

# **Ingredients of Successful Succession Planning – Study in Respect of Select Pune Based Companies**

*Prepared by*

**Symbiosis Institute of Management Studies (SIMS), Pune**

*Supported by*

**National Foundation for Corporate Governance (NFCG)**

\*

**Brig (Dr) Rajiv Divekar (Retd)**

**Prof P K Rajagopal**

**Dr Pravin Kumar Bhoyar**

\*

**March 2017**

## Contents

<b>Sr No</b>	<b>Items</b>	<b>Page No</b>
1	Acknowledgement	3
2	About National Foundation for Corporate Governance	4 – 7
3	About Symbiosis Institute of Management Studies	8
4	Executive Summary	9 - 12
5	Chapter 1: Succession Planning	13 - 22
6	Chapter 2: Corporate Governance in India – Regulatory Framework	23 - 40
7	Chapter 3: Methodology	41 - 44
8	Chapter 4: Observations	45 - 55
9	Chapter 5: Recommendations	56

## **ACKNOWLEDGEMENT**

We would like to express our deep and sincere gratitude to National Foundation for Corporate Governance (NFCG) Delhi for their guidance and support in the completing the study.

We wish to express our warm and sincere thanks to Mr AVR Murty, CEO, ElectroMech Pune and Mr Kedar Phadke, Company Secretary, Thermax Bibcox Willcox Ltd Pune whose ideas and concepts have had a remarkable influence on our entire research work and their extensive discussions around our work and Brig (Dr) Rajiv Divekar (Retd), Director, Symbiosis Institute of Management Studies, Pune for his right direction in structuring and analysis of the research work.

We owe our most sincere gratitude to all the officials of 6 Companies in Pune region who gave us their whole hearted cooperation during our research.

During this work we have collaborated with many colleagues including Dr Dhiraj Deshpande and others for whom we have great regard, and we wish to extend our warmest thanks to all those who have helped us with our work.

## **About National Foundation for Corporate Governance (NFCG)**

With the goal of promoting better corporate governance policies in India, National Foundation for Corporate Governance (NFCG) was set up in the year 2003 by the Ministry of Corporate Affairs (MCA), in partnership with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI) to promote good Corporate Governance practices both at the level of individual corporates and Industry as a whole. In the year 2010, Institute of Cost Accountants of India (ICAI) and National Stock Exchange (NSE) and in 2013 Indian Institute of Corporate Affairs (IICA) were included in NFCG as Trustees.

### **Vision**

Be the key facilitator and reference point for highest standards of corporate governance in India

### **Mission**

- To foster a culture of good governance, voluntary compliance and facilitate effective participation of different stakeholders;
- To catalyse capacity building in new emerging areas of Corporate Governance.
- To further research, scholarship, and education in corporate governance in India;
- To create a framework of best practices, structure, processes and ethics;

### **Stakeholders**

**Ministry of Corporate Affairs (MCA):** MCA is primarily concerned with administration of the Companies Act, 2013, other allied Acts and rules & regulations framed there-under mainly for regulating the functioning of the corporate sector in accordance with law. The Ministry is also responsible for administering the Competition Act, 2002 which has replaced the Monopolies and Restrictive Trade Practices Act, 1969. Besides, it exercises supervision

over the three professional bodies, namely, Institute of Chartered Accountants of India (ICAI), Institute of Company Secretaries of India (ICSI) and The Institute of Cost Accountants of India (ICAI) which are constituted under three separate Acts of the Parliament for proper and orderly growth of the professions concerned.

**Confederation of Indian Industry (CII):** CII is a non-government, not for profit, industry led and industry-managed organization, playing proactive role in India's development process. CII works to create and sustain an environment conducive to the growth of industry in India, parenting Industry through advisory and consultative processes. A facilitator, CII catalyses change by working closely with government on policy issues, enhancing efficiency, competitiveness and expanding business opportunities for industry through a range of specialized services and global linkages.

**Institute of Chartered Accountants of India (ICAI):** ICAI is a statutory body established under the Chartered Accountants Act, 1949 for the regulation of the profession of Chartered Accountancy in India. The Institute has achieved recognition as a premier accounting body for the contribution in the fields of education, professional development, maintenance of high accounting, auditing and ethical standards.

**Institute of Company Secretaries of India (ICSI):** ICSI is a premier national professional body constituted under the Company Secretaries of India Act, 1980 to develop and regulate the profession of Company Secretaries. The Institute is functioning to develop high caliber professionals ensuring good Corporate Governance and effective management, thus contributing to society at large.

**The Institute of Cost Accountants of India:** The Institute of Cost Accountants of India was established by an Act of Parliament, namely, the Cost and Works Accountant Act, 1959. The institute was formed with the objectives of promoting, regulating and developing the profession of Cost Accountancy and is under the administrative control of Ministry of Corporate Affairs. The Institute is a founder member of International Federation of

Accountants (IFAC), Confederation of Asian and Pacific Accountants (CAPA) and South Asian Federation of Accountants (SAFA).

**National Stock Exchange of India Limited (NSE):** operates a nation-wide, electronic market, offering trading in Capital Market, Derivatives Market and Currency Derivatives segments, including equities based ETF, Gold ETF, and Retail Government Securities etc. It accounts for nearly 74% in Equity market and more than 98% market share in equity derivatives segment. Today NSE network stretches to more than 1,500 locations in the country and supports more than 2, 30,000 terminals. With more than 10 asset classes in offering, NSE has taken many initiatives to strengthen the securities industry and has launched several new products like Mini Nifty, Long Dated Options, Cross Margining, Currency and Interest Rate Derivatives, and Mutual Fund Service System. Responding to the evolving market needs, NSE has also introduced services like DMA, FIX capabilities, co-location and mobile trading facilities for various categories of investors. NSE is committed to operate a market ecosystem which is transparent and at the same time offers high levels of safety, integrity and corporate governance. NSE would continue to provide newer products and services to cater to the demands of the market participants and provide an efficient trading platform for the investors.

