“Still a long way to go-THE TATA INCIDENT SHOWS WHY THE JOB OF INDEPENDENT DIRECTORS IS SO CRiTICAL”

by S L Rao

  Cyrus Mistry was a manager selected after careful search and appointed Chairman of TATA sons. He had held the position for over four years. He was unceremonious sacked without notice or given an opportunity to be heard.

 Should a conglomerate like TATA have a “holding company” that sits over 100 or so companies in diverse businesses? What should be the relationship between the holding company and its ‘subsidiaries’? The holding company has other shareholders but control is effectively with the many TATA Trusts with 66% of the shares of TATA sons. They are represented in his lifetime by Ratan Tata. What proportions of shares of these 100 or so companies are owned by TATA sons? Can a major shareholder decide that the bottom line cannot be the priority? Is it lawful (not to say ethical) to sack anyone including the Chairman without notice and giving him a chance to be heard? Did TATA sons  approve acquisitions like Corus, or starting a Nano factory? (The British steel industry was notorious for its intractable left wing unions and huge pension liabilities; NANO started with a confusing product concept and at an untenable price). Ratan Tata persisted with loss making operations for years. What role did independent directors play in approving acquisitions or making major investments and did they review their performance? How could first time Firectors on the Board of TATA sons resolve to sack the Chairman without experience of working with? Did the Board lay down in writing the ethos and culture of the group that had to be followed by each company in  the group? Was their regular review of their  compliance?

Globally, corporate groups could encompass very diverse businesses (like TATA). Others might have companies with much narrower product focus. In well-established conglomerates all procedures are well set (brand strategy and positioning, human resource policies covering all aspects, close watch on talented human resources, financial management, technical parameters, treasury operations, etc). With the enormous diversity of products (electricity, wrist watches, chemicals, information technology, telecommunications, etc). it would be impossible to fit them all into one set of policies, except in the most generalized way. These would be Profit performance, return on capital, debt, market shares, market rteputation, etc, would be common parameters for all companies. However the survival of the company, its modernization and expansion, depend on the the performance of the bottom line. Other values, ethos and culture like  being good employers, keeping the company’s word, doing social good, etc, are expected from all companies. They must follow them while being focused on the financial performance. TATA was known as a great corporate citizen, as a good employer, doing much social good, with concern for employees, customers and environment. But they were mostly poor financial performers.

A diverse conglomerate could for all its companies have common financial parameters for evaluation, approve major investments, review their returns, keep and monitor the best talent in human resources, keep track of unused assets like land and buildings, have a common Treasury function, manage public and government outreach. But it must not get involved in product strategy and implementation.

The holding company must strictly follow shareholder rules and concern itself with adequate returns on investment for all. The Board of each subsidiary company must be supreme for it. It might have a nominee from the holding company. But there must be no outside agency to overrule the Chairman and Board of the subsidiary company.

Independent directors are only gradually beginning to appreciate their responsibilities. But they still have a long way to go before most behave truly independently. The Companies Act makes their duties and responsibilities clear. The Satyam and other incidents have further emphasized yhrm.  Fear of removal and loss of remuneration are no longer fears for independent directors. The Companies Act prohibits more than 2 terms of 5 years each. There are  age restrictions, adequate but not excessive eremunerations are specified, and annual evaluations of each director. Over time we will see directors behaving more independently.

But in many companies, major decisions are taken quickly and almost casually, Not all companies give full information to directors in time nor provide adequate time for discussion.  The law now provides for directors being called to account by regulators and Courts. The Satyam scam hurt the reputations of its directors.

But the Mistry episode suggests that independent directors in TATA sons took the decision to sack him, despite some directors being there for the first time. They voted for the decision without giving Mistry an opportunity to present his response. Some observers say that

My conclusion is that Mistry was sacked without notice or a chance to be heard. His reported faults were in trying to imnprove financial performance fo the company. His predecessor had sold TOMCO and Lakme, that represented TATA to the common man. Mistry was trying to deal with much bigger loss makers. Boards should give enough time and deliberation to major decisions. independent directors should make up their own minds after consideration and not defer to the views of the principal shareholders.  Culture and ethos are important and every company must state their own. They must not be used to give low priority to financial parameters of performance.