The elephant in the board room

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OCCASIONAL ASIDE

AMIT TANDON

A few week ago, FICCI, an industry body, wrote to the finance minister, asking her to reconsider the decision to separate the role of the chairman and managing director/CEO for companies. This separation was bound to be contentious from when it was first mooted. What is surprising is that it has taken two years for industry to formally raise this issue. It is one topic that everyone wants to talk about but is yet to be openly discussed.

The corporate governance voluntary guidelines issued by the Ministry of Corporate Affairs had mooted this separation between the role of the chairman and the CEO of a company in 2009. This was then repeated by the Report of the Committee on Corporate Governance aka the Kotak Committee in October 2017.

The Kotak Committee proposed that listed entities with more than 40 per cent public shareholding should separate the roles of chairperson and MD/CEO (with effect from April 1, 2020). And if this had merit, it was to be extended to all listed companies in 2022.

The report saw the role of the chairman as the leader of the board, and that of the CEO as the leader of the management. Separating the roles provides for a "more balanced governance structure by enabling better and more effective supervision of the management" since the separation will enable the board to act independently. It eliminates conflicts in performance evaluation thereby paving the way for fairer executive compensation. It allowed the CEO to concentrate on strategy, execution and the day-to-day running of business. This greater role clarity was seen as a way of ensuring that boards tasks are not neglected due to lack of time. Importantly, this was also as a way of reducing excessive concentration of authority in a single individual.

The Kotak Committee report was placed for public comments, and when Sebi's board met on March 27, 2018, they proposed that separation may be initially made applicable to the top 100 listed entities (by market capitalisation) with effect from April 1, 2019. Further, in such entities, chairperson and MD/CEO should not be related to each other in terms of the definition of "relative" as defined under the Companies Act, 2013. When this was notified in May 2018, it was extended to the top 500 companies.

The pushback

The FICCI in its letter to the finance minister, referred to above, has argued that India is "different" given the family ownership of business from the largest to the smallest corner grocery store. They highlight the role of the family and family patriarch in the Indian ethos. And finally, that Indian family business has shown stronger top-line growth than non-family business — citing global research to bolster this claim.

Given that such separation takes away from efficiency in decision making (takes away from a unified chain of command), the letter states that there is no evidence of separation leading to better governance (true) or better financial performance (also true).

It goes on to argue, whether to separate the two roles or combine them, whether the chairman should be executive or non-executive are decisions that are best left to the company's and its shareholders. There are, of course, safeguards that are already in place: The provision of having 50 per cent independent directors, when the chair is executive is one example. And finally, there are less disruptive ideas like a lead-independent director if the role of the chairman and CEO are combined.

How many companies are impacted? The FICCI is battling a trend. Addressing media on November 20, Sebi's chairman said that only about a third of the companies still need to separate the two roles — implying that companies, for the most have begun acting on this. This is in line with data Russell Reynolds/Prime database/Conference Board have, showing that 345 of the 500 companies have this separation. The data is not explicit in whether the separation excludes executive chairman or "relatives", even so, it suggests that the issue is not as widespread as it is being made out — atleast not for the top 500, by number.

This data is no different from what we see in other geographies. More than 90 per cent of the Stoxx Europe companies have separated the two roles. In UK this split is for all practical purposes, mandatory. Even in the US, which for the longest have seen no merit in this, is changing. A recent article in *WSJ* finds that as of October 2019, there were 266 companies, or 53 per cent, in the S&P 500 index that have definitively split the two roles, according to a recent article in *WSJ*, up from 35 per cent in 2009.

What now

India Inc needs to fight the real elephant in the boardroom: The requirement that the chairman and managing director are not related. The regulation, in doing so is forcing families to make choices that they are not quite prepared to make — choosing a role — chairman versus managing director and choosing between different family members. Families must articulate what is the causing them anxiety. Perhaps then, the regulators can help them arrive at a workable solution. Merely riling against separation per se is regurgitating yesterday's debate.

The author is with Institutional Investor Advisory Services India Ltd.
Twitter: AmitTandon_in