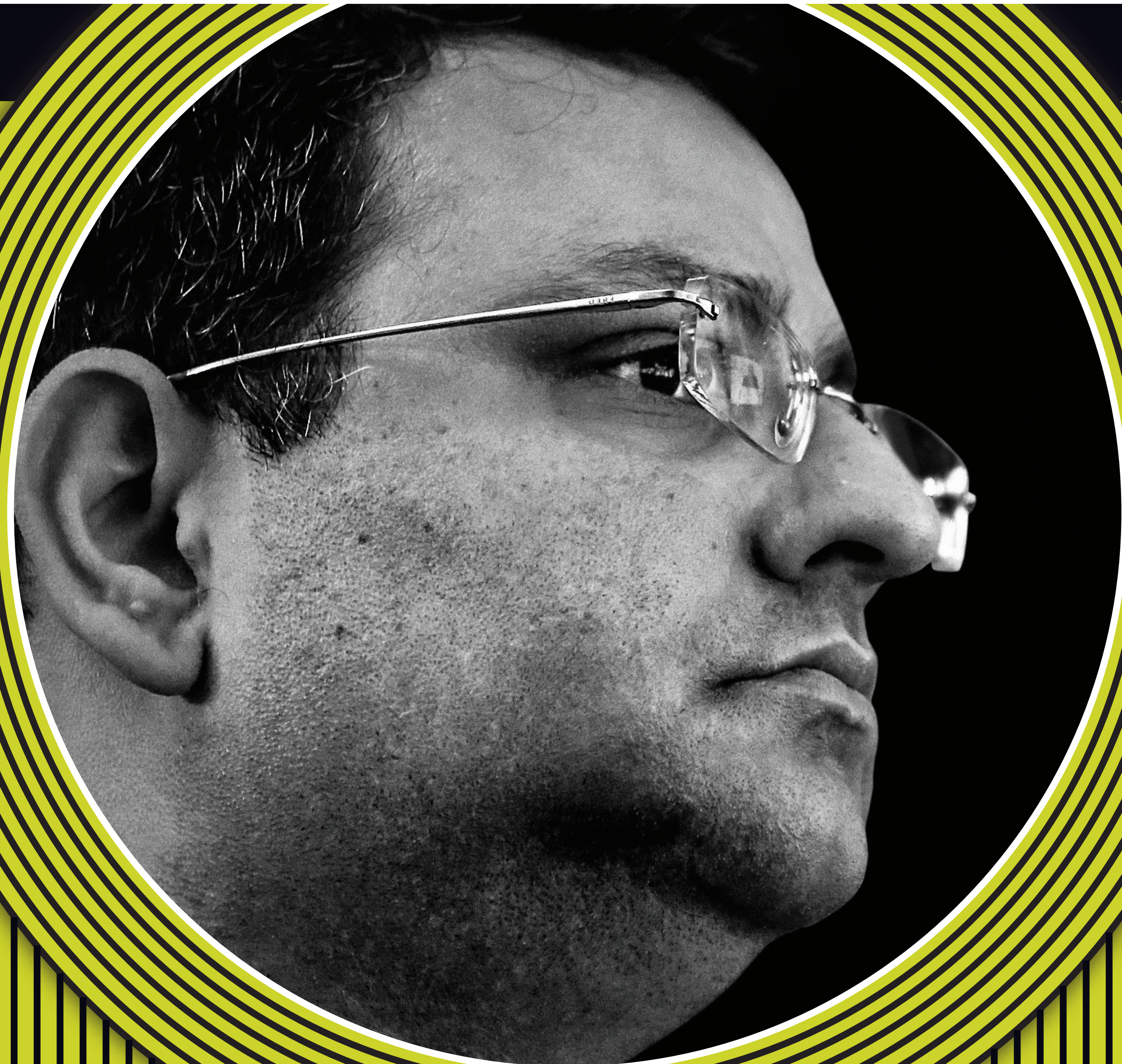

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ANNIVERSARY SPECIAL

BOARDS IN CRISIS

CAN THE FRAGILE BALANCE BETWEEN PROMOTERS, BOARDS, AND MANAGEMENT SURVIVE IN THE FACE OF CULTURE CLASHES AND RAMPANT EGO?

