



Independent Directors Lack Teeth, Says Sanjay Nayar In A Chat With M Damodaran And Arundhati Bhattacharya

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With India witnessing a spate of boardroom battles of late, including in companies such as Yes Bank Ltd. and Fortis Healthcare Ltd., Sanjay Nayar said independent directors need to make a difference.

“I don’t know how you hold independent directors accountable, unless they make themselves accountable, either by resigning, or whatever else,” said the chief executive officer of the private equity firm KKR India in a discussion on the role of independent directors with former Securities and Exchange Board of India Chairman M Damodaran and former State Bank of India Chairman Arundhati Bhattacharya.

Nayar said company strategies often don’t get questioned, with independent directors lacking teeth.

Bhattacharya offered a different perspective. Independent directors can serve as a “missing link” to important decision-making if the management keeps its cool, according to her. She

said the two most important factors company boards must focus on are competence of members and their ability to make time for them.



Independent directors are not supposed to be blood hounds. They are supposed to be watchdogs. If they are going to be watch dogs, they need to understand what is going on, and then thereafter, they need to be able to challenge (the board?)



Arundhati Bhattacharya

Former Chairman, State Bank of India
Independent Director, RIL & Wipro

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The discussion, held at a conference hosted by Damodaran and titled *Gatekeepers of Governance*, touched upon the critical issue of board members and their functioning.

Topics that were discussed included:

- What independent directors bring to the table?
- Is domain expertise important?
- Are independent directors truly independent?
- Relationship of the management and independent directors.
- Do independent directors want to be on a board that's dominated?
- Compensation for independent directors.
- Should there be equal pay for all independent directors?



The more dominant the shareholder management, the lesser the ability, even of a well-meaning independent, to give too much feedback.

Sanjay Nayyar

CEO, KKR India
Independent Director, Apollo Hospitals

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Is there a case for restoration of stock options with some limitations? Having no cap on commissions, leaving it to wisdom of board and shareholders, to get good people on board?

MS Damodaran

Former Chairman, SEBI

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Read the edited transcript of the conversation here.

Damodaran: What is your take on independent directors?

Sanjay Nayar: It is relevant topic and I am not an independent director anywhere. So, I will give you perspective of non-independent directors watching independent directors. This has become a throwaway line. I am starting from cynicism and I am not positive as I see things today. We want to have independent directors so let's have it, is the classic statement and saying that they have got good independent directors and diversity. They have got that mark. I am amazed at the bulk of independent directors and the role they play on board. You have to go beyond and see the best practice in world. In U.S., UK, companies form the backbone of economy. If you want to have sustainable companies then you need right growth path. Independent directors have to play most important role who play the diversity, thought to board, who challenge strategic questions, may not challenge day to day questions beyond a point and hold very high bar on appropriateness of behaviour.

The first criteria is they have to be truly independent which I have real issue on. If you go through UK financial charter of what independence is defined as and how the disclosure has to be made if somebody is remotely non-independent. That itself is the first test. Second, they have to be truly competent, to be in company an opine on strategic issues. Third, which didn't happen in India, independent directors have to be invited. They should be interviewing the chairman and board members and key management before the accept the assignment. So, you shift the whole responsibility of independent director being competent, having the teeth, having ability to say no to an invitation and saying why am I on this board. That's the overall framework.

As things stand today, I am disappointed watching. I have not the best set of companies, but I have a good spread of companies where I sit. We have the long way to go. I don't know how you hold independent directors accountable unless they make themselves accountable, either by resigning or whatever. That's what I can frame right now. I am using common sense. I don't have any theoretical framework. Strategy doesn't get questioned. Chairman is very dominating. Even if you separate chairman and Chief Executive, very dominating Chairman. I

don't think there is independent directors having a separate chat between themselves all the time and updating the chairman, having some kind of teeth to tell him. So, we have long way to go.

Damodaran: Do lenders look at board composition and within that board are they names of independent directors which you look at which will give you some comfort? How important, are in your view, are the independent directors?

