

# A WELCOME REPRIEVE FOR INDIA INC. ON SPLITTING TOP ROLES

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

Sebi's two-year deferral presents firms with a chance to properly plan leadership succession

India Inc. will heave a sigh of relief as the Securities and Exchange Board of India (Sebi) has finally yielded to mounting pressure and deferred its 2018 directive to separate the roles of chairman and managing director in certain listed companies, which was earlier to come into effect from 1 April 2020. Sebi decided to defer the implementation of these norms to 1 April 2022 through a gazette notification published on 13 January 2020.

In May 2018, Sebi amended Regulation 17 of the Listing Regulations of 2015, by inserting a new clause, 1B. This required that India's top 500 listed companies by market capitalization have a chairperson who is a non-executive director and is not related to the managing director (MD) or chief executive officer (CEO). This followed a recommendation of the Sebi Committee on Corporate Governance, under the chairmanship of Uday Kotak. The rationale was that having the same person in both the roles of MD and chairperson of the board would limit the board's independence to question the management, and so the segregation of these powers would result in a better balanced governance structure and allow effective control over the management. Sebi accepted the recommendations and went further on some aspects, saying that separation of the two roles would be necessary to ensure high standards of corporate governance.

As it turned out, the majority of India Inc. did not see eye to eye with Sebi on this. Various representations from industry bodies, such as the Federation of Indian Chambers of Commerce and Industry (FICCI) and Confederation of Indian Industry (CII), were made to Sebi. FICCI said that a mere restriction on having related persons as chairperson and MD/CEO was inadequate to ensure effective board leadership, and that this decision should be left to the wisdom of shareholders. After all, they own the company and it is their capital that is at risk. Top industrialists such as Rahul Bajaj and Venu Srinivasan spoke out publicly against the move. Sebi stayed its course despite voices of dissent growing louder.

A number of promoters and companies were uncomfortable with the requirement that the chairperson had to be a non-executive director. These are typically accomplished people in their 50s-70s, often stalwarts, who are the largest shareholders in companies that they have been running as chairmen and MDs/CEOs for decades. Being told to significantly dilute their role in the businesses they built, by assuming non-executive positions of oversight, struck many as unduly harsh. Added to this woe was the requirement to have an MD/CEO who was not a relative. Promoters largely remain uncomfortable with professionals running "their" companies. Letting go is hard and emotional. The company is their life's work, their legacy. Perhaps a two-year transition was not enough. Having said that, at least a clear period was given to think deeply about such issues and start the journey. Where it ends is a personal choice involving their future in the company and that of the next generation.

The identity of a business has often been linked to the personal brand and reputation of its patriarch. When one suffers, the other does too. Recent corporate governance scandals have shown the risk of this nexus and the wisdom of the committee in trying to loosen or break it. This was what the committee referred to as the "Raja Praja" model, wherein the promoter was the "king" and the company was his kingdom. The committee recommended a "custodian"

approach, taking a more pragmatic approach towards all stakeholders. Hence, the need for separate and unrelated persons chairing the board and running the company's day-to-day affairs.

Nonetheless, in the wake of India's current economic deterioration and the need to keep compliance burdens low, Sebi relented and postponed the shift. The reason for the deferral has not clearly been outlined in its notification, but it seems to have been pushed from above.

Yet, to their credit, several listed companies have already implemented these measures in the spirit of voluntary compliance. However, many have not. Nseinfobase.com numbers show that at present, of the top 500 companies, the chairperson and MD/CEO is the same person in 162 entities. In 52 companies, the chairperson and MD/CEO are related. This suggests room for improvement, and potentially a sizeable number of professional MDs/CEOs can expect employment in large promoter-led companies soon. We anticipate that these companies will devote a significant part of their leadership focus and mindspace over the next two years to succession planning and its spillover effects on the same at the promoter family level. Promoter stakes may be moved into trusts as a means to consolidate power and control, and members of the next generation may see fast-tracked promotions.

While this deferral will bring respite to some, it must not be forgotten that this is only a deferral, and the rule will come into effect on 1 April 2022. This is an opportunity for companies to embrace new governance norms on a voluntary basis. Capital markets are increasingly seen to reward such corporate structures, unlike earlier, when it was primarily a regulator-driven approach. Perhaps it merits reflection by companies that are yet to split the chairperson/MD position, or have an executive chairperson, on whether they should make the switch voluntarily in the spirit articulated by the committee.

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