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# A single-point agenda

***As companies enter the new financial year, there are a few lessons that the just completed year has had to offer. However, investors should expect the SEBI mandated separation of the role of the chairman and CEO to dominate the board agenda this financial year.***

Look at IL&FS, the carnage of bank balance sheets and the pledged share saga currently playing out, and this will be the year governance issues became central to debt investors. It is easy to forget that lenders are as affected by governance failure as are equity investors. Afterall, it is equity investors who get to vote on board appointments, related party transactions, ESOP schemes, capital allocation, even borrowings themselves. Further share price movements are far more spectacular than the basis point change in bond prices, so it is easy to assume that it's the equity investors that bear the brunt of governance slip-ups. But equity-holders vote because they are owners. Further equity investors in better governed companies have the ability to capture the upside by way of higher multiples, their lenders are merely guaranteed their money back and in a timely manner. Governance matters just as much to lenders as shareholders.

One consequence of this will be the on-going scrutiny and regulations of the rating agencies. A recently set-up parliamentary committee has recommended a mandatory rotation of rating agencies and moving to an investor or a regulator pay model. Neither of these to my mind is a solution – and more on this some other time. My suggestion is clawing back of fees combined with prohibitive fines. This will be more effective.

Two, expectations from independent directors have changed. Today each misstep by the company is viewed as a failure of its board and independent directors. This was not always so. From the 'promoters' perspective, directors were names that added a shine to the company and may help open doors. The directors themselves were unsure regarding what was expected off them - oversight (-read compliance), guiding strategy or consigliere to the patriarch. Not so any longer. Both the regulator and investors expect far more now. Boards and the directors need to step-up.

Three, the relationship between corporates and investors has changed permanently, as reflected in their voting and engagement.

Mutual Funds started to vote from 2011. There is no mandated Stewardship Code for the industry, but asset managers pretty much do what a Stewardship code expects – monitor companies they invest in, adopt a voting policy, disclose how they voted and engage with companies on issues that agitates them. The insurance players adopted a Stewardship Policy from 2017. The pension funds had collectively started to vote but has decided to ratchet-up its focus on governance by its fund managers rolling out their Stewardship Policies last year.

FII's own about 21% of the market and vote 99% of their holdings. Mutual Funds own ~ 8% of the equity and vote 90% of their shareholding. Add insurance and pension funds to the mix, and FII 's and DII's, who in the aggregate own about 36%, and will now be voting. Voting has steadily gone-up these past few years and has now reached the tipping point. This is being reflected in how votes are falling - upturning decisions that the boards are placing before shareholders. This has ramifications regarding how investors view issues, but equally on how investors and companies engage with each other.

Four, the role of the company and board vis-à-vis all stakeholders is getting reshaped. From looking at non-receipt of dividends and non-transfer of shares (- tasks made redundant by technology), the Committee now need to meet investors and pro-actively engage with them. This may even entail bringing all stakeholders under the governance umbrella. The supply chain, the distributors, the community in which the company operates, and the oft neglected female employees and workers. Not just external, but internal too. There needs to be a a change to job-description of the Stakeholder Empowerment Committee. The risk committee needs to look at cyber risk. The audit committee needs greater oversight over subsidiaries. This is the right time to do this and more.

Looking ahead, the one item that I expect will dominate the board agenda is separation of the role of the chairman from that of the managing director.

The Kotak Committee cited in turn from the 'Report of the Committee on the Financial Aspects of Corporate Governance

(1992) aka the Cadbury Committee, that "*given the importance and the particular nature of the chairmen'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*". The Kotak Committee concluded that "corporate democracy is built into the interconnected arrangement amongst the board, the shareholders and the management, where the board supervises the management and reports to the shareholders." And further that "the separation of powers of the chairperson (i.e. the leader of the board) and CEO/MD (i.e. the leader of the management) is seen to provide a better and more balanced governance structure by enabling better and more effective supervision of the management"

Although the Kotak Committee had recommended that this separation happens where public shareholding is more than 40%, SEBI while accepting the report stated that "It is proposed that separation may be initially made applicable to the top 100 listed entities (by market capitalization) w.e.f. April 1, 2020. Further, in such entities, chairperson and the managing director/CEO should not be related to each other in terms of the definition of "relative" as defined under the Companies Act, 2013."

No matter what has happened this past one year, and no matter which direction the longer-term trends point us towards, separation of the role of the chairman and CEO is what will keep boards and promoter-CEO's engaged this coming year. This, coupled with the need for a separate shareholder approval to pay non-executive directors over 50% of the total board remuneration pool, will be seen as a clamp-down by several promoters. This is where the back-channelling between promoters, the regulators and boards will take place. And this is what all attention will stay focussed on.

*A modified version of the above comment appeared in Business Standard on 25 April 2019. You can read it by clicking this link or typing the following to you url:* https://www.business-standard.com/article/opinion/a-single-point-agenda-119042501177_1.html

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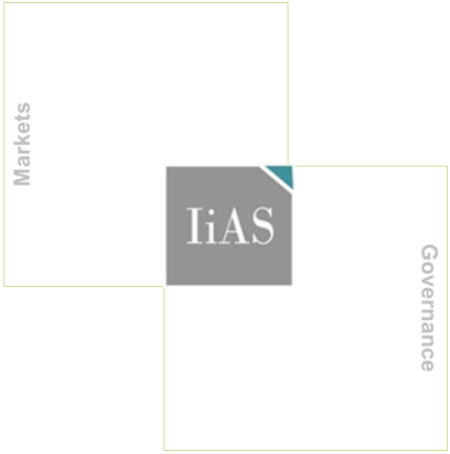


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