# CORPORATE GOVERNANCE – INDIAN EXPERIENCE

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*"Free Enterprise was born with man and shall survive as long as man survives".*

— **A. D. Shroff**
1899-1965
Founder-President
Forum of Free Enterprise

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Corporate Governance implies management assuming the role of trusteeship with all the attendant checks and balances which creates a high performing organisation leading to greater customer satisfaction, high employee morale and commitment, enhancing shareholder value and sensitivity to societal concerns.

The company's concepts, policies, practices and systems must be perceived by all those who have a stake in it, or interact with it commercially - as progressive, forward looking and ethical. It must elevate the reputation of the corporation and the esteem of its management. At the human level it should lead to attracting and retaining talent and motivating employees to give their best.

For creating a more open and participative management style, the spirit is more important than the form. Just adoption of the code has no meaning, unless it has full approval and commitment of top

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management. As the old adage goes "AS AT THE TOP SO AT THE BOTTOM".

Technological developments in the last few years have been at a breathtaking pace, particularly in the "infotech" sector. This has made past thinking and approaches to corporate management almost obsolete. The name of the game is positive and speedy response to the fast changing economic and social environment.

As Charles Darwin, had, with great prescience, observed nearly 150 years ago —

IT IS NOT THE STRONGEST
IT IS NOT THE MOST INNOVATIVE
BUT ONE WHO IS MOST RESPONSIVE TO CHANGE
WHO WILL SURVIVE.

In the evolution of the Indian corporate sector it is important to keep in view that Indian business did not encourage independent professionals. The dominant business culture reflected the ethos of a joint family where the patriarch called the shots. Of course there was a board, as there had to be one by law. However, it usually existed for form's sake. Besides quite often the person formulating policies was not on the board but operated from behind the scene. Management assumed a dynastic role - father to son - and this is still prevalent in many fairly large public limited companies. Fortunately some change is visible with younger members of the promoting families now being increasingly exposed to professional education and training. Nevertheless, this alone does not ensure competence to manage in the absence of adequate on the job exposure and experience.

Large public limited companies in India even in the 1920s and 1930s had boards which comprised of adequate number of independent directors who were indeed men of great eminence in their fields. However, the extent of their participation was limited. They were men who had close family, personal or professional ties with the promoters/directors and did not see the necessity for engaging managements in serious discussions. In short they largely served the purpose of ratifying the decisions taken by the management. The boards had no convention for retirement age and out of reverence members were seldom requested to retire unless they became infirm. However, many of them were men of great acumen and honour and hence helped evoke positive response from the investing public.

While this was the general corporate scene in the first half of the last century there were some notable exceptions like that of the House of Tatas. Tata Iron and Steel Co. Ltd., which till recently was the largest private industrial undertaking in the country, adopted employee welfare and security measures and even introduced workers' participation in management, decades before these concepts were legislated on and became general practice in the developed countries. They built an excellent township and created a very congenial environment for the employees to work and live. They even instituted a Social Audit by a group of very eminent citizens from diverse walks of life.

It may be of interest for this group to know that as far back as 1956 a group of eminent industrialists had published a Code of Conduct for Free Enterprise which even by current standards can be considered far reaching. The code encompassed all the stakeholders, consumers, employees, shareholders, government and the community at large. (Reproduced in an appendix).

It is very gratifying that despite India's relative underdevelopment there were businessmen and industrialists who propagated the need for business to realise its social obligations and evolving a code of governance. However, the acceptance of the code was not compelling in view of shareholder and public apathy. Fortunately there were several other factors which helped initiate and accelerate this process.

After Independence many Indian promoters looked to newer avenues of development and diversification, away from traditional industries. They entered into technical and/or financial collaboration with leading manufacturers abroad. This led to formation of joint ventures. The foreign collaborators, who had an equity stake, sought representation on the JV boards and had an effective say in all important aspects of management. This led to greater professionalisation of boards leading to better participation, reporting and transparency.

Another development which led to change in the same direction, though not necessarily with the same effect, was the increasing resort to underwriting and term finance by companies from public financial institutions. Since 1960s the institutions reserved the right to appoint their nominee/s on the boards of assisted companies where they had a substantial equity stake and/or had advanced term loans. The nominee directors were a mixed bag drawn either from the ranks of senior managers of the institutions themselves or from a pool of experienced professionals from outside. Companies were hence obliged to provide more detailed information to the boards and thus ensure more effective participation by directors.

The track record of nominee directors is far from inspiring. The involvement of nominee directors in most cases has been limited, peripheral and confined to keeping a tab on whether the companies were meeting their obligations to the institutions. Seldom have these directors played an active role in raising and discussing substantive matters like corporate strategy, annual plans, capital budgets, future business plans, human resource development and succession. This has been particularly so when the going was good and the companies reported profits and declared dividends. Lack of vigilance on their part became only when serious discrepancies in working came to light, often through disclosures in the media. The detached and often passive role of these external directors, barring some notable exceptions, often sent a wrong signal to the general investors who rightly assumed that they were acting as their watch-dogs.

