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Boards should not mindlessly support CEOs: Ex-SEBI chief Damodaran

There are boards in and outside India that do not understand their role, says former SEBI chief M Damodaran.

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Corporate governance in India is in a better position than where it was a few years back, says **M Damodaran**, chairperson, Excellence Enablers, and former chairman, SEBI, UTI and IDBI. India does not need more laws to ensure good corporate governance with performing directors in boardrooms; the enforcement of the existing ones is enough.

While there is a positive change in favour of corporate governance among investors and many private sector organisations, the government's response leaves a lot to be desired, said Damodaran in an extensive interview with Moneycontrol Opinion Editor **Viju Cherian.** Edited Excerpts:

Q: On November 19, Nissan's former chief Carlos Ghosn was arrested for fraud, leading to his sacking. How do you think this reflects on the board and on corporate governance in general?

A: It all stems from a clear understanding of the role of the board. There are boards in and outside India that do not understand their role…and in the absence of a clear role, what they end up doing is extending mindless support to the CEO.

The CEO is someone who is identified with the company, who's often the face of the company, in good times the person to whom all good is attributed to, and therefore, they're (the board) quite happy playing the role of cheerleaders.

The board role — and it's not rocket science — is: superintendence, directions and control. It has no executive or operational responsibility as that is the management's responsibility. However, it has to ensure that the management does its job properly. That is the responsibility of the board….The board, as representatives of the stakeholders, can hold the management to account. If this relationship goes wrong, everything goes wrong.

Q: What are your views about corporate governance in India?

A: Let me try hard and be positive to the extent possible. We are in a better position today than where we were 4-5 years back. I think a large number of companies recognise that governance is important if you're going to stay around and prosper on a long-term basis.

Q: How is corporate governance in India in comparison with the international situation?

A: Internationally, there are some who have been doing the right thing both within and outside boardrooms. We will not immediately measure up to them. However, we're certainly better off than many countries where there is not even a pretence of corporate governance.

Q: Can you elaborate on that view?

A: What are we doing now? We're writing new laws and regulations, but that's not the way to go. Laws should be simple, straightforward and not amended too often so that there is continuity and certainty. Enforcement is important and so is regulation.

regulation. This happened even after (the) Satyam scandal. It was a self-confessed fraud which did not need any new legal provision; the existing laws were enough. Our systems are so dilatory — not just the regulatory agencies but also our courts. Compare Nick Leeson and Harshad Mehta: look at what happened to Leeson — everything got over so quickly. Mehta had one conviction under Section 138 and nothing under the Securities Act. In India, the time taken is several years or decades, and by the time we come to a conclusion, that conclusion is meaningless.

Q: From the point of view of corporate governance, is there a mismatch between the pace at which things are moving and the pace required to maintain progress?

A: Let me look at it from SEBI's point of view. More surveillance throws up more cases, which are taken in a chronological order. To clean this up, the consent mechanism was introduced (when I was chairman). This was done so that the technical and smaller issues do not clog the system. The regulatory capacity is also a factor here, and so is the technology application in the commission of an offence.

Q: So we're playing catch-up.

A: That will always be the case. The policeman always runs after the thief…but you got to run reasonably close to the thief; you got to anticipate. Don't wait for everything to go wrong and then act. But do we have the resources for that?

What I would like to see at SEBI — I tried to do it while I was there but it did not find favour at the concept stage itself — is to create a separate organisation outside SEBI for enforcement and requirements of that case. Investigation will get over in a time-bound manner and you'll have people with the required skillsets. Like in the United States and the United Kingdom, we need movement between the regulatory organisation and the regulated entity. We need such a system. Such a movement will help anticipate problems or even plug loopholes.

Q: Why do you think this approach was not considered?

A: It faced the usual problem we face in India: everything is suspected before given a fair trial.

Q: Are we to blame the bureaucratic setup for this delay and attitude?

A: It's unfair to blame the bureaucracy because in the bureaucratic setup you cannot sacrifice process — but the processes are outdated and in some sense they're all creating a defence case. This leads to decisions not being taken because there is safety in not taking decisions.