**Indian Institute of Corporate Affairs (IICA):** The Indian Institute of Corporate Affairs (IICA) was registered as a society on September 12, 2008 under the Societies Registration Act, 1860. An autonomous institute, IICA works under the aegis of the Ministry of Corporate Affairs to deliver opportunities for research, education, and advocacy. It is also a think tank that curates a repository of data and knowledge for policy makers, regulators as well as other stakeholders working in the domain of corporate affairs. Set up as the premier organisation that aims at providing astute and credible intellectual leadership in corporate regulation, governance and running sustainable businesses, IICA is a think-tank, capacity building and service delivery institute. Its work enables corporate growth, reforms and

regulation through synergised knowledge management, and global partnerships thus offering real-time solutions. IICA propels knowledge and training through its network of schools and centres. It has six departments and six hubs of excellence carrying this vision forward.

## **About Symbiosis Institute of Management Studies (SIMS)**

SIMS was set up in 1993 and in the year 2002, the Ministry of HRD, Govt. of India conferred on Symbiosis, the status of Deemed to be University. Symbiosis today comprises of 37 institutes imparting training in diverse disciplines. It has over 45,000 students who hail from all states of India and from 60 different countries. SIMS is a constituent of the prestigious Symbiosis International Deemed University and is accredited by the National Assessment and Accreditation Council (of the UGC) in November 2008. It is an ISO 9001:2008 quality certified management institute and a top-tier provider of business education across the spectrum. SIMS is also an accredited "Centre for Corporate Governance" of the 'National Foundation of Corporate Governance' (established by Ministry of Corporate Affairs and CII).

### **Vision**

Be the premier hub of management education for armed forces personnel and their dependents.

SIMS has been ranked 16th overall in all India ranking and 6th in the west zone by 'The WEEK' magazine in its November, 2012 issue. The rating score was computed taking into consideration broadly- the input value, value addition, learning ambience and brand value. The information was collected from various stakeholders like the corporate Human Resource Managers, current students, aspiring students etc. SIMS was adjudged 4 awards at 2nd Asia's Best B-School Awards organised by CMO Council held at Suntec, Singapore on 21st -22nd July 2011. Asia's Best B-School Awards in collaboration with CMO Asia & CMO Council, USA endeavours to pay a tribute to temples of learning & make a difference to the education fraternity. The event saw the participation of 29 countries including Australia, Hongkong, Singapore, UAE etc. SIMS has been ranked 20th in the India's Best B School Survey 2012 conducted by Business World.



## **Executive Summary**

“To build a successful business organisation takes sincere efforts of several persons but may get destroyed by a successor due to defective succession planning”

Symbiosis Institute of Management Sciences, Pune, affiliated to National Foundation of Corporate Governance, New Delhi took up a project to assess the practices followed in Indian Corporates on “Succession Planning”. Good succession planning is considered as a sign of Good Corporate Governance. “Succession planning” is vital for the sustainability and growth of a Corporate. If handled in an unplanned way it could disrupt the smooth trajectory of growth path. Planned well, a smooth transition results. Most of our big business houses are family-owned. As a result, succession planning was confined in most cases to select one from within the family. However, with globalization and increase in intensity of competition, things are changing. Even family held organizations are looking at outside leadership-sometimes even from outside the country. Perhaps the biggest succession story of our times is the instance when successor to Mr Ratan Tata was named/selected. Also is the recent case of an outsider Mr. Vishal Sikka succeeding Mr. Narayana Murthy to head Infosys Ltd. All sorts of debates, analysis and studies were made. So, it is worthwhile to take that as some sort of a bench mark and see how select Pune based companies are doing their own exercise.

It is wrongly believed that succession planning is needed only for the top management job/person. In fact, succession planning is required for every job/function/department. If an all-inclusive effort is made, It would also facilitate laying and showing the career path/progression to other younger employees in the organization. So, one can look at such

deliberate attempts to think, plan and execute successor at lower levels in the selected firms taken up for study.

**The objectives of the project are to evaluate the following practices -**

- How family owned business and others deal with succession
- Why board diversification is accepted but not CEO from outside
- Justification for family representative as CEO
- Ownership and accountability
- Confusion in age and succession planning
- Widening of family interests and its impact
- Profit centre head vs strategic thought process
- Mapping future operating and leadership skills to meet competitive advantage
- Training / mentoring in leadership development process
- Weakness assessment for succession
- Assessment criteria followed
- Time span estimates
- Policy on insider vs outsider and bench marking internal against external market for talent
- Policy on external support from specialised agencies
- Past experiences and future planning

The project was executed by SIMS in Pune region. The nature of the research was an exploratory research with paramount focus on primary data collected in form of interviews. In all 6 companies were selected that fulfilled the prerequisites for the study. Extensive interviews were carried by the investigators; Brig (Dr) Rajiv Divekar (Retd), Prof Rajagopal and Dr Pravin Kumar Bhoyar. The study of the project was limited to the planning process followed in respect of the following persons only, as they are considered vital for Corporate

Governance. The succession planning was checked on certain selected parameters. The following key parameters were used to create a check list

- i. Promoter succession plan – To understand to what extent the ownership vs control issues are addressed.
- ii. CEO succession plan – To understand whether mere just fill up the gap or even addressing the changes in business cycle and changing growth strategies are addressed.
- iii. Key Management Personnel
- iv. From Within or outsider
- v. Time gap
- vi. Familiarisation programme, and training
- vii. External agency support
- viii. Assessments and data base
- ix. Past experiences and risks
- x. Role of Nomination and Remuneration committee

Our results show that a clear succession policy is in place in all selected companies and these companies were more comfortable on succession from within and they were conscious of the seriousness of the succession planning process and did not consider it as a mere fill in the gap compliance.

Our recommendations are skewed towards improving succession planning is to review performance of persons in critical areas to consider succession, build good database and /or support agencies in order to find the best suited person, review actual performance of persons even after orderly succession, transparency and periodical communication by way of disclosures to minimise stakeholders queries, Periodically review the succession policy.