Arundhati Bhattacharya: Let me talk from the side when I was in management because experience there has been greater. SBI is the bank in entire world where you have board meeting every week. This is the executive committee of board. But the quorum is minimum to independent directors and my people being diligent, they used to invite all the independent directors because they were never sure that there were at least two. Most of the time we had 4-6 independent directors every week in our office every meeting starting at 10 and ending at 4 for 4 years. I don't think anybody in the world has as many board meetings.

So, there is what I have seen the contribution of independent directors. One of the things which SBI did better as a public sector bank is right from beginning, we were allowed to make four independent directors who would represent minority interest. 1.5 percent of SBI was listed long time back. As long as I remember, there was always these four people. These people were of real eminence. We had good people on our board. These people were chosen by the bank in sense that the bank would look for such people, request them to buy 500 shares of SBI so that they qualify and get them to stand for the election, get elected and be on boards. When these people were there on our meetings, the amount of contribution that they made was immense. We were sending them papers which were at least 1.5 foot in height for every single meeting and sending them two days ahead of the meeting. They were reading them and coming back. Some of our independent directors were talking at 3 in night among themselves in respect of some tough proposals, so that they could ask us next morning.

When you have independent directors, which were bringing in a different point of view, there is no doubt that the board is enriched. The point of view they bring definitely adds to the decisions that the board makes. When we go as a management, we have gone through proposals and we come with set of thought and understanding. And here is someone who challenges the understanding and then you need to think through again or maybe you have answers then given them there and then. The difference is made is competence. You have to have people on the board if they are independent directors, competence is first thing and it is way up over there.

You have to understand that they can be competent if they are good, they are good in whatever they have done but they also need to be able to give you the time. If the

independent directors are not in a position to give time and competence, then they are not up to carrying out the role that they carry. At the end of the day, independent directors are not supposed to be bloodhounds. They are supposed to be watchdogs. If they are going to be watchdogs, then the need to understand what is going on and then thereafter they need to be able to challenge.

I have also seen in my current role that I am in, that when you challenge, the people on management side are not always comfortable about it. For that matter, neither was I. If you have been challenged upon something that you have thought through for a long time, for example our digital strategy that we did in SBI. It was discussed over a period of 3-4 board meetings. Because there was lot of money which were going to be spent, what is return of investment, do you need to go that distance, do you really need to spend this much, do you know what you are doing, are you sure that this is the way you see things evolving. So, there are so many things which they bring to table. You have spent 6 months in coming with all of this and somebody keeps asking these questions you feel offended. That I am not stupid, and I have thought through the whole thing and not only me but my whole team has done it. Those managements that can keep their cool and understand where the independent directors are coming from can pick up from that and what is it that they have missed in all of this. If the management and board work in that manner, then you can get the benefit of having independent directors.

If the management is such that they snap at everything that independent directors talked about then there will be time that independent directors would not. At the end of day, you don't want to be belittle because you are asking questions. Some of them may be idiotic questions. Once in a while as I am an independent director, I am asking idiotic questions because I am new on board and I don't know what has happened before. So, some questions may sound idiotic to them. But I told the management that I have joined that I will be asking these questions and please don't mind. We can always talk offline and you can send somebody to brief me and I am fine with it but this has to be asked because I don't understand. If I don't understand I will not sit over there and just nod my head. The management has the role to giving that space to independent directors. Not all managements give that space. From the management side, I would say, that is there. From independent director side, unless you are competent and understand what is getting onto the table then you will not be in a position to challenge. More than anything else, when you are looking at boards with independent directors who are not talking, you need to take a call that whether they are doing the job, whether they understand what is going on, whether it is the thing which you do after a particular age or after retirement. Today with the Companies Act, it cannot be a retirement job. You have to be truly involved what the company is doing and able to spend the time to challenge what is coming on table.

Damodaran: In your opinion, is domain expertise is important or is knowledge sufficient? Do you think independent directors need to acquire domain expertise or is it counter productive that they second guessing management on every decision that is operational?