BY ASHISH GUPTA AND DEBABRATA DAS

FOR THOSE OF US WHO track India Inc. on a regular basis, October of last year will go down as perhaps the most eventful month since July 1991. In many ways, the events of a year ago ushered in a new, more disturbed, era for corporate India. On Oct. 24, 2016, Cyrus Mistry, then chairman of Tata Sons, was summarily sacked by the board. Much dirty linen was then washed in public (more on that later), and 12 months on, with a new chairman in place, Tata Sons is trying to get on with business as usual.

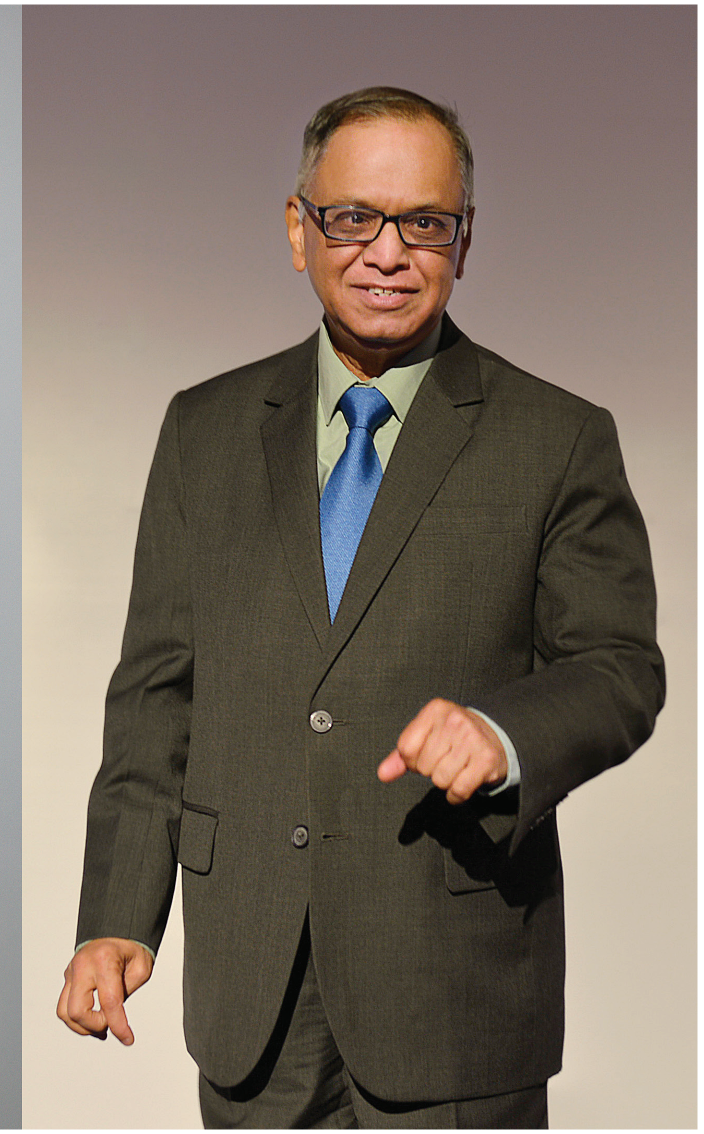
Even as things seemed to be stabilising somewhat at Bombay House, the iconic headquarters of the Tata group, there was trouble brewing down south in Bengaluru. Another stalwart of India Inc., Infosys, found itself in the limelight for far from pleasant reasons. Vishal Sikka, the CEO appointed three years ago to turn around the homegrown information technology giant, resigned. His reason: "false, baseless, malicious and increasingly personal attacks ... amplified by the very people from whom we all expected the most steadfast support". Strong words, especially when it was made amply clear that the "people" he referred to was actually one person, the founder of Infosys, N.R. Narayana Murthy.

