Source : www.thehindu.com Date : 2022-02-22

L'AFFAIRE NSE: IS CORPORATE GOVERNANCE AN ILLUSION?

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

A case for effective governance | Photo Credit: Getty Images/iStockphoto

Over the past 10 days, the revelations about the functioning of the National Stock Exchange (NSE) during the tenure of Chitra Ramkrishna as Managing Director and Chief Executive Officer (CEO) have had people shaking their heads in disbelief. The savvy head of the one of the world's largest bourses taking guidance on organisational matters from a Himalayan yogi?

In his order, Securities and Exchange Board of India (SEBI) board member Ananta Barua makes short work of Ms. Ramkrishna's contention that there was no danger of any damage being caused to NSE as the yogi in question is a 'spiritual force'. He remarks with grim sarcasm, "I note that there is no exception in the Regulations or the SEBI Act or SCRA [Securities Contracts (Regulations) Act], that confidential information of the stock exchange may be shared with a spiritual force." It may be that, in this instance, the NSE did not suffer any financial costs through the leakage of confidential information. But the reputational damage caused to the NSE and to India's capital markets is huge.

Sharing confidential information was one serious lapse on the part of Ms. Ramkrishna. Mr. Barua's order highlights others. Ms. Ramkrishna appointed an individual, Anand Subramanian, first as chief strategic adviser and, next, as group operating officer without following due process.

Mr. Subramanian lacked the credentials for the job, the position was not advertised and Mr. Subramanian was interviewed solely by Ms. Ramkrishna. He was recruited on a salary that was more than 10 times what he last drew and his salary was frequently revised without any evaluation being recorded.

Mr. Subramanian was hired as a consultant and progressively given operational powers until he became virtual second-in-command in the NSE hierarchy. Ms. Ramkrishna ensured he was not designated as a key management person as that would have meant bringing Mr. Subramanian within the ambit of regulation.

Clearly, there was managerial misconduct at NSE. That is no surprise; managerial misconduct is a global phenomenon. That is why we need checks on management such as an effective board of directors. The bigger problem is that the board of NSE has been found wanting.

Explained I SEBI's order against former NSE CEO Chitra Ramkrishna

Mr. Barua documents the board's lapses. After the board was informed about the irregularities in Mr. Subramanian's appointment, it discussed the matter but chose to keep the discussions out of the minutes on grounds of confidentiality and the sensitivity of the matter. Second, despite being aware of Ms. Ramkrishna's transgressions, it allowed her to resign and on generous terms instead of taking action against her. Third, the Public Interest Directors (PIDs) failed to keep SEBI informed about the goings-on at the NSE.

How did all this happen and how could it have gone on for so long? The answers lie in the culture of the corporate world and the board room.

In the corporate world, much is forgiven on grounds of performance. When a performing CEO chooses to unduly favour a particular individual or individuals, boards see that as a forgivable infirmity. Considerations of equity or fairness do not trouble boards unduly — it is a mercy if breaches of regulation do.

The NSE ushered in a revolution at India’s stock exchanges. It rakes in enormous profits. In such a situation, boards would tend to think they can live with a degree of nepotism and other human failings in the CEO. ‘She’s doing a great job, she’s entitled to pick her team.’ Such an attitude may pass muster at your typical private sector company. Not so in a public institution which is a Market Infrastructure Institution (MII) because it amounts to a violation of regulations. The board of an MII must tell itself that there is little margin for error.

As for dysfunctional or ineffective boards, these remain the norm despite numerous regulations, seminars and papers over the past four decades. The issue is not the credentials of board members or their domain expertise. Few boards can match the set of luminaries who sat on the board of the NSE. The SEBI order says that these very luminaries failed to measure up.

The problem is structural. It has to do partly with the way board members are selected and partly with the absence of penalties where directors do not live up to their mandate. Board members are selected by top management (or, in India, by the promoter who is also top management). In leading companies and institutions, board memberships are lucrative, prestigious and carry attractive perks. Board members have every incentive to nod their heads to whatever the management wants done.

To challenge management is to ensure that one’s term is not renewed. It also means antagonising one’s colleagues on the board, not just the top management. The dissenting board member becomes an outcaste on the board — he will find it difficult to make conversation over lunch. In the closed club from which board members are drawn, word spreads that the dissenter is a ‘trouble maker’. Other boards will be reluctant to touch him.

As long as the top management selects all board members or can influence their selection, there is little hope of any active challenge to management. If we are to bring about meaningful change, we need to bring in diversity in the selection of board members.

The top management must be allowed to choose not more than 50% of the independent directors. The rest must be chosen by various other stakeholders — financial institutions, banks, small shareholders, employees, etc. Then, we will have independent directors who are not beholden to the top management for their jobs. They will be accountable, not to the top management, but to stakeholders who have appointed them.

Once that happens, the dynamics of the boardroom can be expected to change. Of course, we cannot be certain it will. At the NSE, there were five PIDs who were required to keep SEBI informed about any untoward happenings. They failed to do so. All we can say is that where independent directors are chosen by diverse stakeholders, there is at least the theoretical possibility of directors challenging the top management.

A second thing that needs to happen is holding board members accountable for lapses. In the NSE case, SEBI has penalised Ravi Narain who happened to be vice chairman. Mr. Narain has made the point that there is no reason why he should be singled out as the board of NSE was collectively responsible.

Regulators act against directors where there is financial malfeasance. They seldom act where there are breaches of regulation as in the present instance. This must change. Regulators must penalise errant directors through a whole range of instruments — strictures, financial penalties, removal from boards and a permanent ban from board membership.

Lastly, regulators themselves must be held to account. In the NSE affair, questions have been asked of SEBI. For instance, why did SEBI not seek the help of the cyber police to ascertain the identity of the yogi? SEBI needs to explain itself.

We need periodic independent audits of all regulators by a panel of eminent persons. The audits must evaluate the regulators' performance in relation to their objectives. The internal processes and governance mechanisms of regulators must be subjected to the glare of public scrutiny. It is vital to guard the guardians.

Convulsions of outrage after particular episodes will not take us very far. We need significant institutional reform if corporate governance is not to remain an illusion.

ttrammohan28@gmail.com

Our code of editorial values

END