Sanjat Nayar: If you are too dominant in that knowledge space, you will be forced to give the views on business and the management may have the kind of reaction you heard. If you have to cherish the diversity of thought, domain awareness is good but the ability to spend the time to understand the business is good. One of the companies where I am board of where the independent directors are taken to sites, knock centers to see how it works like how fuel gets consumed. Everyone who is remotely competent and have some domain awareness with in three meetings became familiar, but you have to give space to diversity of thought. SBI is a good example where you don't have dominant shareholder management sitting there. My comments where to do with people who don't have real management talking about real independence but shareholder management of big promoter lead company or smaller promoter lead company dealing with management. That is where my cynicism is. Her experience is most diversified management, great talent, they are vested in business, but they are not vested in their shares as much as promoters are and that's where the challenge is. Fortunately, and unfortunately, that part of the economy is huge and has to be governed better. SBI is great example. They are professional management, they take criticism. People like her can take wisely others may not.

Arundhati Bhattacharya: Management needs to give that space. Very often you find that management doesn't give that space. If the independent directors start asking questions and the responses are cut, then they stop asking. If responses are such that belittle you or try to bring you down from whatever you are trying to ask, then they will stop asking. That is not what you want. Management's role is very important in allowing that space to the directors to ask whatever they need to ask and welcome and invite to talk on these subjects.

One board which I know, the Chairman goes around the table asking their views when they are talking about strategy. Every director is required to come up with something as what they felt about it, what they liked about it, what they didn't and what could be the improvements. Director is forced to speak. So, they need to be attentive and speak. That is one board and not all board do this.

Damodaran: When you look at other companies which you are a lender of, do you get the sense that those boards had the sense of give and take, expression by independent directors or views that was inconsistent were tolerated or were they put down quickly?

Arundhati Bhattacharya: I share some cynicism that Sanjay has talked about. If you see the board of companies that we have lend to and the kind of interactions that they board has with the management and we have talked to some of them, it has been disappointing. To that

extent, we have long road to travel. Traditionally, when promoters were setting up boards it was more like old boy's club. They would bring people whom they knew, whom they were on friendly terms with, probably spend leisure hours together, they knew that if they were trying to do something, they will have this people to back them up. I have seen that company after company. It is very recent that some of the boards, the ones which are professionally managed where much more conscious about quality of people, they were bringing in. In one of the NBFCs, somebody has asked me, but I said I don't have time, so they requested other women as they needed a women director. I recommended name of one of my colleagues who is very good, and they asked me that will she speak. I told them that she will speak but at sometimes you may not want her to speak so much but the fact is she will speak. But it was the question which I appreciated. It was for first time asking me for an independent director, somebody they didn't know at all, they wanted someone truly important to do stuff and they wanted that person to speak. This is the change which is creeping in newer smaller companies which are coming up.

If you are looking at old Indian companies, the kind of crony board membership which we used to see is very much prevalent. In those boards, I am not saying that we are doing stuff which envisaged in new companies.

Sanjay Nayar: We have to give India another decade not just from equity point of view but as private equity, venture capital are playing a significant role. We give capital to companies, so promoters gets diluted then we exit by either IPOs, forget strategic sales. So, overtime there is transformation of shareholder base happening. Promoter holding comes down to below 51 and somewhere in 26 range. You will see transformation of boards happening automatically then you cannot get your cronies, friends as there is true representation of retail or significant or minority shareholder seating alongside you. It will take some time.

Where you have dominant management or shareholder, there cynicism level is higher. But where the shareholding is going down, taken the chips out the table or have taken money from strategic, FDI or private equity to get diluted for growth is improving. It comes back to core question that do independent directors really want to be on board which is so dominated. Did they have ability to manage and give feedback to chairman? The more dominant the shareholder management, lesser the ability even for well meaning independent to give feedback. If two time you get snubbed, third time you won't ask.

Damodaran: Is there a case of restoration of stock options with some restrictions? Is there a case for having no cap for commission and leaving it to the wisdom of board, shareholder to pay it, so that you get good men and women on boards who think that their time is valuable, and it is being recognized too?

