How boards of directors of PSU and private banks can be made more responsible

ET CONTRIBUTORS | Updated: Apr 14, 2018, 11.58 PM IST

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Every CEO should be given a fixed term of 5 years and all terms of office should end on 31st July.

By M Damodaran

Years ago, during an impassioned discussion on banking, especially lending practices, a friend, in a moment of excitement, coined a new word — creditability. The rest of us laughed.

Recent developments seem to indicate that he was spot on. Creditability, a combination of creditworthiness and credibility, implying thereby the ability to repay and the willingness to repay, seems to have been a missing ingredient in the decision-making process in several banks.

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The focus of this piece is, however, not the credibility of the borrower but the credibility of bank boards. Corporate governance theory rests on the foundation that the Board of Directors is the custodian of the interests of all stakeholders. Simply stated, its role, and also its responsibility, is to keep management honest.

The relationship of the board and the management ought to be one of constructive tension, and not of peaceful co-existence. It is therefore disquieting, to say the least, when a board, speaking through its Chairperson, asserts that it is fully behind the CEO, against whom allegations, hitherto unverified, are flying thick and fast.

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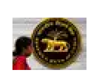
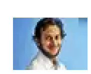

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In a disclosure-based regime, transparency is paramount. Stakeholders are entitled to know the basis on which a board arrived at a conclusion that the allegations were baseless, when admittedly, no factfinding enquiry has been conducted.

Corporate governance can be said to exist only when there are robust processes to address the terrible twins of information asymmetry and conflict of interest. It is idle to pretend that the ills of information asymmetry are manifested only in the case of insider trading.

It is information asymmetry that Gokulnath Shetty exploited since only he (and perhaps his factotum) knew that in PNB, the core banking solution and SWIFT were not on talking terms. What ought to interest us is what the board did when the scam surfaced. For days on end, the only voice from the bank that was heard, was the managing director's, who bravely asserted that it was a case of contributory negligence, and that other banks too must carry the can.

The world waited in vain for the board to articulate its position. When things go wrong, as they sometimes will, and when reputation risk is writ large, it is incumbent on the Chairperson to communicate in clear terms that remedial action has commenced. Such communication should be clear, concise, correct, complete and contemporaneous. That however was not to be.

In the case of ICICI Bank NSE 1.62 %, the chairperson chose to put out a statement. It raised more questions than it answered. If neither assuaged nor assured the stakeholder who needed to be told in clear terms that the board had got the allegations independently verified before it took a position in the matter.

When boards proudly proclaim that they are solidly behind the management, even in an atmosphere of allegation, conspiracy theories, innuendos and insinuations, they unwittingly lend credence to the view that boards are at best a procedural nuisance or a substantive distraction. Systems of Board Evaluation When conflict of interest, and much worse, is alleged, boards must be seen as occupying the driver's seat. Boards that are cheerleaders and by implication urge the stakeholders to practice a willing suspension of disbelief, do not augur well for Corporate governance.

Where do we go from here? The process of springcleaning must start with the boards. Those who add no value and merely make up the numbers must be asked to leave. Cromwell's exhortation to Parliament members - "You have sat too long. In the name of God, go!" — is particularly relevant in the trying times. Going forward, a rigorous system of board evaluation on an annual basis should weed out non-performers on a continuing basis.

At AGMs, stakeholders should also question directors on whether they are able to commit quality time to the board and its committees, and whether they are conflicted by prior, existing or impending relationships in the discharge of their duties.

Corporate governance in public sector banks (PSBs) constitutes a huge challenge. The unwillingness of the majority shareholder to distinguish between ownership and management results in unwarranted interference in transactional matters.

It must be ensured that the process of selection of chairperson and executive directors is robust and throws up the right candidates. The reconstituted Banks Boards Bureau (BBB)

The chairman and the three recently appointed members of the BBB have impressive credentials, but there is no evidence of first-hand experience of three of them in PSBs. As for the fourth, he comes from SBI which is as different from other PSBs as chalk is from cheese. Even the previous BBB, with three of its members having PSB experience performed suboptimally.

Adding to the confusion is the recent statement of a senior ministry official, which in part, reads as: "The government has from the beginning kept an arms-length on (sic) the senior level appointments to ensure that people with adequate ability are selected as senior leaders of the bank."

One does not know whether to laugh or to cry. Such appointments are a statutory responsibility from which government cannot shy away. As for keeping an arms-length from the selection process, the less said the better. It is not a secret that in the pre-BBB days, government officials passed on "lists from above" to the members of the Appointments Board.

If things are to improve, the reconstituted BBB which has excellent private sector experience, should do a no holds barred evaluation of existing boards. Every CEO should be given a fixed term of 5 years, notwithstanding the normal dates of superannuation.

All terms of office should end on 31st July, so that the new appointee is in position for most of the year after the earlier incumbent has finalised and rendered accounts.

Confidence, morale and motivation which have been casualties must be restored. As for private sector banks, institutional activism is a crying need. Individuals must matter much less than institutions. Will all this work? Honest intention and hard work never hurt.

(The author is former Sebi chairman.Views expressed are his own.)

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