Succession policy should reckon disruptions if any which may arise due to estate and wealth succession issues which will affect business successors.

Chapter 1 gives an introduction to Succession Planning followed by Chapter 2 which highlights the corporate governance regulatory framework in India. In chapter 3 the investigators discuss the method of research and selection of key parameters. Chapter 4 the investigators discuss the observations of the study followed by recommendation in chapter 5.

Date: 11<sup>th</sup> March 2017

Brig (Dr) Rajiv Divekar (Retd)

Prof P K Rajagopal

Dr Pravin Kumar Bhoyar

## **Chapter 1 –Succession Planning**

“I like to see succession as an opportunity for change. Every organisation, I believe, needs a booster every 7-10 years to take it to the next level” – *R.Seshasayee, Ashok Leyland Ltd*

“In the few boards where I have worked, I always found that only those nominations committees that are pretty serious about getting a broader database can really produce a good board. In the end it is all about getting the best fit.”- *N.Vaghul – Former Chairman ICICI Bank Ltd.*

“What we have seen is that if you actually respect your board and don’t use it merely for compliance purposes, only then will you be able to invite individuals who can play active and contributory roles on your board.” – *Arun Nanda –Mahindra Mahindra.*

“If succession planning at the board level is done with truly valuable inputs to the board, it will ultimately be very good for the board and for the company”- *Adi Godrej – Godrej Industries Ltd.*

“We need to be sure we are focusing on the right issues – are we grooming shareholders who have the controlling interest or are we looking for the right successor, who knows the business and is the best person to be appointed.” – *Hemendra Kothari – DSP Black Rock Investment Managers.*

“Ultimately, if you want your company to be sustainable over a period of time, it will have to turn into a broad- managed company. There is no escaping this fact.”- *Harsh Mariwala – Marico Industries Ltd.*

“We are often asked by our global leadership about our last audacious appointment. The idea is to break the mould, find the nuggets and gems within our people and test them out.”-

***Ranjit Shahani – Novartis India***

“The biggest scarcity in the world is great general managers. What is in large supply is great functional leaders...There are very few companies that bring it together and get those functional leaders into positions where they can become potential CEO’s of large, complex, geographically dispersed businesses”- ***Dayten Ogden – Spencer Stuart – World’s leading executive search consulting firm.***

“The skills required to run a business are quite different from those required to run a board. Somebody who runs a board badly can do more damage to the company than almost anything.” – ***David Kimbell, Spencer Stuart - World’s leading executive search consulting firm.***

GE is well known for its exhaustive and systematic approach to identifying and cultivating its business leaders. Yet it’s not just the CEO and Chairman whose roles are important to the success of the company. Succession planning is an integral part of the business continuity plan throughout GE. And leaders help grow other leaders, and are expected to aid in the cultivation of their own replacements.

As GE Capital mentioned in Succession or Failure: Why Succession Planning is Key to Long Term Success - Succession planning flows naturally from their comprehensive and integrated talent management. Business leaders are held accountable for the growth of their people. Their succession plans are the result of a continuous assessment of the skills, experience, and expertise needed to meet their most pressing business challenges. This takes an honest and thorough evaluation of their people, as well as leaders who get excited by the idea of spotting and nurturing their best people and cultivating GE’s future leaders. Succession planning should be proactive, not reactive, and a natural outgrowth of performance management and leadership development. Reviewed and recalibrated

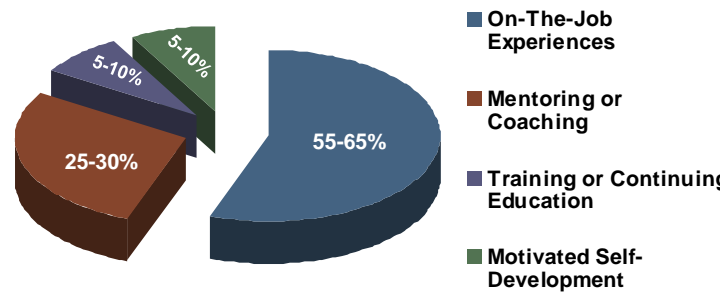
regularly, succession plans can help reinforce and perpetuate core organizational values and ensure the future success of the company.

Josh Bersin (October 26, 2011, Leadership Strategy, Succession Management), Succession Management at IBM Contrasted with Apple and HP, has mentioned that IBM's talent management process (which is detailed in their case study of IBM's Talent Strategy) is very mature, integrated, and global. At the executive level the company takes development planning and succession very seriously. In general, however, our research shows that only 19% of the large organizations they surveyed have a business-integrated strategy to identify and develop high-potentials. Almost half the companies they surveyed have an ad-hoc or locally managed approach – or no approach at all.

