Investors must rethink their equation with some promoters

Although investors have recently voted out the CEO of two banks, they have yet to take a stand on promoter CEOs in the corporate sector. Even so, there are instances where the long-term interests of the company will be better served by a leadership change. Investors have been shy in rocking the boat - they should not be.

> *"Promoters do not have a divine right to stay in charge regardless of how badly they mismanage an enterprise nor do they have the right to use the banking system to recapitalise their failed ventures." – Raghuram Rajan, former Governor, RBI*

The banking sector has seen its fair share of Managing Director exits - several of these being unplanned and forced by either the regulator or the investors. The recent shareholder vote against the CEOs[1] of two banks, although rare, is a welcome change, given how

[1] *Managing Director and CEO are used interchangeably in this article*

poorly these banks have been performing. At a time when investors are getting increasingly vocal, will corporate India be next and promoter CEO heads roll?

One argument is that it is easier to let go of professionals seated as Managing Directors or CEOs, since there is a belief that another professional would do just as well. But this may not equally hold true for promoters. Having promoters in the driver's seat has generally been considered beneficial for companies because promoters have the most skin in the game. Because promoters have a generational view about business, there is reasonable balance between short-term and long-term objectives. Investors are hesitant in pushing out promoters because of the latent concern on whether the professional that takes over will have the same degree of ownership and foresight. These concerns would be allayed if investors believed the companies had a stronger board, or a strong leadership pipeline and good succession planning. Consistent engagement on these issues will perhaps build greater confidence in the organization structure.

When promoters are allowed to use the company for their personal gain and destroy shareholder wealth, it is the failure of the board to disassociate the interests of the company from its promoters and protect the company from its promoters. In such instances, investors need to step in – using their shareholder vote and by engaging with the company – to unseat the promoters and push for professionalization of management. The argument that if the promoters created the mess, they need to stick around to clean it up should come with a best before date. To this extent, investors have missed the opportunities to unseat promoters of a slew of companies, where performance has repeatedly faltered.

The Reserve Bank of India (RBI) has no qualms in cutting short the tenure of bank Managing Directors and it has done so for a few private sector banks in the past. RBI's discussion paper on governance in commercial banks has mandatory rotation of CEOs – 10 years for promoters and 15 years for professionals. While we disagree with a tenure-based rotation for CEOs, especially in banks that are well-performing, RBI's larger intent is compelling board to address succession planning and develop a leadership pipeline.

For the rest of corporate India, Fortis Healthcare Limited should serve as an example where the risk of uprooting the board and the promoters, at a time when there continued to be lack of clarity on the succession plan, paid off. The choice for investors was between knowing what would become of the company if the erstwhile promoters stayed, vis-à-vis taking a chance by replacing the board and hoping for a different but better, outcome. The new board was successful - albeit after several challenges - and has been able to stabilize the company, bring in a strategic partner as a promoter, and set the companies on the path to create shareholder wealth.

Institutional investors in India are caught between beating the index and doing the right thing - these can be at odds with each other, especially in the immediate. But in the longer run, Indian markets can attract quality capital only if there are clear expectations of corporate behaviour and errant promoters are punished by the market itself. Institutional investors must take the lead in setting both, performance and behavioural expectations from corporate leadership.

moneycontrol

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The attached article is a general commentary on the happenings observed in the securities market. An excerpt of this article was published on Moneycontrol.com.

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