Independence of Board - **Reality or Sham?**

* J. C. Laddha

A lot has been written and codified in the enactments about how to protect the interest of the stakeholders of the Company by improving the corporate governance and accountability. But despite of several enactments and amendments which time and again have contributed towards strengthening of corporate governance practices and increased disclosure norms, corporates are still failing as we continue to witness many corporate scams and frauds being reported every now and then. For the success of the corporate governance norms, it's important that corporates have a closer look not only at the 'letter' of the provisions, but also the underlying 'spirit'. Equally imminent it is for the regulators to be more vigilant in plugging up the corporate governance lapses and taking corrective actions without much delay and loss to the stakeholders.

Despite various changes pertaining to rotation of auditors, increased disclosure requirements, transparency in share dealings by promoters, enhanced roles of audit, remuneration, nomination and risk management committees, strengthened internal financial controls, disclosure of related party transactions, robust safety and security policies, increased emphasis on adoption and strong implementation of whistle blower policies, proper stakeholders redressal mechanisms, expansion of eligibility criteria of independent director and their increased role, thorough observance and implementation of these norms by Indian corporates still lie in tatters.

In yet another corporate battle involving some of the leading corporates, the need is felt for greater transparency and for measures to safeguard the interest of minority shareholders. Concerns have also been raised on the governance standards followed by these renowned corporates in India which involved violation of provisions pertaining to related party transactions, undervalued transactions -not on arm's length threatening the governance standards. Such high profile board room battles have yet again exposed the realities of substantial concerns over corporate governance regime in India.

In India, unlike USA, family businesses constitute more than 95% of all businesses and have largely remained owner-driven and there creeps in the issue of board acting upon the directions of promoters which also result in under-representation of minority shareholders. Whereas in USA, the shareholding is widely dispersed and this imposes a greater responsibility on the board and its accountability.

Interference by the Majority Shareholders

As apparent from the prevalent high profile cases, the concerns that loom largely over the promoter driven conglomerates is excessive interference by the promoters who are also the majority shareholders, in the overall management of the Company's affairs. Most listed entities and other business houses in India were born mainly as family-owned businesses, where the family occupied the key managerial positions and were entrusted with substantial powers of managing the Company's affairs. With evolution of equity markets, many of such family owned businesses listed themselves on exchanges, however, the traditional way of managing business affairs continued and promoters, who are no longer the sole owners, continued to wield disproportionate influence over management decisions. Vested with large voting powers, promoters can and do abuse related party transactions (RPTs) as a means for expropriating corporate value. By reason of which and as apparent from many such corporate scams in India, the Companies continues to freely extend loans to group entities, enters into business deals with friends and family as per convenience, extend exorbitant managerial remuneration to family and friends, enters into risky mergers and amalgamation to deprive the shareholders of profits which is rightfully theirs and exploit the interest of the minority shareholders.

Despite of constituting series of committees — Kumar Mangalam Birla Committee in 2000, Narayana Murthy Committee in 2003 and Adi Godrej Committee in 2012 — to come up with more elaborate governance norms for India Inc. in order to keep a check on such governance lapses, which also resulted in enactment of Companies Act, 2013, various amendments in SEBI listing regulations and Clause 49 of the listing agreement, the governance lapses still get reported.

We have also in past witnessed the simmering tensions in one of the leading IT Companies in India between former CEO and the board on the one hand and the founders on the other, which started when latter and couple of other promoters voted against the salary hike given to the then CEO, questioned the severance payout to then CFO and departing legal counsel, alleged that the acquisition was overvalued etc. While the Board came out full guns blazing in support of the former CEO, hours within his resignation and against the co-founder, leaving the stakeholders in total confusion and loss of faith in Company's future.

Vulnerability of Independent Directors

Furthermore, removal of independent director by one of the renowned corporates in India apparently for presenting an opinion contrary to majority shareholders has also put on spotlight the vulnerability of India's independent directors who take a stand on a dominant shareholders of the Company. This puts on stake the independence of the independent directors in India. This brings us to question "Why would independent directors act in an independent manner, if they would face threat on account of they being vocal about the governance lapses?"

This brings us again to the conclusion that since Indian corporate houses are majority promoter owned, it becomes easier for latter to quell dissenting independent voices unlike in US or UK where shareholding is more diffused.

Data from Prime Database shows that of the 1,594 listed and actively traded company's on India's main bourse, some 88% have dominant shareholders with 30-80% stakes.

While independent directors are expected to protect minority shareholders from misdeeds of the promoters, it is ironical that the promoters themselves appoint the independent directors in many cases.

Passive Role of Retail Investors

One more bigger concern pertaining to the passive role of retail investors in the Company's management who mostly demonstrate financial interest on their shareholdings, also needs a closer look. On account of their least/no participation, the shareholding percentage of promoters/promoter groups further gets strengthened. Therefore, initiatives need to be taken for encouraging the participation of retail investors in company's management and enhancing their level of awareness regarding corporate matters.

Under-representation of Minority shareholders on Management Decisions

Furthermore, in most of the Indian corporates there is always a possibility of under representation of minority shareholders and dominance of majority shareholders on management decision by reason of conferment of significant authority in favor of the directors appointed/ nominated by the majority shareholders.

In order to curb such practices, it also becomes imminent that corporate governance literacy be imparted among the retail investors to enable them to take informed decisions for the company.

In past we also witnessed some of the serious violations in series of transactions involving leading financial institutions in India and renowned corporates where serious irregularities pertaining to appointment of directors, false disclosures about board meetings, inadequate or misleading disclosures in annual reports and financial statements, issuing shares to directors beyond prescribed limits, risky corporate restructuring, violation of provisions related to related party transactions came to light. These cases demonstrate how the corporate governance norms pertaining to grant of loans to related parties, transfer of shareholding and many such risky restructuring, independent directors' view on alleged conflict of interest were absolutely disregarded by people in power.