Most large companies still have nominee directors on their boards. The institutions which appoint them have yet to evolve a clear policy of the specific role they expect their nominees to play. This has now become all the more imperative, as according to a recent SEBI announcement institutional directors will be treated as independent directors. There are serious short-comings in the current system which need to be addressed. The nominee directors, who are officials, should be empowered to act like other independent directors, while deciding and voting on important issues and resolutions, and not making these decisions subject to the approval of their respective institutions as done currently. Further the institutions should draw up a list of totally independent individuals with requisite competence and adequate experience and who can spare sufficient time. What is vital is that these nominees have complete freedom to act in their best judgement, of course within the broad policy framework laid down by the institutions. The nominee directors should be adequately rewarded and provided with back-up support, by way of analytical studies and secretarial assistance. Increasingly nominee directors should be selected from the second category.

Between late 1950s and 1970s many large public sector corporations were formed which were wholly owned by the state. The directors were largely civil servants who were nominated as ex-officio directors. However these boards had little autonomy and had to function strictly within the policies laid down by their respective government departments. Besides these officials were subject to frequent transfers and were pre-occupied with their own whole-time assignments. Consequently they contributed little either to policy formulation or effective monitoring of the business. The chairman and/or CEO of these corporations have also been either incumbent senior secretaries or ex-bureaucrats and their tenure seldom exceeded three years. Tragically several of these PSUs have even remained headless for months leaving them rudderless. As the members of these boards have an even shorter tenure, the chairman's task was educating new appointees about the business of the corporation. In short these boards have been largely ineffective and this is reflected in the relatively poor performance of most public sector undertakings. These undertakings, floated by central and state governments and including public utilities, represent over Rs. 5000 billion of public investment and occupy a dominant position in several key industries and services. It must be said to the credit of these boards that they are meticulous as far as compliance of procedures and systems are concerned. However such compliance does not constitute good corporate governance in the real sense, unless used as a vital tool for effective performance.

The largest stake of the public is in nationalised banks, financial institutions, insurance companies and government owned mutual funds and provident funds. The aggregate funds managed by these entities, controlled by the state through boards largely comprising of government nominees, represent in all resources of the magnitude of Rs. 10,000 billion mobilised from the citizens by way of savings and taxes. The total funds thus deployed in all these undertakings, which are within the entire or substantial control and ambit of the government, exceed Rs 15,000 billion, almost 75% of the gross national product of the country. One cannot possibly overemphasize the urgent need for total overhaul in the management and governance of all these state enterprises.

There are several multinational companies and large international banks which have been operating in India for long, some for over 100 years. These are either wholly (few) or substantially (several) owned by foreign investors. Directors are either nominated/appointed by the investors. Many well-known Indian professionals and business executives do adorn such boards. However, the role of independent directors is limited

- confined largely to help measure performance against targets, advise on local environment and laws, recruiting senior personnel and succession. They are seldom involved in laying down of strategy or framing long term vision of the enterprise. Nevertheless in view of the high degree of professionalisation, sound systems and procedures and transparency in reporting they are considered investor friendly and enjoy high valuations on the stock exchanges.

The board's most important task is to become a pivot. The chairman and CEO must set the tone and take the lead in encouraging a participative style. Chairman is the custodian of corporate ethics and must lead by example on issues of morality and business principles. As the old axiom goes "The bottleneck is at the head of the bottle. No business is likely to be better than its top management, have broader vision than its top people or perform better than they do."

The Chairman must ensure that the board and the top management have a right balance, knowledge and competence, to set strategies and lead the organisation. He must be like an orchestra leader effectively harness the talents of the board. The board should not be a medley of different interest groups but a constellation of stars, each star of different magnitude but moving together with a common purpose across the firmament. He must create a compelling vision for the corporation which would motivate all the employees and ensure their identification with corporate goals. One of his key roles is to ensure that human resources are developed to meet the needs of a growing organisation by placing great stress on management and renewal of top talent on the board and at highest executive levels.

There has been an attitudinal change in the approach to this subject in the last few years. Even before the publication of CII and SEBI codes, many progressive managements started introspecting and reviewing the way their companies were functioning. What is refreshing is that some young scions of promoters, who have substantial stake in their companies, have been appointing competent non-executive directors on their boards to measure their own performance. Not only the boards have been adequately strengthened by credible independent directors, but the frequency of meetings has been increased. Further the information provided to the boards is far more exhaustive than done earlier and independent directors are actively involved in evaluation of strategies and formulation of long term growth plans. With the code of governance now having become mandatory in the case of listed companies, the chairmen and CEOs have been looking out for independent directors who can make an effective contribution to the working of their companies in an increasingly competitive environment. Further the search for such directors has now expanded beyond the normal circle comprising mainly of businessmen, lawyers and accountants, to business economists, academicians, scientists and ex-civil servants. Few companies have even appointed renowned academicians and consultants in USA, UK and other developed countries on their boards so that they can bring global insights into the functioning of these corporations.