Arundhati Bhattacharya: if you got to get competent people, you have to pay for their time. Today, whatever you say, it is not that we have surfeit of skill and competence. No country has surfeit of these things. If you want to compete for best people, you have to remunerate them in that manner that is fitting. There is lot of competition for that amount of talent and competence. I don't think putting just a cap will work. It is always said that if you pay peanuts, you will get monkeys. That is fact. This is area where there is lot of competition because people are not that prevalent, and you cannot take on too many boards as you have to give time. To that extent, really good ones will take a few. If you are going to take on few, how many are available to do that. And if you don't give them enough, it may not be worth their while. If you see the kind of responsibilities which is put on them, it does mean that lot of time is to be given by that person of not only go through board papers but overall like keep track of what industry is doing, keep track of how the competition is performing, keep track on where the entire ecosystem is evolving. You need to do lot of work other than be on board for one day and sign off at the end of it. that is not expected. If you are not expecting it and expecting quality stuff, then on remuneration I don't think this kind of short sight view is right thing to do.

Damodaran: How much is too much and at what stage does it impact independence? The government argue that you pay too much and neutralize the independence.

Sanjay Nayar: If you don't pay, you will not get the competent people. If they are good people, they will feel more responsible if they are getting paid. You pay me Re 1 and I will have a very lackadaisical attitude on board. So, you lost the whole concept of what we discussed. I don't know how much is how much. When we hire directors, we are paying them. They are high quality people, they feel responsible and obligated to help out. If the government say that they are getting too rich, they can pay them through other kind of agreements. If you want to have transparent and above board, I don't know what the cap should be, but you should pay for competence and time.

Damodaran: Should there be a cap?

Sanjay Nayar: I don't know some of the practices of other countries. What we have right now is too short. We cannot get good people with it.

Arundhati Bhattacharya: This are rubber band kind of reaction. You come up with something and say this is the answer. You need to think through and see the practices what the other countries has. The sitting fees in anything is capped that you can't pay beyond a certain amount. The only difference is the commission. The commission comes when the company is doing well and not otherwise. Even there you have put cap that it could be only 1 percent. I doubt that there are companies who are paying 1 percent. Most of them pay very small percent of it. It is not that huge which is getting paid out. To think that this is compromising on your independence seems to be very short-sighted view.

Sanjay Nayar: On government thought process, I never understood. I remember old days, and the government companies could hedge petroleum. But they could say that we have been told not to hedge. If you get it right, you don't get any accuracy. If you get it wrong, there would be CVC. You cannot change the thought process. They are not hedging anything. They should be hedging lot of things right now and won't hedge anything because it is safer not paying or hedging.

Damodaran: Should the evaluation process not lead to determine which independent director is contributing more and based on it you pay differential composition?

Sanjay Nayar: You should be able to pay differentially. The scoring mechanism has started. If you have serious evaluation system, then you have to pay differentially not only for attendance but also for real contribution.

The problem is what kind of board we are talking about. Is there a dominant shareholder or diversified base? SBI can implement it like a breeze. Other family dominated companies won't do it. If you got somebody who will always challenge you and comes down to paying Rs 15 lakh versus Rs 20 lakh, I will pay Rs 15 lakh. I don't see that will change in a hurry. There are very few evolved promoters but there are lot of them have, I am back to cynicism on kind of independence we have on board. So, it all emanates from there.

Arundhati Bhattacharya: I would say it is right, but it is very difficult to implement. In SBI when we first time did the evaluation it was only the board members evaluating themselves. In second time, we hired one of the Big Four. It was not only an evaluation among themselves but the Big Four then interviewed each of the directors regarding their performance, as well as what they felt of the performance of others. Then they came up with scoring. Only thing is we were not mature enough to reveal these scorings.

We took the qualitative stuff which came out and those things, as a feedback, we gave to directors and it was an open meeting in the board of directors without naming the directors, but these were things we found which was lacking. If you take that kind of exercise to maturity, you might be able to come up with differential way of rewarding directors. To get to that point of evaluation is going to take time. I don't think most boards are mature enough to do it. We may aim for it, but we not have objective and criteria to do it. Second time when we did it, we have observers of the company who was doing the evaluation sitting in two of the board meetings. We did number of things to try and make sure that we are getting it right. It is tough thing to do. Therefore, I don't think happening in near future. Till the time, most of the people will get paid the same. Attendance is the criteria which you can make out. But on qualitative piece, it is very difficult to do it.

Sanjay Nayar: People are paying differentially for experience and age. It is not for qualitative inputs that they are giving. Somebody which is retired big guy gets more. I find that kind of

basis which is relevant. Senior ones are getting paid more than the junior ones on board.

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