Misuse of Powers by the Majority Shareholders

It has also been observed that in cases where there is a possibility of opposition by the independent directors or the board, in general, on any matter which is of prime interest to the majority shareholders, the matter then gets placed before the shareholders for approval making the stance of directors ineffective.

Deepak Parekh, chairman of HDFC Bank, said independent directors are bound to closely monitor operations of the company on which they are a board member. "In case they come across any governance issues they should put across their views strongly to the promoters or step off such boards," he said. While the judgement may be seen as harsh, independent directors cannot alienate themselves from company issues. Though independent directors are appointed to protect the interest of minority but in reality they can't even protect themselves in the organization because it's on the whims of the controlling shareholders whether to keep or remove them.

Some of the recent cases prove that independent directors opted escape route when the sailing wasn't smooth. Mr. Vikram Mehta abruptly resigned from Jet Airways where he was an independent director and member of the audit committee. Gitanjali Gems, which was embroiled in the loan scam involving Punjab National Bank, reported that their independent director Mr. Anil Umesh Haldipur resigned citing personal reason. Mr. Anil Khandelwal resigned from the board of JM Financial ARC Ltd. citing that the company's perception about governance issues is in wide variance to his understanding about a transparent governance process.

Why Participation of all Shareholders is Important?

Shareholders obviously have the most to lose if a company is prone to bad governance. Related party deals, exorbitant managerial remuneration, risky mergers and acquisitions, accounting frauds, abuse of authority etc. directly deprive shareholders of dividends that are rightfully theirs.

Not only this bad governance practices can have a bearing on all the stakeholders a company deals with – lenders/banks who extend finance, suppliers who sell it goods or services, employees who invest their career in it and customers who put faith in its brand, product or service quality. The ongoing fracas at Infosys and Tata's has not just decimated the stock prices, it may also lead to uncertainty for its clients and employees. It is therefore in interests of all these stakeholders that corporate governance is treated with the seriousness it deserves.

How about adapting to Dual Board System?

The idea of a two-tier board—a management board and another in a supervisory role—needs to be tried, as is practiced in some European and Asian countries. This will delineate the interface between owners and the CEO. The management board, with just the managing director and employee directors, could be responsible for formulating a shared vision and strategy, and for the company's management. The supervisory board, with independent and other external directors appointed by shareholders, would provide strategic direction to the other board and

oversee its performance. The professional CEO would thus enjoy managerial freedom and also be held effectively accountable. If implemented, a two-tier board would also align the role of independent directors with what they're liable for. As part of the supervisory board, they would not be held liable for decisions and actions of the management.

Succession Planning is important

Succession is an important and critical part of Business planning. Succession arrangement not only helps the new management to get full control but also helps in a smooth transition in a phased manner. Unfortunately as witnessed in the recent past from the popular corporate tussles involving one of the leading IT corporates in India and also one of the renowned corporate houses, where both seemed to have been disastrous in their succession planning and seemed to have fallen into a trap that the external candidates as successors are more exciting and promising and perhaps overlooked some of the critical parameters involving due consideration of softer qualities of the successor or if the successor would meet the ethos and the culture of the organization.

Conclusion

Continually raising critical responsibilities and stringent regulatory provisions maintaining the effectiveness of board is not going to be an easy task.

Aditya Birla Group Chairman Mr. Kumar Mangalam Birla said **"For India to reshape the global economic order, Indian companies will have to hold themselves accountable to global standards of governance. I believe this cannot happen by running roughshod over minority shareholders."**

The numerous challenges of growth, technology disruptions, a paradigm shift in the regulatory regime and global competitiveness over the past two decades have led family owners and promoters with controlling interests to increasingly engage professionals to lead their businesses while also trying to retain their intervention in the Company's affairs. However, by reason of growing concerns over corporate governance practices in family businesses and pressures to enhance stakeholder value, amid tightened regulatory norms and strict actions on corporate failures, professional CEOs at the centre of the governance structure have begun to exercise independent judgement, which goes against the interests of owners or promoters at times. This has caused tensions and, in some cases, led to bitter fights between them and the owners.

Business owners and professional CEOs are meant to complement each other and deliver value within the bounds of good corporate governance. In recognition of this, the current governance structure needs to be revisited so that a professional CEO is granted the requisite freedom to act within the mandate given to him, and he can be held accountable based on an objective evaluation of his performance by the board. The structure must ensure that no fraud or impropriety takes place, and this will be easier if there is some distance between the professional CEO and the owners.

As also stated by Mr. Birla **"issues such as professional CEOs acting as promoters and founders wielding undue and disproportionate clout also needs to change."**

Owners and professional managers need to be in sync in order to succeed and sustain good governance. Owners should limit their engagement to long-term value creation, and a company's management be best left to a professional CEO while professional CEO's should act with utmost accountability and with absolute regard of all reasonable checks and balances in place and should always be open to genuine questioning of decisions.

***Mr. J. C. Laddha** is the Managing Director at Century Textiles and Industries Limited., India.

Building® Tomorrow's Boards

Institute of Directors

GENERAL BODY NOTICE

A General Body Meeting, of the Institute of Directors will be held on

Monday, March 23, 2020 at 1600 hrs

at the IOD HQ ,M-56/A, Greater Kailash-II (Market), New Delhi - 110048

to elect the

"Governing Council Members"

for the period April 01, 2020 to March 31, 2023.

All members of the IOD are requested to attend.

For Institute of Directors
Sd/-
Manoj K. Raut
Secretary General, 2017-2020
Date: 02/03/2020