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(AN M. DAMODARAN INITIATIVE)

Expert Expressions
Corporate Governance Demystified

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LESIONS AND LESSONS

M. Damodaran
Chairperson, Excellence Enablers
Former Chairman, SEBI, UTI and IDBI

The promise for a better tomorrow is what sustains humankind. May 2024 be no different. Wish you a very Happy New Year.

It is that time of the year when we look back at the year gone by to see whether things could have been different, had governance practices been strictly adhered to. 2023 had so many failures on the Corporate Governance front that many a crime reporter could have been salivating at the possibility that he/she could get a change in assignment. The year had its share of family feuds as well as stand offs between persons who had come together to set up business, and then drifted apart.

Nothing could have been more unseemly than the washing of dirty linen in public by a high profile husband wife duo. The Chairman and Managing Director of Raymonds, and his better half, both Directors on the Board, traded accusations, raising questions on whether this acrimony could affect the stability of operations of the listed entity. Prompted by a suggestion by an advisory firm, Independent Directors (IDs) got into the act, and sought advice from a legal expert on what, if anything, they should be doing, to protect the interests of the company. Would they not have been better off suggesting to both the protagonists to step down from the Board in order to address the interests and concerns of other stakeholders? The image of the "Complete Man" took a complete beating.

In another high-profile dispute, a brother and sister are ranged against each other for the control of Hikal, a group company of the Kalyani Group. With around a week left for the year to come to a close, the sister succeeded in ensuring that the brother did not get re-elected to the Board. Would this bring down the curtain on yet another family dispute, or is it the appetiser, with the main course to follow?

The Kirloskar Group saw a continuing standoff among the siblings. There were allegations of insider trading, but SEBI saw no merit in them. A provision exists for arbitration to settle disputes, but it does not seem to have been availed of.

IDs had their moments in the Sun. In the case of Dhanlaxmi Bank, one ID quit citing multiple issues, including lack of support from the Board, and alleging *inter alia* that the bank's business was not conducted in an ethical manner. The other Directors did not seem to agree, with the result that the complainant Director had to resign. It might have helped if the management shared its perspective on these issues.

Modulex Construction Technologies created a record of its own, with one ID resigning after writing a 65 page letter, containing various allegations. Around the same time, the auditor also resigned. The curious explanation trotted out was that the ID's complaint had led to a lot of compliance requirements, which hampered other work. Clearly, in the pecking order, competing for the company's attention, governance seemed to be bringing up the rear.

PTC India Financial Services was a unique case in which IDs got together and flexed their collective muscle (in 2022) to ensure that governance practices were put in place. Happily, SEBI, RBI and MCA saw it fit to endorse the stand taken by the IDs, and brush aside the somewhat feeble defence put up by the management. Hopefully, this will send a signal to other entities, especially public sector undertakings (PSUs), that the power that resides with the majority shareholder and its agents cannot be exercised by turning a blind eye to improper practices.

Atlas Jewellery had a different set of issues. The auditors questioned Corporate Governance structures and practices, and pointed out that there was an imbalanced Board, and no Audit Committee in existence. With such basic deficiencies, one wonders whether companies of this kind ought to be in the listed space. Clearly, all that glitters is not gold.

One standoff, which is still playing out, is the proposed acquisition of a controlling stake in Religare Enterprises by the Burmans of the Dabur Group. The IDs of the target company have complained to the Regulators against the Burmans, also alleging *inter alia* that they had colluded with the former promoters of the company. At the same time, questions have been raised by the Burmans on the issue and quantum of stock options to the Chairperson of Religare Enterprises.

There were several other shocks in store. Tata Consultancy Services had to deal with an ongoing "bribes for jobs" scam, involving the taking of bribes from staffing firms by the senior executives of the company, in order to provide jobs to candidates of the staffing firms. Following an internal investigation, the company sacked 16 employees. Clearly, a malpractice of this kind must have been going on for a while, and it is passing strange that with the checks and balances, especially in IT companies, this scam remined under the radar for as long as it did.

Dish TV presents an interesting saga, where the ongoing developments are more riveting than the developments in the serials that they stream. The latest development, following several months of standoff, is that the shareholders have voted out all the IDs, leaving the company with a truncated Board, numerically inadequate to provide leadership. Separately, Zee Entertainment, a sister company, has seen 2 of its IDs voted out, while a third has resigned, leading to delay in the company's merger agreement with Sony.

2022 had seen the first case of a rating agency being asked to shut shop by SEBI. Following directions of SAT, SEBI reconsidered the matter and allowed Brickwork Ratings to continue its business, with a number of preconditions and stipulations. It would be worthwhile for a policy to be formulated on how to deal with allegedly errant service providers, which have a significant role to play in the ecosystem, so that regulatory fiats are not disruptive, and do not go against the interests of the stakeholders.

Finolex Cables brought to the fore, some of the underlying weaknesses of the dispute resolution mechanism. There was nothing unusual in the fact that 2 parties contending for control had to go by the wishes of the shareholders who voted at the AGM. The matter was taken to the NCLAT. Meanwhile, an order was passed by the Supreme Court stating that the results of the voting at the AGM should be declared, and no order should be passed till that was done. Ignoring this directive, a 2-judge bench of the NCLAT passed orders which rightly attracted the adverse notice of the apex Court. With the Supreme Court's glare on the entire process, the judicial member resigned, and the administrative member tendered an unconditional apology. Whether such an apology ought to have been accepted, is a matter that merits careful consideration.