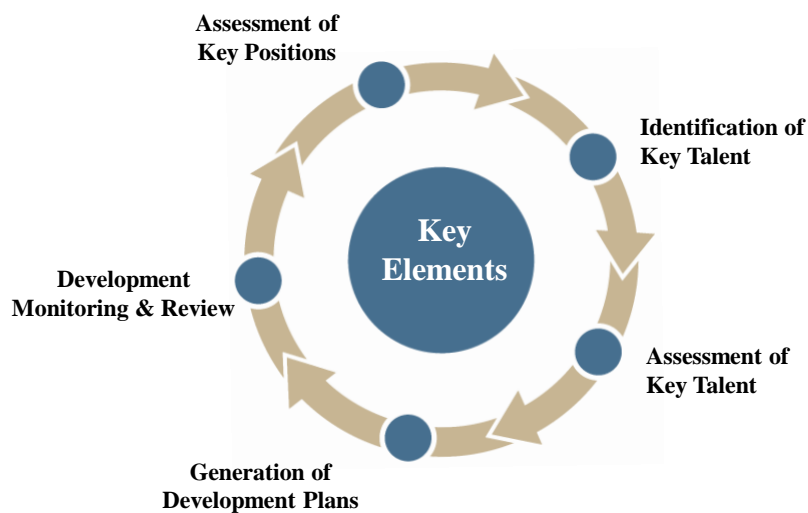
Apple ex-CEO and founder Steve Jobs planned his succession for years, and built a large library of instructional and multi-media materials to help continue his legacy. Tim Cook, his successor, was also groomed for many years. In this case there were likely other candidates, but it was clear to the outside world for quite some time that Tim Cook was Jobs' replacement. But unlike IBM, where Palmisano stood aside calmly at the peak of his career, Mr. Jobs chose to work right up until his death. This is an admirable and inspirational approach, but it does not calm shareholders, customers, and employees. Apple stock has dropped about 6% since this transition took place, and most Apple watchers are nervous about what will happen next. Also there research shows that deep and serious succession plans for top executives are critical to business continuity. CEOs play a vitally important and very difficult role. They must lead the organization forward, drive internal execution and operating success, and communicate strategy to outside stakeholders. In some cases and outside CEO brings important new skills and perspective to the company (Lou Gerstner was one of the most successful CEO's in decades, and he came into an IBM in the 1980s which was insular and struggling). But in most cases companies benefit greatly from building leadership internally – this develops candidates who have

deep understanding of the business, know the company culture, and can calm investors and customers.

## FOUR LEVERS FOR LEARNING



## Succession Planning: Key Elements





## **Global Practices**

### **OECD requirements:**

Principle VI (D) (3) of the “OECD principles of Corporate Governance” states “Responsibilities of the Board” requires the Board to oversee Succession Planning.

Purpose is to ensure that the Company does not suffer due to a sudden, unplanned for gap, in its leadership and ensure successful succession transition.

They also emphasised the important role “Independent Directors” can play in succession planning.

### **United States:**

Succession Planning is not mandated.

Shareholders can require companies to disclose and vote on the Succession Plan of listed companies.

Viability of a mandatory disclosure at periodic intervals to the Board / Shareholders is being considered.

### **United Kingdom:**

UK Corporate Governance Code recommends that the Board should satisfy itself that plans are in place for the orderly succession for appointments to the Board and to Senior Management.

Guiding principles of Corporate Governance lists Succession Planning as one of the guiding principles.

### **Japan:**

Japanese Ministry for economy, trade and industry (METI) will survey 2,500 listed companies to “determine the state of their succession planning,” the *Financial Times* reported on September 8, 2016.

Japan has “a glut” of listed as well as privately owned companies run by aging members of the founding families. Many lack a next-generation member with the skills or the desire to take over, the *FT* report noted.

**Some expert views on OECD recommendations on Succession Planning:**

**Annotation to OECD Principle VI.D.3:**

In two tier board systems the supervisory board is also responsible for appointing the management board which will normally comprise most of the key executives.

**Selecting and replacing management:**

“CEO selection is the board’s most important role. Before selecting a CEO, the board should agree on the company’s strategic direction and needs for the future, as the CEO’s job is to be successful at pursuing the company’s strategy.

A CEO is bound to fail if there is a mismatch between the skills, abilities and style of the CEO and where the company needs to go. Although the board may choose to overlook the CEO’s pursuit of a different strategy when the company is successful, this cannot be ignored when the CEO is not successful.

For example, if a board is concerned about the company’s lacklustre performance over a long period of time, the non-executive directors should discuss in ‘executive session’ (i.e. without senior management present) whether the incumbent CEO understands the board’s concerns and is moving to address them. The board should also consider whether the company is pursuing the most effective strategy. If the CEO is pursuing a strategy that is different to the one the board wants, and is not achieving the agreed-upon results, that CEO is the wrong person for the environment the company is in and the board should move to replace him or her.

Some companies may require a CEO who steps down to also retire from the board because of power and control issues – in particular, former CEOs are often perceived to be unable to truly step aside, to relinquish to their successors their former responsibilities and relationships with management. This can undermine the new CEO as he or she seeks to establish their position in the company. It can also foster problems with board dynamics if

the former CEO tries to control the agenda rather than letting their successor do their job. Former CEOs can often make difficult directors where their former companies are concerned.

Retirement can take place either immediately or after a short transition time. It is best if a succession plan is implemented that allows a successor candidate to join the board 6 months to 12 months prior to the retirement of the CEO. This allows the successor candidate and the board to have increased exposure to each other and the issues of the board to facilitate a smooth transition.” - Michele Hooper

“When interviewing potential CEOs, the board should ask the CEO how he or she expects to work with the board. Many boards also present potential CEOs with a list of board responsibilities and see how they react.” - Jack Krol

“Where two companies merge and the CEOs of the merging companies assume positions in the merged entity, it is important that those executives share a strategic vision for the merged entity. If not, the board should remove one of the executives as soon as possible.” - Anonymous Contributor

“An effective working relationship between the board and the CEO is one of the keys to board effectiveness – this is often a question of chemistry and succession planning. The CEO and the board should understand each other’s roles and responsibilities, and the CEO should be forthcoming with information. Maintaining a good relationship can be challenging, as the board must still be able to fire the CEO when required.” - Red Wilson

### **Selecting and replacing management in developing countries:**

“The power of the board to select and replace senior management is still conceptual and theoretical in some developing countries. In these countries, this power in fact resides with controlling shareholders, who select senior management based on professional competence and personal loyalty to the major shareholders; these choices are then ‘rubber-stamped’ by boards. The gap between theory and practice must be narrowed, but it will take time.” - Jesus Estanislao

“Replacing the CEO is one of the board’s most difficult tasks. For example, a board attempting to replace an imperial-type CEO may be rebuffed by the CEO and told that the board does not have the power to fire him or her.” - Ira M. Millstein

### **Succession planning in family-controlled companies:**

“Succession planning in companies that are controlled by families can be complicated by the fact that members of the family may have different ideas about suitable successors. The board of a family-controlled company can help streamline the process by adopting a succession planning policy that requires family members and incumbent senior executives to consider succession planning as an ongoing priority issue. The board should also adopt broader policies addressing human resources and employment of family members.” - Jesus Estanislao

