THE HINDU BusinessLine

What price regulatory credibility?

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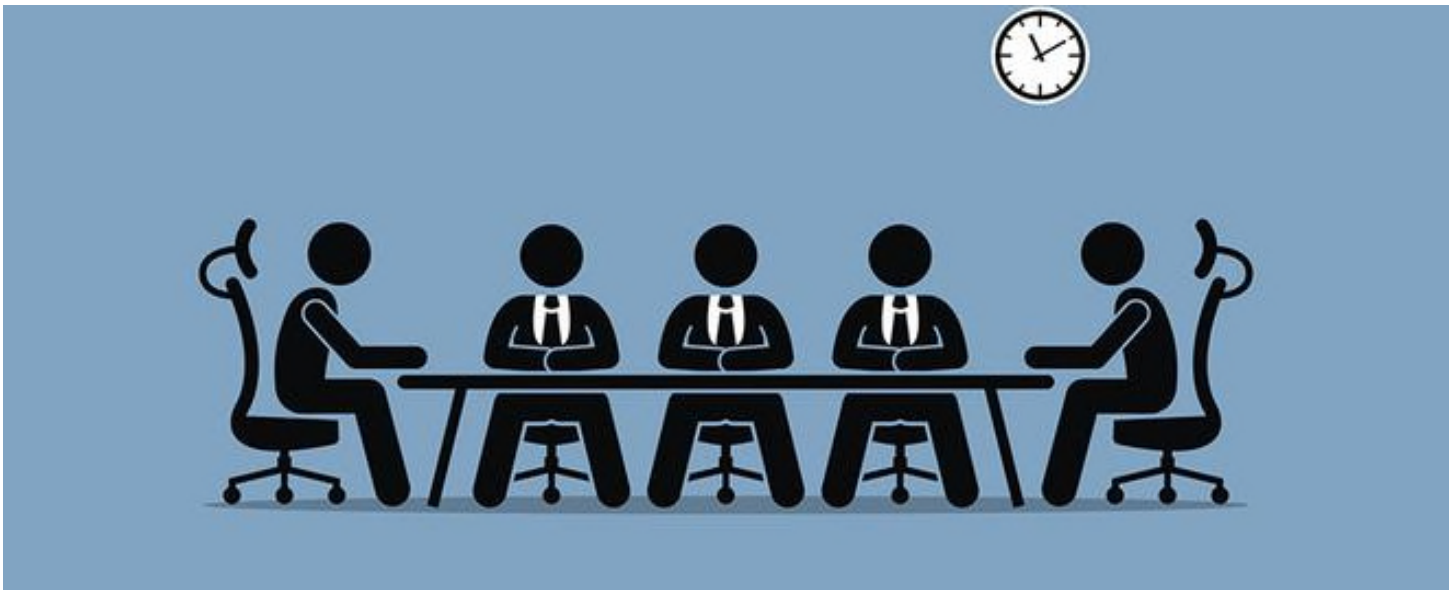

An individual taking on the roles of Chairman and MD/CEO is the ultimate negation of corporate governance | Photo Credit: Ieremy

The SEBI decision to make separation of the role of Chairman and MD/CEO voluntary has deficiencies and is uncalled for
On February 15, 2022, the SEBI Board decided that the provision relating to the separation of the "role" of the Chairperson and the Managing Director (MD)/ Chief Executive Officer (CEO) of listed companies would be moved from the mandatory category to the voluntary category. The applause will take a while to die down. Meanwhile, it would be useful to look at all the deficiencies inherent in this decision.

The issue of conceptual clarity needs to be addressed upfront. The "role" of the Chairperson and of the MD/CEO are different. The Chairperson is the Chair of the Board, and leads its discussions and deliberations. The MD/CEO is the head of management, tasked with the responsibility of running the affairs of the company.

The roles have always been different, and it is not necessary for SEBI, or anyone else, to separate the "roles". What had to be addressed was the question whether the same individual should perform two different roles, namely, that of the Chair of the Board, and that of the MD/CEO.

