindsight, they should see that this kind of error does not recur.

As far as auditors go, many of them seem to think that the management that gives out the letter of engagement is their client, even though the auditor's report is to the shareholders.

If you look at the disclaimers in any audit report, it is all standardised. I want to appeal to the ICAI, 'please don't standardise the report, let each auditor write his or her own piece'. Also, if there is a qualification, just go ahead and qualify. At the end of the day, you are the conscience keepers.

I'd like to share an episode from my days in the Unit Trust of India (UTI). As you may know, I went to UTI at a very difficult time. When the first year's audit was done, there were close to 150 objections. Normally there are discussions between the management and the auditors about these objections, following which the number is whittled down. I said, if it is 150, so be it. I want to know where the problem lies. The auditors almost wanted me to plead with them to bring down the number. My question was, if it is 150 this year, how many qualifications were there last year? The previous year, it was a clean report whereas at least 95 per cent of the problems must have been present the previous year or the year before.

The IL&FS auditors seem to be saying that everything was alright up to March 31, 2018. The Board will now have to look into what they said, and why they said what they said.

What does this episode tell us about the manner in which the managements in government undertakings function? The former CEO of IL&FS was in office for 30 years. Shouldn't there be a ceiling for CEOs' term in office?

A lot of people have believed – and I take great pride in the fact that I did not subscribe to this – that the so-called professionally run firms are all cat's whiskers and it is only the “lalaji-promoter” who plays ducks and drakes with the system. We have now seen in a few cases that that is not true.

It is also not true that the public sector is alone badly run and the private sector is smelling of roses. If the management is around too long, they start thinking of the company as their own, in some sense. They do what they think is right by the company. But the checks and balances – voices to tell them that they are going too fast or that they are diversifying into unrelated areas – are not there or are not heard.

It's not just IL&FS that faced this problem of long tenures. In ICICI too, professionals have functioned like owners. There is one stretch of Bandra Kurla Complex – IL&FS, ICICI and the NSE – 200 meter stretch of road with similar problems. If you stay too long in any position, you start believing that you are infallible. In the public mind, you get identified with the company. That said, IL&FS had considerable experience residing in its leadership. To my mind, the problem was a business model that went horribly wrong.

At the other end of the spectrum are public sector banks, where the chiefs hold office for extremely short periods, even one month in one case. You cannot have Chairmen/MDs holding office for too short a term, especially in difficult times when people in the organization are looking up to the leader for reassurance.

The tenure for bank Chairmen cannot be 25 years as it is in private banks. But it cannot be a few months either. I am a firm believer that a 5-year term is best whether for bank chiefs or heads of regulatory organisations. At the end of 5-years, after a close hard look, a 3-year extension can be given in very exceptional cases. After that, even if he is the best person on the earth, bid him goodbye.

You helped revive UTI as well as IDBI. What in your opinion needs to be done to fix IL&FS?

There is admittedly an asset liability mismatch in IL&FS' books. There are dues from the government, which do not get paid in time, and there are importantly, issues of morale and motivation at this point in time.

There are good people in the organization who are looking for guidance and support in these difficult times. When I took over UTI, I called my officers and said 'While I am here, no case will be referred to an external investigation agency. If I find something wrong, I will take care of the offender myself. I don't need anyone's help to do that.'

What I noticed here is that the day the new Board was announced, that afternoon SFIO gets in there and computers etc. are seized. What will all the employees be thinking? Is the organisation going to be shut down? Is there a massive scam? I think this approach makes things difficult even for the new Board, and cramps their style.

The Board needs to be empowered by giving them the freedom to act as they should. Now, even if the IL&FS tries to sell some of the assets, they may not get the right value as everyone knows that it is a distress sale.

I'll give you a parallel from my experience in UTI. Everyone knew that we were facing redemption pressure and we had to sell our holdings. We discovered that if we kept selling shares, we were only hurting ourselves. I asked a big shot in the market, 'Don't you think SBI is underpriced at this level?' He said, 'You are sitting on tons of this stock that you have to unload soon. That's when we will buy.' That evening, I decided with my colleagues that we are not selling any more stocks, we'll issue bonds after getting government guarantee'. When UTI stopped selling, the stock market recovered, and unit holders that stayed invested benefited.

What the Board needs to do, is to carve out entities that can do well or are doing well. Don't necessarily sell them off. See that these units have the money they need. Then you are shrinking the size of the problem. The universe that commands your attention gets smaller.