Two unrelated incidents at two vastly different organisations. But both being held up to scrutiny, and both, to some extent, found wanting. The Tata group has always been seen as one of those icons of modern business. And at Infosys, Murthy had garnered much praise for his uncompromising views on corporate governance. To find that such idols of corporate India have feet of clay threw much of the business community into disarray. And the fact that promoters could unceremoniously wrest control from management and the boards set off shockwaves that are yet to subside.

"THE DECISION TO CHANGE THE LEADERSHIP OF TATA SONS WAS A WELL-CONSIDERED AND SERIOUS ONE FOR ITS BOARD MEMBERS."

RATAN TATA IN A LETTER TO EMPLOYEES IN NOVEMBER 2016

FORTUNE INDIA ARCHIVES



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The big questions being asked at companies today is whether corporate governance matters any more. What exactly is the role of the promoter? Do we need to reconsider the relevance of independent directors on a company's board? (The role of independent directors was actually formalised and spelled out only in the Companies Act of 2013.) Most important, do we need to codify corporate governance itself? It would be highly impractical to do the last, says Rudra Pandey, partner at Shardul Amarchand Mangaldas, a leading law firm. "As long as the board of a company is acting, or taking decisions in the best interest of the company, the promoters should refrain from interfering in such decision making, even if they do not completely agree with such decisions," adds Pandey. Promoters, he says, should discuss their concerns with the board only when the decisions of the board seem to be against the best interest of the company.

SOME TIME BETWEEN Mistry's ouster and Sikka's, the markets regulator, Securities and Exchange Board of India (SEBI), set up a committee headed by Uday Kotak, executive vice chairman and managing director of Kotak Mahindra Bank. The role of this panel is to advise SEBI on matters related to corporate governance.

"MY PROBLEM IS WITH GOVERNANCE AT INFOSYS. I BELIEVE THAT THE FAULT LIES WITH THE CURRENT BOARD."

N.R. NARAYANA MURTHY IN AN E-MAIL STATEMENT LEAKED TO THE MEDIA

In its recently released report, the Kotak-led Committee on Corporate Governance recommended, among other things, that the SEBI Listing Obligations and Disclosure Requirements include a clause that there must be at least six directors on a company's board. Also, among the most significant recommendations is the inclusion of a chapter dealing with information rights of certain promoters and significant shareholders. This is something that the Listing Obligations do not touch upon, and is fast becoming a contentious issue between boards and promoters.

In his preface to the report, Kotak spells out the two ways companies are run: the 'raja' model and the 'custodian' model. The difference, he says, is that while promoter self-interest guides the former, Gandhian principles of trusteeship guide the latter model.

Interestingly, this is something R. Seshasayee, till recently chairman of the Infosys board, said weeks before the report was released. While he refused to comment on the Infosys imbroglio, Seshasayee was happy to talk of the issue of corporate governance in general. One of the first things he told us, in fact, had to do with his views on boards. "At the core of governance is the concept of trusteeship. The board of directors is a trustee of the interests of various stakeholders. Trusteeship has two dimensions: One, you always put the interest of the organisation ahead of your own; two, as trustees of all stakeholders, you take the most optimal decision in the overall interest of all stakeholders."

There's a certain sense of alignment in thinking in much of corporate India, where boards are seen as trustees. However, as recent events show, this agreement may be far more hypothetical than actual. Take the case of what happened at Infosys. Sikka had been accused of financial improprieties by a whistleblower; "despite all allegations being proved false and baseless by multiple independent investigations", as his resignation letter says, some people including Murthy, wanted more done to prove that everything was above board.

"If there is a corporate tussle between the management and shareholders, you can use different veneers based on which you can fight. It is easiest to take this high moral ground of corporate governance to push your agenda," says Kaushik Dutta, founding co-director of Thought Arbitrage Research Institute, a Delhi-based think tank.

That's pretty much what happened at Infosys. Murthy, for long seen as the protector and promoter of good corporate governance, used that as a stick with which to beat the board and get his way.

In an e-mail written soon after Sikka's resignation, accessed by some media houses, Murthy is supposed to have said: "My concern primarily was the deteriorating standard of corporate governance which I have repeatedly brought to the notice of the Infosys board."