“At family-controlled companies, the independent directors should work with the family to develop a succession plan. This may be a gradual process. If a dominant family member is not willing to talk about succession, the independent directors should gently press the issue to develop a mechanism over time, like ‘water dripping on a rock.’” - Jack Krol

“Succession planning in many family-controlled companies is primarily an issue to be resolved by the family, with minimal involvement by independent directors. In addition, in some developing countries, CEOs are often considered dispensable (this applies even to favourite sons and daughters) and succession planning is not a high priority for the board. However, succession may be accorded a higher priority at some family-controlled companies. For example, the first generation owner of a company works hopped succession ideas at a director education course he attended – he knew that other family members were not interested in running the company and wanted to consider other options well in advance of his retirement.” - Charnchai Charuvastr

### **Selecting and replacing management in state-owned enterprises:**

“The CEO of a state-owned enterprise is generally selected by the government, which may also assume responsibility for firing the CEO. It is often unclear what the role of the board is

– if any – with respect to management selection and removal at a state-owned enterprise.

“Claude Lamoureux

“Succession planning should occur through development of a modern enterprise system based on teamwork, rather than grooming an individual successor. This is particularly important in state-owned companies, which may experience abrupt changes to the top one or two executives in the company – depth in the management team should reduce the impact of such changes. However, developing a modern enterprise system in some developing economies can be challenging where there is a dearth of professional managers.” -

Anonymous Contributor

### **CEO selection and removal in the two-tier board system:**

“In a two-tier board system, the supervisory board can make decisions with respect to CEO selection and removal, without requiring participation by the management board. Supervisory boards should have the ability to make management dismissal decisions quickly. Conflicts can arise between employee directors and shareholder-elected directors in situations where shareholder-elected directors propose people to executive positions who are not personally known to the employee directors, for example, people recruited from outside the company. Employee directors often want to become familiar with potential managers before approving appointments – indeed, some employee directors will not make a personnel decision based purely on a curriculum vitae.”- Dr. Roland Koestler

“It may be difficult for a supervisory board to remove a CEO who has the support of the employee directors on the board, even if the CEO does not have the support of the remainder of the board and the shareholders of the company. Boards that cannot replace management when required and deal effectively with unions run the risk of falling behind with respect to global competitiveness.” - Red Wilson

### **Board familiarity with the management team:**

“Senior officers should be invited to board and committee meetings where appropriate to make presentations and respond to director questions. However, the practice may be discouraged by CEOs who fear erosion of their perceived status and authority within the organisation.”- Dr. N. Balasubramanian

“The board should encourage interaction with management teams outside of formal settings to increase management visibility to the board. Good relationships between boards and management are important, particularly as the board should be familiar with the management team and be comfortable with the talent coming through the organisation for succession planning purposes.

For example, a board may wish to hold a board dinner the night before each board meeting, at which one or two members of senior management give short presentations followed by informal discussions between management and the board (including questions and answers). This will permit board members to get to know high potential and senior executives through less formal discussions than can be had in the boardroom.” - Michele Hooper

### **Evaluating the CEO:**

“The board should be responsible for evaluating the CEO and should work with the CEO to develop an evaluation process. The independent board chair or lead director should drive the process. For example, the board leader could develop an evaluation form by asking each director for ideas on what a ‘model CEO’ should look like. The board leader may then ask each board member to list the main strengths of the company’s CEO and the major areas that the CEO can improve on for his or her development. The board leader should synthesise the information gathered and use it in evaluation discussions with the CEO. The board should avoid using outside consultants to evaluate the CEO”. Jack Krol

## **Chapter 2 – Corporate Governance in India – Regulatory Framework**

### *Evolution of Corporate Governance in India*

Poor governance and lack of transparency was attributed to the Asian crisis. This set a trigger for inculcating good corporate governance practices in India. The key differentiator in running a business in Asia was the ownership model. Majority of the companies were family run businesses. Such family run businesses were biased towards other family members resulting in funnelling of corporate gains. India has far surpassed other Asian countries in terms of corporate governance. The Companies Act 1956 has been the foundation of Corporate Governance and Accounting Systems in India. New amended law i.e., The Companies Act 2013 has incorporated several provisions for the first time and penalties specifically on Corporate Governance principles to be followed not only by listed companies but also by non-listed companies. Rules regarding disclosures on Related Party transactions, Role of Independent Directors, internal control procedures, rotation of auditors, whistle blowing mechanism etc. are some of them. Since liberalization wide-ranging changes were brought about in the laws and regulations relating to the financial markets. The single most important development has been the establishment of Securities and Exchange Board of India (SEBI) in 1992. SEBI has played a crucial role in establishing the basic minimum compliance norms for corporate governance by listed companies<sup>3</sup>.

### *The CII trigger*

The initial corporate governance framework was initiated by CII in 1996. A National Task Force was set up under the Chairmanship of Rahul Bajaj, past President of CII and presently Chairman of the Bajaj Group. The Task force made a number of recommendations relating to board constitution, role of non-executive directors, role of audit committees and others.

The committee submitted its Code in 1998.

### ***SEBI and Kumar Mangalam Birla Committee***

In 1999, SEBI set up a committee under the Chairmanship of Kumaramangalam Birla, to suggest suitable recommendations for the Listing Agreement of Companies with their Stock Exchanges to improve the existing standards of Corporate Governance in the listed companies<sup>1</sup>. The committee emphasized on composition of the Board of directors, disclosure laws and share transfers. The committee found that accountability; transparency and equal treatment of all stakeholders are the key elements of corporate governance and hence create a code of governance considering then market conditions. The Code was accepted in 2000 by SEBI and incorporated into a new Clause 49, which was inserted into the Listing Agreement of Companies with their Stock Exchange.

