



Independent Director needs to be a comprehensive package

*Mr. G. Mahalingam

Introduction

First of all, I would like to thank Lt. Gen. J. S. Ahluwalia, Mr. Pradeep Chaturvedi and Mr. M. S. Sundararajan in IOD, for giving me this opportunity. My heartfelt thanks to the earlier Speakers - Mr. J. Sundharesan, Ms. Nagalakshmi, Mr. S. Santhanakrishnan and Mr. A. T. Krishnakumar.

I will be responding to the excellent points raised by these speakers.

Lt. Gen. Ahluwalia spoke on how Corporate Governance is very important. He underlined the importance of good Corporate Governance. Being an Independent Director (ID) is not a bed of roses, as stated by Mr. Krishnakumar. An Independent Director to function effectively requires the Promoter and Management to cooperate. When there is no cooperation, it is time for the ID to leave. A good number of Companies are good. A very small number of Companies are not good, as stated by Mr. Santhanakrishnan.

ID has opportunity to play a very useful role when the graph of the company is going down. ID has to be alert and must sound the Concerned Authority, to be alert.

Lt. Gen. Ahluwalia raised the point that **70% of IDs are not aware of how value is created in the Company.**

- Is there a problem there?
- Do I take up as ID of a Company, when I am not able to understand the business of the Company?
- Why to take up an ID responsibility when I do not understand the business of the Company?

When I am totally scared of technology, I cannot become ID of a Technology Company just because I know how to read the balance sheet. Reading balance sheet is one skill, but one must be able to understand technology, reasonably well.

Mr. Krishnakumar rightly said, **'you need a judicious combination of domain expertise, financial expertise and common sense'**, a point also supported by Mr. Santhana - krishnan.

***"ID needs to be a Comprehensive Package, if the package is found short of any particular skill
Better not to accept the responsibility of an ID."***

Who is forcing you the responsibility of Independent Directorship? If you cannot match the skills required, just get out of it and mention your reasons for leaving from such situation.

Mr. Sundharesan and Mr. Sundararajan mentioned, **'personal friendship with the promoter must only be outside the boardroom'**. If you are a friend of the promoter; let that friendship stop at the door of the boardroom. When you enter the boardroom, you are an ID. You are a neutral umpire in a one day match that is taking place between two countries, for example, India and England. We never had the concept of 'Neutral Umpires' at all. We had a lot of country umpires and the country umpires were coming under a lot of criticism. Now, after the neutral umpires have come, people talk about 'umpiring skills'. But people do not talk about 'favouritism among umpires' at all. That is a very important concept, which has to be imported as far as IDs are concerned. You may be very close in terms of

friendship with the promoter but keep it aloof, and raise all the right questions.

Mr. Sundararajan rightly highlighted, '**Ask challenging questions**'. You need to get all the challenging questions on the table. If you don't get satisfactory answers, give them one days' time. If you are not getting satisfactory answers and something smells fishy, it's time for you to think what needs to be done as 'a next step'. He also mentioned that 'independence' is a question of mindset and professionalism is very important.

All these points, needs to be stressed over and over again. I am happy that the speakers have brought out the real essence of what an Independent Director is supposed to contribute.

Now, let me come to what Mr. Sundharesan said on SEBI's Board Meeting on June 29, 2021. He talked about appointment, and in the first Consultation Paper, there was a dual voting procedure where actually by the Ordinary Resolution of the entire shareholders, you are supposed to clear it and not only supposed to clear it, you are also supposed to clear the 'majority of minority'.

Regarding '**Majority of Minority**', I would like to add a few points to which Mr. Sundharesan mentioned, 'it looks like a confusing concept' but let me tell you, it is not confusing at all. It is a very important concept as far as a Listed Companies are concerned.

In a Listed Company, the Promoter holds a large number of shares, of course. He can hold 75% of the shares, but the remaining 25% must be floating stock, available to the public. Now, in this public shareholding of 25%, there are some public shareholders who are not institutional shareholders, who have nobody to look upto but to an ID. So, SEBI brought in the concept - **Please look into the minority shareholders, when you are going to take a very contentious decision**. Go to those people and ask them to vote amongst this minority people, if the majority support that this particular decision is good for the minority shareholders, then go by a democratic decision. So, the point here is, we should not forget about the minority shareholders, holding only 25% shares or much less. Even if they hold 20% of the Company Shares, conduct a voting among themselves and find out what is the majority opinion amongst the minority; that opinion counts. This is a very important 'democratic concept' not invented by SEBI but some advanced economies. We have actually brought this concept in our country, where many of the companies continue to remain under the promoter's strangle-hold i.e. a situation where the promoter and management is not well-minded.