The state of affairs in some unlisted entities merits comment. The case of GoMechanic indicated to what levels founders could go. One co-founder confessed that there were "grave errors in judgement" and added that the three co-founders got "carried away" and that their passion got the better of them. Stated simply, they cooked their books and got caught out. Any dictionary would have told them that "governance" comes before "growth".

Bharat Pe and Byju's are interesting illustrations of the ambitions of the founders leading to the companies going astray. Unbridled growth, without putting adequate controls in place, is sooner than later likely to lead to a grinding halt, bringing grief in its wake. Leaving governance too late, while in pursuit of growth, is clearly not the right formula for success as these 2 founders have discovered to their cost.

PSUs and public sector banks (PSBs) continued to grapple with age old problems that do not seem to be going away anytime soon. In 2023, some PSUs were pulled up for not having an adequate number of IDs or for not having a woman ID on the Board. The explanation that the entities were not responsible for the non-compliance, since the decision-making powers were with the Government, was rightly not accepted by the Regulators. As for PSBs, there have been vacancies in critical positions such as that of the Chairperson, creating an avoidable imbalance in the construct of the Board of Directors.

As if all the negative developments referred to in the preceding paragraphs were not enough, there was the curious case of an admitted short-seller putting out a negative research report on the Adani Group of companies, causing a precipitous fall in the share prices of those companies. SEBI's role in allegedly turning a blind eye to the developments in the Adani Group came in not only for adverse comments, but also for challenges in the Supreme Court. Consistent with the directive of the Court, SEBI has filed a detailed report, indicating the action taken in 22 out of the 24 matters that needed to be gone into. Short-sellers causing heightened volatility in the market, and benefitting therefrom, is a development that is likely to have its sequel in the coming years.

The foregoing paragraphs contain a small sample of the kind of irregularities and transgressions that seem to be plaguing the corporate sector. As if this was not bad enough, SEBI came in for considerable criticism, with the challenges to its orders being upheld by the SAT. Almost every other day, there have been reports of some high profile case or the other in which SAT has not only set aside SEBI's orders, but also passed scathing comments, as well as levied penalties in a few cases. SEBI's woes got further compounded when the Supreme Court, after confirming an order of SAT, setting aside a penalty of Rs 2 lakhs imposed on Tata Steel, remarked that SEBI should not be filing appeals in a routine fashion against every adverse order passed by SAT. As if that observation was not bad enough, the apex Court directed SEBI to file a detailed statement, indicating the cases in which they had gone in appeal to that Court. While on the surface, the Supreme Court's observations might pass muster, there is another aspect that should not be lost sight of. If, for argument's sake, SEBI does not file an appeal in the case of an adverse order of SAT, who is to prevent some agency or the other from questioning why an appeal was not filed, and whether the intentions in not filing the appeal were entirely honourable? Safety seems to lie in preferring appeals, even if there is prima facie very little chance of success. The larger, and more important, issue that needs to be addressed is why the quality of orders cannot be improved, so that more of them are sustained in appeal.

SEBI has on a number of occasions argued that in a large majority of cases, the orders are not set aside by the Appellate body. However, with a number of high profile cases attracting adverse notice, the truth that perception is more important than reality seems to hold ground. It is useful to remember that dog bites man is no news, man bites dog is news. In the public mind, a Regulator is not expected to be wrong.

There are several takeaways from the year gone by. Corporates clearly need to get their act together because any violations of law or regulation could attract strict adverse notice. Even if orders passed by the Regulator in the first instance are set aside in appeal, there is every possibility that the reputation of the company would get significantly impacted. It is also useful to remember that the setting aside of orders in some cases does not come as a vindication of the practices by the corporates, but only as cases in which there was insufficiency of proof to lead to an adverse finding.

At the same time, the task of significantly skilling persons responsible for adjudication of disputes should be given high priority. Sometimes, good cases fail because the orders are badly written, and this emboldens the ill-intentioned individuals and entities to cut corners, and to take their chances. The related element of delay should also not be lost sight of. SAT has, on quite a few occasions, commented adversely on the time taken by SEBI to arrive at decisions and pass orders. Strangely, in the recent case of Karvy Broking, SAT itself had reserved orders in February 2023, and passed orders in December 2023. Justice delayed is justice denied, whether at the original level or at the appellate level.

Exchanges, which are the first-level Regulators, also need to act with alacrity. It is useful for them to look at the time taken after a significant development is posted on their websites, to ascertain facts, and more importantly, to follow up on matters where the explanations offered do not hold water.

The Ministry of Corporate Affairs on its part has rightly decriminalised a large number of offences in the Companies Act, 2013, but at the same time has stepped up on enquiring into non-compliances, and levying significant penalties on the defaulting entities.

NFRA, the latest kid on the regulatory block, has demonstrated its seriousness of intent is streamlining the auditing process, to increase its reliability. Conventional wisdom has it that when accounts are audited and opinions expressed, the stakeholders in the ecosystem can place reliance thereon. This position of comfort has been rocked by recent findings, which has found a number of irregularities in the work done by the big 4 auditing firms. Separately, the Regulator has also touched on the concept of network firms in which one entity does the audit, and the other, a closely related entity, provides non-audit services. If a satisfactory solution can be found to this obvious subterfuge, we will step into 2024 with legitimate expectations in place of misplaced hopes.

In a scenario that seemed dismal for most of the year, the RBI stood out as an embodiment of hope, with its exhortations on Corporate Governance, and by making it clear to banks, NBFCs and Directors that governance is a non-negotiable requirement. Clearly, the banking Regulator is deserving of appreciation and applause. It needs to be mentioned that the organisation, led by a history scholar, who the commentariat thought was unsuitable for the role, has earned the plaudits of the global banking community, with the history scholar himself making history as the best central banker during 2023.