The case for separation is not new. As early as 1992, the Committee on the Financial Aspects of Corporate Governance (the Cadbury Committee) noted: "Given the importance and the particular nature of the Chairman's role, it should in principle be separate from that of the Chief Executive. If the two roles are combined in one person, it represents a considerable concentration of power."

Two decades ago, this author had described the combination of the two roles in the same individual as the ultimate negation of corporate governance. This conclusion emerged from the fact that managements, led by the MD/ CEO, were expected to run the company, and the Board, led by the Chairperson, was to ensure that the company was run well by the management. Combining the two roles in the same person was the equivalent of making that person a judge in his own cause.

Kotak Committee

The Committee on Corporate Governance 2017 (the Kotak Committee) recommended thus: "Listed entities with more than 40 per cent public shareholding should separate the roles of Chairperson and MD/CEO with effect from April 1, 2020. After 2020, SEBI may examine extending the requirement to all listed entities with effect from April 1, 2022."

Based on the recommendations of the Kotak Committee, SEBI decided that the separation of MD/CEO and Chairperson would be made applicable to the top 500 listed entities, by market cap, with effect from April 1, 2020. The effective date for this decision to be implemented was later moved from April 1, 2020 to April 1, 2022.

Addressing a conference a few months ago, the SEBI Chairman exhorted the companies to give effect to the mandated separation before the due date, namely, April 1, 2022. It is reasonable to presume that since 2020, SEBI must have received a number of representations pointing to the difficulties, real and imaginary, in giving effect to this provision. The SEBI Chairman's exhortation should be presumed to have come after the system had digested all the objections and suggestions that it had received over several months.

Things appear to have been on course for the separation to be effective in most, if not all, the companies. In what must have clearly been a last-ditch effort, with more expectation, than hope, the CII brought the matter to the attention of the Union Finance Minister. The Minister's response was that SEBI should give a hearing to the corporates, having regard to their stated difficulties and objections. She added, for good measure, that SEBI was an autonomous regulator, and that she was not giving a diktat.

It would have been appropriate for SEBI to apprise the Minister of the process of consultation, followed by the extended time given for implementation, to the entities impacted by the proposed regulations. It is no one's case that SEBI should have again called representatives of corporate India for a physical hearing, since the concept of a hearing does not necessarily translate to yet another round of physical hearing. It must be noted that the Kotak Committee, headed by a corporate luminary (also a CII President later) had among its members, the then Presidents of CII and FICCI.

Change in stance

Ten days after the Minister's remarks, the SEBI Board decided that there were good enough reasons to move this provision from the mandatory category to the voluntary category. The excuse, masquerading as an explanation, was that as on December 31, 2021, only 54 per cent of the listed companies had complied with the provision. SEBI's conclusion was that "expecting the remaining about 46 per cent of the top 500 listed companies to comply with these norms by the target date would be a tall order".

It is passing strange that a legal provision is being abandoned/diluted because of the misplaced apprehension that a large number of entities would not comply. Non-compliance being respected, and in fact rewarded, goes against the grain of a law-abiding society. What SEBI clearly has not factored in is that many companies that had not complied up to December 31, 2021, had already decided what they would do in order to comply by March 31, 2022.

Yet another excuse trotted out was that "constraints posed by the prevailing pandemic situation" would have stood in the way of companies being able to implement this provision. The virus itself must be blushing because of its being used as a crutch to dilute an "inconvenient" provision.

The expectation, that most corporates had, was that the second stipulation by SEBI, namely that "the Chairperson should not be related to the Managing Director or the Chief Executive Officer" would be abandoned. Such a provision does not exist in any other jurisdiction, nor does it form a part of the recommendations of the Kotak Committee.

In her remarks at the CII event, the Minister referred to the history of Indian companies, presumably pointing in the direction of the expectation of family members to aspire for positions of leadership. This could have been taken care of by jettisoning the needless provision regarding the non-relationship of the Chairperson with the MD/ CEO.

If, as understood, the objection was majorly regarding the element of the provisions regarding non-relationship, discontinuing the entire provision for separation would amount to a classic case of throwing out the baby with the bathwater.

What SEBI's decision would mean for the credibility of regulatory organisations, and the need for continuity in regulatory provisions, is a matter worth losing sleep over.

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