**The below material is taken from the NFCG report titled, “Corporate Governance Practices and Financial Performance of Selected Family Managed Companies in India”.**

#### ***Clause 49 of the Listing Agreement***

The provisions of this Clause are applicable to all entities seeking listing approval and having a paid up capital of Rs. 3.0 crore and above or a net worth of Rs. 25 crore or more at any time in the history of the company. The provisions contained in Clause 49, took effect in phases between 2000 and 2003 as described later in this chapter.

#### ***RBI Advisory Group headed by Dr. R H Patil***

The recommendations of this Group which were submitted to SEBI in 2001, covered some more codes and principles of private sector companies including consolidation of accounts incorporating performance of subsidiaries, criteria of independent directors and disclosures.

#### ***N R Narayan Murthy Committee***

In 2002, SEBI constituted another committee under the Chairmanship of N R Narayan Murthy the then Chief Mentor of Infosys Technologies Ltd., to further streamline the



provisions of Clause 49. Based on the recommendations of the Committee SEBI revised some sections of the Clause in August 2003 and later once again after further deliberations in December 2003.

In October 2004, SEBI published a revised Clause 49, relating to corporate governance, which set forth a schedule for newly listed companies and those already listed to comply with the revisions. Major changes in the Clause included amendments /additions to provisions relating definition of independent directors, strengthening the responsibility of Audit Committees and requiring Boards to adopt a formal Code of Conduct. Later the date for compliance with these new provisions was extended to December 2005, since a large number of companies were unprepared to fully implement the changes.

**In January 2006, SEBI issued some further clarifications on Clause 49 which included:**

1. The maximum time gap between board meetings of listed companies to be increased from three to four months.
2. Sitting fees paid to non-executive directors would not require the previous approval of shareholders
3. Certifications of internal controls and internal control systems by CEOs and CFOs would cover financial reporting only. The revised Clause 49, came into effect on January 13, 2006.

Further amendments were made in some of the provisions of the Clause in July 2007 which dealt with quarterly reporting. SEBI made it optional for companies to either present an unaudited or audited quarterly result and year to date financial results to Stock Exchanges within one month from the end of each quarter. If the option is to present unaudited results then the results will be subject to limited review and the report will have to be submitted to SEs within two months from the end of the quarter.

***National Voluntary Guidelines for Social, Environmental and***

***Economic Responsibilities of Business – July, 2011***

These form a refinement over the earlier 'Corporate Social Responsibility Voluntary Guidelines, 2009 and are designed for all businesses irrespective of size, sector or location.

**The Guidelines have nine basic principles:**

- I. Businesses should conduct and govern themselves with Ethics, Transparency and Accountability
- II. Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycles
- III. Businesses should promote the wellbeing of all employees
- IV. Businesses should respect the interests of and be responsible towards all stakeholders, especially those disadvantaged, vulnerable and marginalized
- V. Businesses should respect and promote human rights
- VI. Businesses should respect, protect and make efforts to restore the environment
- VII. Businesses when influencing public and regulatory policy should do so in a responsible manner
- VIII. Businesses should support inclusive growth and equitable development
- IX. Businesses should engage with and provide value to their customers and consumers in a responsible manner

***The Companies Act 2013***

The Companies Act, 1956 provides the legal framework for corporate entities in India. The Act has made provisions for some aspects of corporate governance which include number, role, powers, duties and liabilities of directors and restrictions placed on them. Other provisions include number and frequency of board meetings, rights of minority shareholders, maintenance of books of accounts and development of accounting standards, audit obligations and report of auditors. Since 1956, as many as 24 amendments have been made in the Act providing statutory provisions relating to corporate governance.

Several major amendments had been proposed in the Companies (Amendment Bill) 2003.

As a first step of the review a Concept Paper on Company law was drawn and put up on the

electronic media for opinions and suggestions from all interested parties. The need was to bring about harmony between SEBI's Clause 49 provisions and those of corporate governance in the Companies Act.

### *Preliminary*

Some of the new definitions introduced refer to One Person Company, An Associate Company, Small Company, Employee Stock Option, Promoter, Related Party, Turnover, Chief Executive Officer, Chief Financial Officer, and Global Depository Receipt.

### *Matters relating to Incorporation of a Company*

**Declaration by the Director:** Within this list of amendments, the major one is the declaration by a director in a prescribed form that the subscribers have paid the value of shares agreed to be paid by them and a confirmation that the company has filed a verification of its Registered Office with the Registrar.

### *Accounts of Companies*

**Scope of Directors' Report Widened:** The 2013 Act recognizes that books of accounts may be kept in electronic form. Balance Sheet and Profit & Loss Account have been defined collectively as Financial Statements. Along with financial statements, consolidated financial statements of all subsidiaries and associate companies shall be prepared and laid before the AGM. This disclosure of consolidated financial statements will bring to light all transactions done by the listed company with its subsidiaries and give an opportunity to minority shareholders to question suspect dealings with the associate companies. The scope of the Directors' Report has been widened to include additional information like number of board meetings, policy of the company relating to appointment of directors and their remuneration, explanation or comments by the board on every qualification, reservation or remark or disclaimer made by the company secretary in the Secretarial Audit Report, particulars relating to loans, guarantees, investments, etc. The Directors' Responsibility Statement in case of a listed company should include additional statement relating to

internal financial controls and Compliance of all applicable laws. These provisions have placed greater responsibility on the directors in the areas of loans and investments, appointment of directors and their remunerations, explanations with regard to audit qualifications, and commitment on internal controls and compliance with all types of regulations. Directors' Report and Directors' Responsibility Statement being part of the published annual report will make all the shareholders aware of the decisions taken by the board in these key areas of governance and any shortcoming can be challenged by the shareholders and investors.