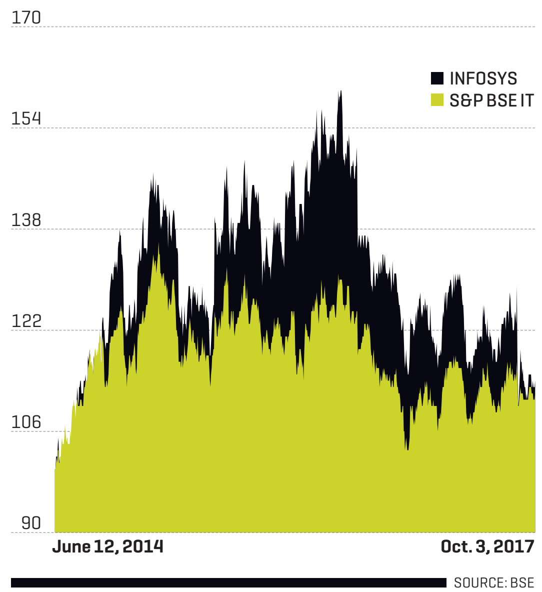
The story of what actually went down at Infosys in the months preceding Sikka's exit are all in the public domain, but a quick recap will help put things in perspective. Almost all the drama hinges on an acquisition Infosys announced in early 2015, of Israeli software company Panaya for $200 million (Rs 1,263 crore). News reports early this year say that a whistleblower contacted the Infosys board and select media houses, claiming that the price for Panaya was too high and that then chief financial officer Rajiv Bansal had not approved the transaction. Later, the board was accused of having paid too much as severance pay to Bansal, and this amount was widely seen as hush money.

Accusations flew thick and fast, including from Murthy. The board, meanwhile, got external agencies to investigate; it hired Gibson, Dunn & Crutcher, an international law firm known for conducting internal investigations, and Khaitan & Co to advise on Indian law. Both agencies gave the company a clean chit. But, from what sources told reporters, Murthy was unsatisfied with the probe. After much to and fro, Sikka quit, followed soon after by Seshasayee. "If the shareholder doesn't accept the findings of the independent investigations there is not much one can do from a legal point of view," says Dutta.

W**HAT WENT DOWN** at Tata Sons was vastly different. Mistry, who had been named executive chairman after a long wait for Ratan Tata to name his successor, was sacked by the Tata board for

How Infy moved

How the stock performed once Sikka came on board



SOURCE: BSE

1,397
DAYS
Cyrus Mistry's tenure at Tata Sons

1,114
DAYS
Vishal Sikka's tenure as CEO, Infosys

"repeated departures from the culture and ethos of the group". Unlike Sikka, who opted to walk out, Mistry has chosen to fight.

"To 'replace' your chairman without so much as a word of explanation and without affording him an opportunity of defending himself in a summary manner, must be unique in the annals of corporate history. The suddenness of the action, and the lack of explanation, has led to all manner of speculation and has done my reputation and the reputation of the Tata group immeasurable harm," Mistry wrote in a letter to Tata Sons' board members a day after his ouster. With this fight moving to the courts, none of the players in this drama would speak to us on record.

The several legal cases between Mistry and the Tata group reveal something more disturbing than a clash of personalities or working styles. One, it shows how opaque the decision-making structure is at the 149-year-old conglomerate. And two, it shows an unhealthy trend of allowing a promoter or large shareholder a disproportionate say in management.

Most of the experts we spoke to said that the promoter's influence on a company's operations should be exerted through the board of the company, no matter whether the promoter is a charitable trust, a corporate entity, or an individual.

While the impression given to the public is that the Tata Sons' board decides what happens within the group, the reality reveals that the board is little more than a rubber stamp for the Tata Trusts. On the board of Tata Sons, the unlisted holding company of the Tata Group, Tata Trusts have the power to nominate one-third of the directors. These directors were also given veto powers after an amendment to the company's articles of association in 2014. They also have greater powers to decide on removing and appointing a chairman.