If the minority shareholders thought that the only person they can look upto is the ID, then the second process is **Majority of the Minority**. But unfortunately, during the Board Meeting, people felt that it might create a huge problem in terms of logistics, in terms of conducting vote through this procedure. So, finally the method of 'special resolution' was opted, whether it is

an appointment, re-appointment or removal of director, everything is put at par.

Mr. Sundararajan rightly mentioned, there is a difference between the Companies Act and the LODR. He also raised a very important point, that the ID have moved from the concept of 'majority of the ID' to '2/3rds of ID' in the very important Committees. He asked a question, why in the Audit Committee, we have limited ID to 2/3rds, can we not move it to 100%? Yes, very relevant, but then, whatever SEBI does, let me discuss here.

1. We go through a democratic consultation process, where a lot of stakeholders are taken into consideration. This consultation process comes through the Primary Market Advisory Committee and Secondary Market Advisory Committee, where all these points are threadbare discussed with a lot of stakeholders sitting around the room.
2. Stakeholders will consist of academicians, market participants, institutional representatives and regulatory representatives (not just SEBI, it could be RBI, IRDA, PFRDA, Central Government Representatives), and all these people come to some sort of conclusion.
3. With that conclusion, we take it forward with the Consultation Paper.
4. When it assumes the shape of a Consultation Paper, people at large, get an opportunity to react on this and their reaction is the real ammunition for us, which is used for the final policy making.

In fact, today the consultation mode has gained so much credence in SEBI, that any important policy decision takes atleast 4 to 6 months because the process is long. We don't mind if the process is long. This is simply because a lot of stakeholders are consulted and ultimately the opinion which has gained a lot of credence among the stakeholders that is being weaved as a policy.

Now, to answer the question (*in the Audit Committee, we have limited ID to 2/3rds, can we not move it to 100%*), if you read the June 29, 2021 Board Meeting, we did not stop at 2/3rd, it says **atleast 2/3rd Independent Directors**. So, if the Company wants to appoint more IDs, we have no problem. But again, look at what kind of proviso we have introduced, which was also mentioned by Mr. Santhanakrishnan, '**the Related Party Transaction must be approved only by the Independent Directors**'. They cannot be approved by Audit Committee as a whole, which consist of other representatives. Clearly, the concept Mr. Sundharesan mentioned is a very meritorious concept. But to bring this victorious concept, there has to be a path of gradualism and in this path of gradualism we moved to 2/3rds. We are proposing atleast 2/3rds as larger and larger number of Companies have an inclination to move to 100%. Perhaps, SEBI will also at a conducive time, move to 100% and in the meantime Related

Party Transactions is a minefield. We do not want to leave it to 2/3rd, we want to take it to 100% of IDs. I thank Mr. Sundharesan, for mentioning this point.

There is another point I want to react to which Mr. Sundharesan mentioned 'ESOPs'. Yes, today there is a legitimate dilemma of whether we will get talented Independent Directors, given the kind of minefield they have to go through, and given the pittance of remuneration they get.

Now, this is a point which has been engaging SEBI for a very long time and SEBI has come out with the concept of ESOPs for Independent Directors. Yes, upto this point what Mr. Sundharesan said was correct. Let me add a hopeful note - if you read that Agenda, we did not want to come to a conclusion there. The reason is, we have to do it in consonance with the Government of India. It is now written to the Government of India and they have to take a call whether the Companies Act needs to be amended. Perhaps, now we have to take a call. ESOPs is a very important thing, we cannot keep the IDs away from it. They are contributing meaningfully to the company and they deserve it. If they spend about 4-5 years in a Company, they deserve ESOPs, and the time has come for us to think to think over it but may not be able to jump into the bandwagon tomorrow. It requires a lot of discussion and debate, perhaps a concurrence on the part of the Government and a look at the Companies Act. But certainly the point is left wide open; it is just not closed at all. It is a very important point. Thanks a lot Mr. Sundharesan for raising it.

Mr. Krishnakumar raised a very important question; **'Do you know what a Blue Chip Company is?'** If you look at the graph of a Blue Chip Company, it is not going to remain as a Blue Chip Company forever. If you look at the Stock market, 20 years ago, you will find there are several companies quoting very high, whose names are not found today. These companies are gone, perhaps they are closed tightly.