**Corporate Social Responsibility:** Every company having a net worth of Rs. 500 crore or more or turnover of Rs. 1,000 crore or more or a net profit of Rs. 5.0 crore shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors (at least one being an independent director). The committee will recommend the CSR policy of the Board. The Board of every such company must ensure that in every financial year the company spends at least two percent of the average net profit of the company made during the three immediately preceding financial years in pursuance of the CSR policy. Failure to do so needs to be reported with reasons thereof in the Directors' report. This move to make CSR compulsory for certain high net worth companies will ensure that this function of giving back to the Society is taken more seriously and made sustainable by the promoters and directors of the company . Earlier it was treated as a mere compulsion with some funds channelized in this direction. With the passing of the 2013 Act there will be a commitment to ensure that a certain percentage of profits flow into CSR activities every year. This is an excellent provision in the direction of inclusive growth and social sector reforms.

#### ***Audit and Auditors***

**Rotation of Auditors and Audit firms:** The 2013 Act provides for compulsory rotation of individual auditors every five years and of audit firm every ten years for listed and certain

other class of companies. A transition period of three years has been provided to comply with this provision.

**Prescription of Auditing Standards:** Central Govt. will prescribe the auditing standards as recommended by the Institute of Chartered Accountants in consultation with the National Financial Reporting Authority.

**Responsibilities of Auditors:** Auditors have to comply with auditing standards. Certain new provisions for disqualification of auditors have also been prescribed. Partner or partners of the audit firm and the firm shall be jointly and severally responsible for the liability, whether civil or criminal as provided in the Act or any other law. If any fraudulent practice civil or criminal, by the auditors is proved the Audit partner/partners and the firm are punishable. The prescriptions for Auditors and their compulsory rotation every five years together with compliance to auditing standards recommended by Institute of Chartered Accountants of India, will ensure complete transparency in the internal workings of companies in order to avoid any future Satyam like scams.

#### *Appointment and Qualification of Directors*

**Appointment of Independent Directors (IDs):** One of the major criticisms of the current policy of appointment of Independent Directors is that the promoters exert tremendous influence in determining and appointing Independent Directors. This issue has been addressed by making it mandatory for all listed and certain other class of companies to constitute a Nomination and Remuneration committee consisting of three or more Non-Executive Directors of which not less than half should be Independent Directors. The Committee has to consider candidates for appointments as IDs and recommend them to the Board. The 2013 Act also proposes the formation of a Databank of IDs from which suitable persons may be selected. This is expected to bring in greater objectivity in to the process of nomination of IDs and preclude the influence of promoters on them. The 2013 Act prescribes that at least one-third of the directors on the Board should be IDs. This is a

departure from the prevailing norms wherein half the directors had to be independent in case the company has an Executive Chairman or he is related to the promoter of the company. This represents a dilution from the existing position. The 2013 Act also provides for at least one woman director on the Board.

**The definition of an ID has been considerably tightened:** The definition now includes positive attributes of independence namely that the Director should be a person of integrity and possess relevant expertise and experience in the opinion of the Board. Central govt. is also vested with powers to prescribe qualifications of IDs. Every ID is required to declare that he or she meets the criteria of independence. Participation of minority shareholders in the appointment of IDs has been kept non-mandatory.

**Directorship in not more than 20 companies:** The number of companies in which a person can be a director has been increased from 15 to 20. Of the 20, he cannot become a director in more than 10 companies.

**Role and Functions:** Section IV of the 2013 Act lays down the code which sets out the role functions and duties of the IDs and also those relating to their appointment, resignation and evaluation. These prescriptions make the role of the IDs quite onerous and could enhance the level of monitoring of the listed companies which is so crucial for good governance practices. **Liability of the IDs:** The 2013 Act limits the liability of the ID only in respect of acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes and with his consent or connivance or where he had not acted diligently.

**Remuneration:** In a break from the earlier norms, an ID is entitled only to fees for attending meetings of the boards and possibly commissions within certain limits. The 2013 Act expressly disallows IDs from obtaining stock options. Companies may find it difficult to get directors of the requisite caliber unless they are appropriately remunerated.

**Tenure:** To ensure that IDs maintain their independence, the term of their tenure has been prescribed. The initial term is prescribed as five years following which further appointment would require a special shareholder resolution. The total tenure shall not exceed two consecutive terms. All the provisions relating to IDs, their appointment procedures, their liabilities, tenure, role and functions are in the right direction and place greater responsibilities on the IDs which was very vital for ensuring greater board independence. Limiting the liabilities of IDs to acts which have occurred with his knowledge or in his presence, provides a safeguard mechanism for the ID who need not be held liable for all Board decisions, even those taken without his presence. Mandatory constitution of Nomination and Remuneration Committee, Stakeholders Relationship Committee and CSR Committee means that the IDs and Non-executive Directors would be more involved in the operations of the company and would have to take greater interest in the appointment of Directors and key management personnel. They will also have to be more engaged with all the stakeholders and resolve grievances of all security holders. *Meetings of Board and its Powers*

**Audit Committee:** Composition of the Audit Committee has been changed. The committee shall now comprise of three minimum directors, majority of them being Independent Directors. Majority of them should also be having the ability to read and understand financial statements.

**Vigilance Mechanism:** Every listed company and such other class of companies shall have a vigilance mechanism in the prescribed manner.

**Stakeholders Relationship Committee:** Every company which has more than 1000 shareholders, debenture holders or deposit holders shall constitute a Stakeholders Relationship committee consisting of a Chairman who is a non-executive Director and such others as may be decided by the Board.

**Disclosure of Interest by a Director:** This has been made mandatory and not discretionary as was there in the Companies Act of 1956. Even in case of a Private Company an interested

director cannot vote or take part in the discussions relating to any matter in which he is interested.

**Investments by a company:** A Company, unless otherwise prescribed, shall not make investments through more than two layers of investment companies subject to certain exemptions.

**Related Party Transactions:** No approval of Central Govt. is required for entering into any related party transactions. No approval of Central govt. is required for appointment of any director, or any other person to any office or place of profit in the company or its subsidiary. Certain new Related Party Transactions are provided in the 2013 Act which requires approval of the Board. The 2013 Act provides for certain new matters which are to be transacted by the Directors at their Board meetings only.