While Seshasayee was firm about not talking

"AT THE CORE OF GOVERNANCE IS THE CONCEPT OF TRUSTEESHIP. THE BOARD OF DIRECTORS IS A TRUSTEE OF THE INTERESTS OF VARIOUS STAKEHOLDERS."

R. SESHASAYEE, FORMER CHAIRMAN OF THE BOARD, INFOSYS

of specifics, he did say this: "If issues of ethos and culture are used to drum up an opposition or rake up a controversy or even an assault, it will ruin the organisation."

Dutta, who is also an independent director on several boards, agrees. "What has happened now is that corporate governance has entered the moral realm."

S**O, WHAT EXACTLY** is corporate governance? "Broadly, corporate governance is defined as the systems and processes by which a company is governed. It is built on three things—accountability, transparency, and reliability," explains Dutta.

That, clearly, is not a complete definition, since corporate governance is much more. For Seshasayee, it is to do with looking after shareholder interests and looking out for the best interest of the company. Corporate governance also has to do with morality, says Nirmalya Kumar, Lee Kong Chian professor of marketing at Singapore Management University and distinguished executive fellow at INSEAD Emerging Markets Institute.

Corporate governance is a nebulous concept that cannot be codified. "One thing you don't need in India is more laws," says Kumar, who had been part of the Group Executive Council at Tata Sons in Mistry's tenure. "At the end of the day, you can't legislate morality." That's something Dutta also agrees with. "Today, ethics, morality, and corporate governance are being used in the same tone," he says, explaining why this makes it almost impossible to write rules that govern corporate governance.

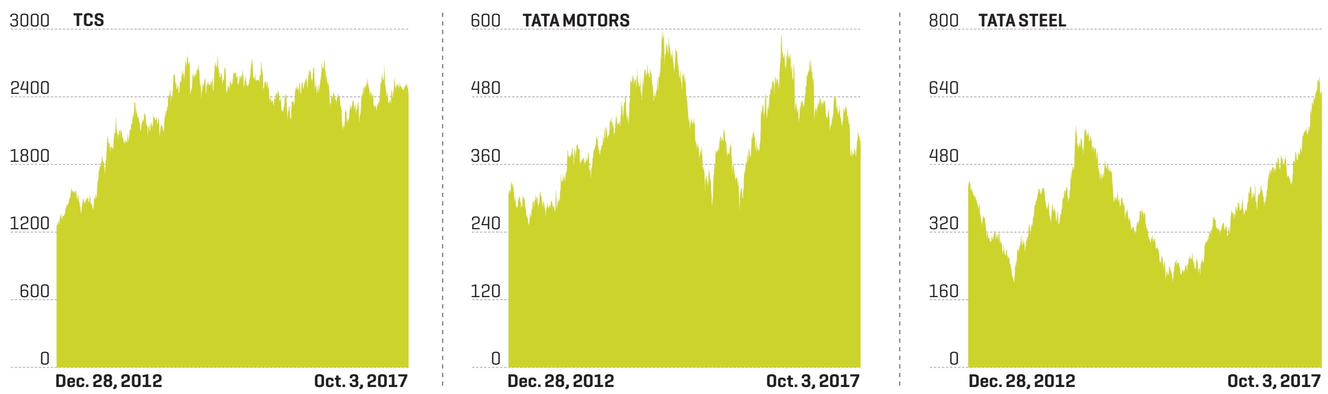
That seems to be the overwhelming consensus. Pandey of Shardul Amarchand Mangaldas says it will be "completely impractical" if "regulators or legislators are compelled to codify the day-to-day behaviour of promoters".

ALL OF WHICH leads us to perhaps the most important question in India Inc. today: Without a clear definition and setting out of checks and balances, is it possible for the board of any company to insulate itself from what Sikka called the "drumbeat of distraction and negativity from the promoters".

▲ PHOTOGRAPH BY **NARENDRA BISHT**

The Tata effect

Performance of key Tata group companies since Mistry took over



SOURCE: *Fortune India* research

Kumar is unambiguous. "There is no way to protect the board from the unilateral attack of the promoter in India. The message that these two incidents [Mistry's ouster and Sikka's resignation] has sent is that if you want to have a view which is not consistent with the promoter then you cannot be on the board."