Mr. Krishnakumar mentioned the companies go through difficult times or may go through liquidity crisis. **Are IDs susceptible to these problems?** Yes, it is a legitimate question. Let me give a note of confidence that when such things happen, I will allude to what Mr. Santhanakrishnan said, **SEBI looks at what has been the role of the ID.**

There are several cases in the recent past. If you can take time to go through the orders by SEBI, atleast in the last one year. Of course, SEBI orders could be a remedy for insomnia, you will sleep off if you start reading the orders seriously. This apart if you go through these orders we have several cases where we have examined the role of ID and we have exonerated them very clearly, not putting any liability on them. At the initial stage, Show Cause Notice was issued, they were asked to make a representation, and if they wanted a personal hearing, they were

asked to appear before the member. There are several top IDs who have come before me and have made a very cogent presentation on what exactly was their role when such a decision was made by the Company. Whether they have given dissent note? Whether they have voiced something? Whether they were not present at all? It was a pure executive decision where the IDs were not involved at all. Whether they were taken for a royal ride?

Now, this is the last question I am focussing on right now. For the earlier questions, **SEBI is not going to tie down the ID for any of the misdemeanours, the Company is actually responsible.** If there is a business cycle downturn, certainly the IDs are not going to be held accountable, even if a bank treats you as a wilful defaulter. Certainly these wilful defaulters very clearly differentiate from defaulters arising out of distressful times. To be accountable, there must be the 'wilful' element.

- Now, I am openly taking the name **DHFL**, if you are a party to the wilful element. Now, have you been the party? Have you actually been helping him to do the fraud? No, you might not have helped him to do the fraud. But you are an ID and sitting on the Board Meetings. Agenda notes are sent to you. Diversion of funds was there for people to clearly recognize. You could have asked 10 questions to these people. Why are you giving this loan to the Promoter Company? What prevents an ID from asking these questions? So, you should have asked these questions to the Management, to come out with a very cogent answer. I do not understand why 600 crores loan has to be given to a Promoter Company by the Listed Company, where the 600 Crores belongs to the shareholders. It does not belong to the Promoter alone. Promoter has a share in that but that does not mean 600 crores can be doled away to a Promoter Company. We are asking the question here, 'Why Independent Directors didn't raise this question?'
- In **IL&FS**, what were the IDs doing there? These frauds have taken place over a period of time. It is not a one-time technology based fraud where people like us, namely people above 60 years who do not know about technology. We are taken for a royal ride about technology. If a technology related fraud even slaps me on my face, I will not be able to recognize it. Where there are long-standing, protracted frauds, Management has come to a conclusion that I can take the entire Board for a royal ride. This is where the Regulators have a real dilemma. You should be able to understand that whether the enforcing authority is going to take action against the Board as a whole.

You are not able to identify somebody as not connected with the fraud at all. Not connected means you have not responded to the Board note where it is glaringly seen in the Agenda item. Identified gaps in the Balance Sheet, Profit and Loss Account, Cash Flow Statement and Fund Flow Statement. You must be

able to identify the gaps! Yes, it is difficult no doubt, but the moment the heat is on, better come out of the Company. No problem at all. Again, I would like to respond to Mr. Sundharesan's question about the '**Resignation of Directors**'.

If you think that there is something wrong with the Company, then spill the beans. Write in your resignation letter that I am resigning because I did not get a cogent answer for this question. There was a deliberate effort to seal information from me. Who can do anything to you? They will throw you out of the Company. For goodness sake, you have revealed a major fraud which has just not hit the surface. You have actually helped in the fraud hitting the surface. And perhaps, somebody else is going to take over and unravel the fraud. Perhaps, several other shareholders are going to be saved. You are actually doing a good deed to the Company. There is nothing to force you to remain with the Company in times when the Company is on a fraudulent path. I am not asking you to come out of the Company in stressful times. Business cycles are different from frauds.

Mr. Sundharesan raised the question of **Jet Airways** which is a very unique case in the history of Corporate Governance where the Promoter went first. Ashok Chawla and Sharad Sharma, both celebrities in their own right, were stuck in the Company because they couldn't exit. Under these circumstances, what could be advised? I will not be able to give you a very satisfactory answer, so I am coming with an anticipatory bail in the beginning itself. When the promoter jumps out first of the sinking ship, it means something is all the more wrong with the Company. If IDs have fulfilled their jobs and roles well, maybe they have to go through initial difficult times but I am sure they will be exonerated. They will not have any problems at all.

All these are good policy inputs for us. ■

*Excerpts from the '**Keynote Address**' delivered by **Mr. G. Mahalingam, Whole-Time Member, Securities and Exchange Board of India (SEBI)** at IOD Tamil Nadu Region's Webinar on '**Latest Rules - SEBI on Independent Directors**', held on August 07, 2021.

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THEME:

Developing a **Roadmap** for the Effectiveness of **Independent Directors (IDs)**

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