Vineet Nayyar is an outstanding person, the way he dealt with Satyam was phenomenal. I have the highest respect for him. But he is being made the Managing Director at the age of 80. This involves someone rolling up their sleeves and putting in 16 to 18 hours of work everyday, given the challenges. Vineet is capable of doing it. Whether it is fair to him, I don't know. At least give him 2 Deputy Managing Directors of his choice.

Looking back at the manner in which IL&FS evolved, what do you think went wrong?

What is IL&FS? Infrastructure Leasing and Financial Services. The financial services arm of the company was mostly sold off and the company was stuck with infrastructure. The infrastructure business suffered because the government contracts didn't lead to timely payments and the nature of the business was very aggressively competitive.

The problem with infrastructure institutions is the externalities that have derailed projects. When you get into a project, how many imponderables can you address? The main problem lies in the time it takes for project approvals.

The solution lies in the government forming an SPV for infrastructure projects. If there are, say, 30 approvals needed for the project, let the SPV get all the approvals, then tender out the SPVs through global bids. You will get very attractive prices.

Many years ago, I told some senior State Government officials – who made the mistake of asking my views on improving governance in institutions -- to go for deemed approvals; if approval is not given for 3 months or 6 months, it should be deemed as given. They laughed in my face.

How independent should a Board be? It was seen in IL&FS and ICICI that the Board tends to rally behind the incumbent CEO...

Without commenting on specific boards, when the CEO becomes very powerful, the Board ordinarily tends to get subservient. If you have "flower-vase directors" they will not take a stand. Something more strange is being done now. A test to be held by Indian Institute of Corporate Affairs (IICA) is being prescribed for intending Directors. This seems to be a good method through which IICA can earn revenue. What else it will accomplish, remains to be seen.

Understanding the provisions in Companies Act and LODR is not what Board members need to be taught. They can learn it themselves by reading the texts. They need to understand Board-management interface, the Board-CEO interface, how does the Board interface with the KMPs -- these are more behavioural than knowledge- derived. You need a certain amount of maturity and wisdom to be on the Board. No test can assess you on that count.

While Boards have to be independent, they have to support management when required. People are beginning to think that the role of the independent director is to oppose what the management does. That is a recipe for disaster. The most sensible section in the Companies Act, is 166(2) which says *inter alia* that every Director is to act in the best interests of the company. So, independent directors are responsible to all the stakeholders, and not just minority shareholders.

Schedule IV of the Companies Act, dealing with independent directors, is a long laundry list. If someone complies with all of it in letter and spirit, he must be recommended for sainthood. I think the more we prescribe, the more foolish we become. I don't think drafting is taught properly in law colleges; evidence in support of this apprehension is plentiful.

The Board must challenge the management and there should be constructive tension in the board-room. The management runs the company and the Board must ensure that they do it properly.

If you go back in time, there were DFIs or development finance institutions. You helped revive one of them, IDBI. Any takeaways from the manner in which these DFIs shut shop?

IFCI came to grief for a few reasons. Firstly its location was disadvantageous; if you are going to be located in the National Capital, you will be under pressure, by phone calls, to lend, where you may not want to. Then came about an informal division of sectors between the three DFIs – IFCI, IDBI and ICICI – and IFCI got the worst sectors. Then they had fairly ordinary leadership, unlike ICICI and IDBI that had good leaders at various points.

ICICI realised that to stay relevant for the long term, you need to become a bank. They got a bank license, set up a bank and did a reverse merger. IDBI held on to development finance for a long time due to their strength in project appraisals and the limitations derived from majority government shareholding. IDBI had capital adequacy in excess of 13 per cent. But, they were not able to access low cost funds unlike their competitors, SBI and ICICI. Over time, the good borrowers left and the “next best” borrowers remained, and asset quality went through the tube.

The PLR was unduly high and business shrank. In one Board meeting, I reduced the PLR by 225 bps, from 12.5 to 10.25 per cent. When I joined, out of the top-twenty accounts, only one borrower had top rating, when I left we had several such accounts. Through the SASF mechanism I cleaned out the entire bad assets.

The way we planned the restructuring in IDBI was, we had a commercial bank, post the merger which was one SPV, the old IDBI with institutional lending was another SPV and a third SPV was to be formed to provide common services. I wanted these entities to function separately for 5 years, the reason being, the pay-scales were different, the skill sets were different, age profile of employees was different. It did not turn out that way after I left and the results are there for all to see.

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