That seems depressingly true. In the Infosys case, the board seems to have taken all the steps in its power to defuse the situation, even to the extent of seeming placatory to the promoter. In the Tata case, the public line seems to be that the board had agreed to sack Mistry. However, sources at that level in the company, who asked to remain unnamed because of the court cases, say this was not what really went down. It was, effectively, the promoter running roughshod over the board.

The Kotak panel report does consider the role of promoters, although its recommendations do not add too much to the existing rules, other than the addition of a chapter on information rights of the promoter. There are, of course, specific recommendations made when promoters want to reclassify companies as being professionally run, on compensation to be paid, etc. But on first reading, the report does not seem to mention anything on the responsibilities of the promoter.

The reason why this is important is that there needs to be some rules "to ensure the promoter's rights are asserted only through his shareholding and it shouldn't be the case that one individual or family ends up running the entire group," said a person working with the committee, on condition of anonymity, adding that this was a direct result of what happened at Tata Sons.

> "WHY INDIAN BOARDS ARE MORE SUSCEPTIBLE TO PRESSURE THAN THOSE IN THE WEST IS BECAUSE THE SHAREHOLDING PATTERN [THERE] IS MORE DISTRIBUTED."
>
> **RAJESH CHAKRABARTI,** EXECUTIVE VICE DEAN, JINDAL GLOBAL BUSINESS SCHOOL

On his part, Seshasayee makes a clear distinction between promoters on the board/ management and those outside of it. He says promoters who are on the board are legally entitled to their authority. Those who stay away from the responsibility of a board position want power without responsibility, is the gist of his argument.

T**HE FRAGILE POSITION** of boards today is accentuated by the lack of activism of institutional shareholders, even when a promoter is disrupting the company. Unlike the global norm, the Indian institutional investor suffers from the hangover of a promoter-led culture. That often leads to the investor blindly supporting the promoter, irrespective of the issue at hand.

"There are not many instances of institutional investors taking an adequately strong position on a substantive issue and voting on it. They would rather side with the promoter," says Seshasayee. He believes it is a cultural issue, especially in India where respecting elders is considered good behaviour, but sometimes may lead to problems.

THE WHITE KNIGHTS?
N. Chandrasekaran (left) was chosen to lead Tata Sons, and Nandan Nilekani asked to head Infosys.

© CHANDRASEKARAN: ALAMY; NILEKANI: *FORTUNE INDIA ARCHIVES*

Kumar agrees, and is, in fact, even more scathing. "The few shareholders who have some power, like the institutional investors, hate to go against the promoter. This is because if they go against the promoter, life can be very difficult for them in the future."

This is somewhat unique to Indian companies. That's because "the shareholding pattern of most companies in the West is far more distributed than in India", says Rajesh Chakrabarti, professor and executive vice dean at Jindal Global Business School, Jindal Global University.

Chakrabarti adds that unlike in India, most promoters of companies incorporated in the West have less than 5% stake in the company. "It is the pension and insurance funds that hold majority stakes in these companies and their interests are not always aligned with those of the promoters."

Coming back to the state of boards in India, Kumar makes an interesting point about Life Insurance Corporation (LIC), a major institutional investor. "In rare cases, foreign institutional investors may abstain or even vote against. But LIC, which is a major institutional investor, would hate to take an independent call on a major controversial vote. In such cases, LIC nominated directors would wait for instructions from higher ups."

Chakrabarti minces no words about this. "The institutional shareholders in the West are far more active in annual general meetings, questioning virtually all decisions of the management, unlike the Indian institutional shareholders," he says, mentioning LIC in this context.

So here's the thing. By law, it is the responsibility of the independent directors to safeguard the interests of the minority shareholders. But at both Infosys and Tata Sons, it has been made very clear that for all practical purposes, it is virtually impossible for the independent director to remain independent.