Q: Talking about complacency in boardrooms, what do you make of the IL&FS episode?

A: For one, it was a business model gone horribly wrong. Without enough capital, you cannot indefinitely get into every conceivable space. You don't have to have a piece of every action. I suspect the board got swept along by the enthusiasm and energy demonstrated by the management.

To be fair to the board members, for the last two-and-a-half-years they have been discussing alternatives and they looked at bringing in off more than it could chew, and the board watched without understanding what was happening.

Where the board did not measure up is where the risk management committee did not meet for two years. The audit committee knew that things were going wrong and at some point, it should have dug in and said enough is enough.

Q: Private sector banks have had a lot of corporate governance issues in recent times: We have the conflict of interest in ICICI and the fiasco at Yes Bank. Your comments?

A: Over the years, we have come to believe that private sector and privatisation is a synonym for efficiency and honesty. Because you've seen some transgression in the public sector, you cannot jump to the conclusion that the private sector is bathed in milk.

What has happened in the private sector, and partly the media is to blame, is that we have raised people to the level of godheads. Others are made to believe that these people are infallible, invincible and that they are clearly indispensable to the organisation. The fact is, as we're discovering now, nobody is indispensable.

Q: …we create superstars out of CEOs?

A: We created a superstar out of Harshad Mehta; he and his Lexus car were on the cover of every magazine.

The strong CEO model, which is the model for growth at a certain stage, has its limitations. The strong CEO should not be so strong that everybody and every process is reduced to irrelevance. Look at what happened at ICICI: the ink had not dried on the complaint when discovered that you didn't inform the exchanges what you did with the complaint. Then the board didn't have the courage to ask the CEO to step down. I was the first to recommend that the CEO go on leave while an outside enquiry is held. All of that eventually happened, but by then it was too late.

Q: Coming to independent directors on boards and their role in corporate governance; is it counterproductive to view them as the 'opposition party' in a boardroom?

A: It's completely counterproductive. Laws are being written where you have raised the expectations from the independent directors… Now as a result of action taken against independent directors in the Jaypee case, assets of family members are attached! When you travel that far, the remaining independent director on the board will ensure that he/she does not meet such a fate. As a result, almost every proposal will be questioned and blocked.

What if the independent directors gang up in the boardroom and take a decision to oppose every proposal because every proposal will be beneficial for the majority stakeholder?

Q: Given this scenario, what do you think needs to be done to make the boardroom more effective?

A: The board constituted must not be unidimensional. You get people on board based on what are the needs of the company. Then it must be ensured that all the board members perform. So there ought to be an induction. Then there is the annual evaluation of the board. If the evaluation is not proper and every board member is evaluated 6 on 5, the board won't function properly. I must confess I have a vested has boardroom experience. Boardrooms must also have a mix of both old and young.

Q: How many organisations go for external evaluation?

A: Very few. Less than 5 percent.

Q: Investors seem to penalise only performance not any lapse in corporate governance. Is that a reflection of society as a whole; or is it because corporate governance is not given the primacy it should be?

A: About 15 years ago, there was no relationship established between good governance and good performance. Today it is an established fact that good corporate governance is a necessary condition for sustainable performance, otherwise, the company will fail. Today there is a feeling among investors that 'I will not put my hard-earned money in a company where I don't know what's happening'. Institutions are backing companies with good corporate governance. You get a market premium for good governance.

Q: The rules of corporate governance do not seem to matter in public sector firms, especially public sector banks. Your views?

A: Public sector in some sense is the anti-thesis of governance. When you have a majority stakeholder who confuses ownership with management, and steps on the toes of the management on a continuing basis, you cannot have governance. The tenure given to the CEOs is short. The directors who come to the board do not necessarily add value to the company. Governments that make the law must also comply by that law. Be it independent directors or women directors, the government was the last to follow it.

We must not forget that 'governments that make the law have the highest responsibility to obey the law'.