Another welcome development is that companies have started laying down upper age limit for retirement of both executive and non-executive directors. Boards are also now actively looking at renewal, beyond a certain tenure, to inject fresh thinking.

While the movement towards more effective corporate governance has certainly gathered steam, a lot remains to be done. In a good many cases this concept is being observed more in its form to gain respectability. There is still desire to hold vital information close to the chest and present a fait accompli to the board merely for ratification. Competitive pressures, the desire to attract and retain managerial talent and the compulsion to induct more independent directors on the board will compel these managements to fall in line as else these companies will get marginalised and be even obliterated.

The concern of investors and for that matter all constituents cannot be addressed or enhanced merely by a code of conduct or by-laws. Regulators can protect investors to an extent. Luckily the searching eye of the research analysts has been a material factor in making corporate managements more alive to their responsibilities. Performance of companies cannot be judged merely by the price of their shares in the stock market as that depends largely on perception of investors at any given time about the future prospects of a particular industry and the valuation attached to it. The essential test is how efficiently and productively are resources entrusted to management being utilised to the benefit of shareholders.

While external regulation and corrective measures will more or less apply to all companies, the real cutting edge is the extent of self assessment and self regulation the organization is prepared to place on itself and its actual performance.

Shareholder activism, now becoming visible, and the growing threat of hostile takeovers will spur entrenched managements to ensure better governance.

# CODE OF CONDUCT

## (Published by the Forum of Free Enterprise on 18th July 1956)

This code of conduct for Free Enterprise has been prepared by the Forum of Free Enterprise and is now placed before Industrialists, businessmen and those belonging to .different professions and vocations in India in the belief that they find it worthy of acceptance and of application in their daily activities. The Forum pledges itself to do all it can to create a widespread awareness in the ranks of Free Enterprise of the obligations that are contained in this Code. We feel that Free Enterprise, which has been tested and proved by time and experience of all democratic societies, should maintain its reputation by insisting on high standards of integrity which are dictated by social purpose. Honesty, hard work, courtesy and continuous initiative are the foundations on which the edifice of Free Enterprise rests.

Producers and distributors owe it to the consumers of their products that they shall always be of the highest quality and available at reasonable cost. They shall maintain fair measure and guard against adulteration. Customers are entitled to courtesy, promptness and good service and every endeavour shall be made to see that they receive them.

Employers owe it to labour to recognise that welfare is not conceived in terms of philanthrophy, but as a social obligation. Men and women engaged in production shall do so with dignity, honour and a sense of security. Fair wages should be paid for work done. Working conditions shall be as pleasant as possible. Opportunities should be made available for the worker to gain technical skills and better his economic prospects and social status. Procedures should be instituted for the removal of legitimate grievances so that the employee is satisfied that he gets a fair deal. The employers should welcome the existence of stable and democratic trade unions. They should recognise that in the sphere of employee-management relations, as in other spheres, checks and balances are essential for the working out of rational and democratic solutions. They should accept the role of labour as one of creative co-operation and recognise the need for providing increasing opportunities for consultation of employees and their progressive association with Management to help in the promotion of increased productivity from which all will benefit.

Management owes it to those who invest in their enterprise that they receive a fair return on their investments, commensurate with the risk they take. At the same time, reserves must be created for expansion and modernisation of the plant and machinery and in their utilisation the Management remains accountable to the investor. Money must also be provided for research. The earning by the shareholder of a fair return or profit by the enterpreneur under competitive conditions and after payment of fair wages must be regarded as a legitimate reward for the risk and the work of promotion and development which the community urgently needs. Certain malpractices have crept into the system of company management. They are to be condemned and should be removed. Hoarding, black-marketing and profiteering are anti-social and evil. Honest business practices can be promoted and encouraged by an honest and efficient administration in a democratic State.

Professional men – lawyers, teachers, doctors, auditors, or writers – owe it to those who avail themselves of their services to maintain the highest standards and traditions. They should discharge their duties truly and faithfully and should always subordinate considerations of personal gain to the larger objective of service.

We all owe it to the community that we accept our obligations as good citizens. We shall bear our share of taxation honestly. We condemn unequivocally any attempt at tax evasion. We shall actively participate in the promotion of social, cultural and civic improvements. Wealth or power shall not be a justification for vainglory or ostentatious display, but an opportunity for rendering service to the community.

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*"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".*

**— Eugene Black**

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The Forum of Free Enterprise is a non-political and non-partisan organisation started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions and other means as befit a democratic society.

Membership is open to all who agree with the Manifesto of the Forum. Annual Membership fee is Rs.100 (entrance fee Rs.100) and Associate Membership fee Rs. 40 (entrance fee Rs. 20). Students (Graduate and Master's degree courses, full-time Management students, students pursuing Chartered Accountancy, Company Secretaries, Cost and Works Accountants and Banking courses) may enrol as Student Associates on payment of Rs.10 per year (no entrance fee).

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