Plus, as with most things, there's the matter of money. "You must understand that independent directors don't get compensated heavily. If there is even one case of them standing up against the promoter, they are unlikely to get directorships from other companies as they get branded as a troublemaker. Therefore, while the law has given them enough power, the practical exertion of this power is very difficult," says a person close to Cyrus Mistry on condition of anonymity.

Kumar says that as long as a promoter votes on who should be an independent director, the concept will be an oxymoron. "Every promoter decides the independent director. This is because 90% of the minority shareholders don't show up for voting. Therefore, even if the promoter has only 20%

shares in the company, it is the promoter who ends up deciding the independent directors of the company," he says adding that such a situation forces the 'independent director' to vote in line with the promoter or else he or she can be voted out the next time.

It has happened in several companies, but in light of recent events, look at the Tata group. Nusli Wadia, chairman of the Wadia group, which has brands like Britannia, Bombay Dyeing, and GoAir, was removed as independent director from Tata Steel, Tata Chemicals, and Tata Motors after he expressed support for Mistry.

Today, many of those who are eligible to become independent directors are shying away from the responsibility. Under the Companies Act 2013, independent directors are criminally liable for malpractices by the board of directors. The trouble is that these directors, because they are not part of the company, are often unable to effectively highlight potential red flags. This leaves them in a precarious situation, where they are held liable but their hands are, to some extent, tied. A survey by the Federation of Indian Chambers of Commerce and Industry along with Thought Arbitrage Research Institute in 2016 revealed that most small companies in India are struggling to recruit independent directors.

W**HILE THE DEBATE** is on how corporate governance can be enforced through regulations, it shouldn't be forgotten that ultimately companies need to do what makes economic sense.

In this regard, a 2010 research paper by former Reserve Bank of India governor Raghuram Rajan, current RBI deputy governor Viral Acharya and Stewart Meyers, professor of finance, emeritus at MIT Sloan School of Management forms an interesting foundation given the current scenario in India.

In one of the findings in the paper titled 'The Internal Governance of Firms', with the help of some clever mathematics, Rajan, Acharya, and Meyers find that in companies with a high amount of external governance by shareholders, investments are higher and the top decision maker acts like an innovative entrepreneur.

If we extrapolate their findings to the Indian context, in cases like Infosys and the Tata group, we find that minority shareholders have little to no powers in the operations of the company, resulting in poor external governance.

Such an academic research provides another reason as to why both the Tata group and Infosys before Sikka's arrival faced criticisms of lack of innovation and slow capital investments. Therefore, for large corporations who have a long-term view, it does make economic sense to give the minority shareholders a greater say in the company's affairs and thereby strengthen external governance.

There's also a much-overlooked fact, which Rohtash Mal, founder and chief executive of EM3, and former CEO of Escorts and, earlier, Airtel, points at. Infosys, particularly, he says, was an issue of a clash of cultures and not necessarily an issue of corporate governance. "The 'founder-promoter family' was steeped in middle-class, value-driven, frugal, intensely intellect-driven Brahmanical values, and was highly grounded," Mal says. Murthy, by picking Sikka to head the company, "did not possibly realise that he was releasing a bull in a china shop. The reason: While Sikka may be an Indian, he was intensely American at the workplace, weaned on a different corporate governance diet".

Be it a clash of cultures or a failure of corporate governance, as the dust settles on the upheavals at two highly regarded institutions, the unfortunate takeaway is that boards have never been under more threat than they are now.

Nothing prevents future family-owned businesses from abusing their power and justifying it, or even attempting unilateral boardroom coups. After all, corporate governance is a set of rules, laws, and regulations implemented by human beings. And human beings will always remain fallible due to their egos, emotions, feelings, and judgement. F

"CORPORATE GOVERNANCE HAS ENTERED THE MORAL REALM. TODAY, ETHICS, MORALITY AND CORPORATE GOVERNANCE ARE BEING USED IN THE SAME TONE."

KAUSHIK DUTTA, FOUNDING CO-DIRECTOR, THOUGHT ARBITRAGE RESEARCH INSTITUTE

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