**Insider Trading:** The Act already had a provision relating to prohibition on forward dealing in securities of the company by a director or key management personnel. The 2013 Act now provides the provisions for prohibiting insider trading in the company. All these provisions are aimed at strengthening the supervision mechanism of the company by the regulators, strengthening the powers of the Board especially the Ids and above all prohibiting fraudulent transactions with related parties for which the Board is made responsible.

#### ***Appointment and Remuneration of Managerial Personnel***

**Managing Director/Whole Time Director/Manager:** These appointments have to be approved by a General Meeting by special resolution instead of ordinary resolution. The 2013 Act provides for provision related to Secretarial Audit in certain prescribed companies and also prescribes the functions of the Company Secretary. This ensures greater involvement of shareholders in key appointments on the Board and management.

#### ***Inspection, Inquiry and Investigation***

Central govt. will set up a Serious Fraud Investigation Office (SFIO) for investigation of frauds relating to a company. The affairs of a Related Company can also be investigated by



the inspector. If a fraud is reported Central govt. is empowered to file an application to the Tribunal for appropriate disgorgement of such assets, property or cash and for holding of such director, key management personnel, officer or other person liable personally without any limitation of liability. SIFO however can act if and when someone has lodged a complaint or someone has initiated an enquiry.

### ***Corporate Governance Rating***

Rating of practices of Corporate Governance and Value Creation for its Stakeholders is being carried out by leading Rating Agencies like CRISIL. This type of rating helps the companies greatly as an unbiased evaluation of the company's corporate governance practices is carried out by an outside and reputed agency and an appropriate Rating Certificate is given. The Company can use this certificate for raising finance from the market as well.

With the introduction of Companies Act 2013 wherein Corporate Governance regulations were incorporated, it was felt that the Listing agreement between the listed company and the listed entities in itself was felt insufficient to have a force of law.

Therefore a simplified version of listing agreement for listing of shares was introduced from Dec.1, 2015 and Corporate Governance Regulations covered under erstwhile Clause 49 of listing agreement was replaced with Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015 (LODR Reg).

Briefly the important provisions of LODR Reg. are:

1. Chapter II having Regulation 4 lists the principles governing disclosures and obligations of listed entity.
2. Regulation 4(1) explains the principles.
3. Reg. 4(2) explain what all a listed entity shall comply with the corporate governance provisions as specified in chapter IV which shall be implemented in a manner so as to achieve the objectives of the principles as mentioned below.

**a. The rights of shareholders:** The listed entity shall seek to protect and facilitate the exercise of the following rights of shareholders:

1. Right to participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes.
2. Opportunity to participate effectively and vote in general shareholder meetings.
3. Being informed of the rules, including voting procedures that govern general shareholder meetings.
4. Opportunity to ask questions to the board of directors, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.
5. Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors.
6. Exercise of ownership rights by all shareholders, including institutional investors.
7. Adequate mechanism to address the grievances of the shareholders.
8. Protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and effective means of redress.

**b. Timely information:** The listed entity shall provide adequate and timely information to shareholders, including but not limited to the following:

1. Sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be discussed at the meeting.
2. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership.
3. Rights attached to all series and classes of shares, which shall be disclosed to investors before they acquire shares.

**c. Equitable treatment:** The listed entity shall ensure equitable treatment of all shareholders, including minority and foreign shareholders, in the following manner:

1. All shareholders of the same series of a class shall be treated equally.
2. Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors, shall be facilitated.
3. Exercise of voting rights by foreign shareholders shall be facilitated.
4. The listed entity shall devise a framework to avoid insider trading and abusive self-dealing.
5. Processes and procedures for general shareholder meetings shall allow for equitable treatment of all shareholders.
6. Procedures of listed entity shall not make it unduly difficult or expensive to cast votes.

**d. Role of stakeholders in corporate governance:** The listed entity shall recognise the rights of its stakeholders and encourage co-operation between listed entity and the stakeholders, in the following manner:

1. The listed entity shall respect the rights of stakeholders that are established by law or through mutual agreements.
2. Stakeholders shall have the opportunity to obtain effective redress for violation of their rights.
3. Stakeholders shall have access to relevant, sufficient and reliable information on a timely and regular basis to enable them to participate in corporate governance process.
4. The listed entity shall devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

**e. Disclosure and transparency:** The listed entity shall ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the listed entity, in the following manner:

1. Information shall be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.
2. Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by users.
3. Minutes of the meeting shall be maintained explicitly recording dissenting opinions, if any.

**f. Responsibilities of the board of directors:** The board of directors of the listed entity shall have the following responsibilities:

**I. Disclosure of information:**

1. Members of board of directors and key managerial personnel shall disclose to the board of directors whether they, directly, indirectly, or on behalf of third parties, have a material interest in any transaction or matter directly affecting the listed entity.
2. The board of directors and senior management shall conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture of good decision-making.

**II. Key functions of the board of directors-**

1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans, setting performance objectives, monitoring implementation and corporate performance, and overseeing major capital expenditures, acquisitions and divestments.
2. Monitoring the effectiveness of the listed entity's governance practices and making changes as needed.

3. Selecting, compensating, monitoring and, when necessary, replacing key managerial personnel and overseeing succession planning.
4. Aligning key managerial personnel and remuneration of board of directors with the longer term interests of the listed entity and its shareholders.
5. Ensuring a transparent nomination process to the board of directors with the diversity of thought, experience, knowledge, perspective and gender in the board of directors.
6. Monitoring and managing potential conflicts of interest of management, members of the board of directors and shareholders, including misuse of corporate assets and abuse in related party transactions.
7. Ensuring the integrity of the listed entity's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
8. Overseeing the process of disclosure and communications.
9. Monitoring and reviewing board of director's evaluation framework.

### **III. Other responsibilities:**

1. The board of directors shall provide strategic guidance to the listed entity, ensure effective monitoring of the management and shall be accountable to the listed entity and the shareholders.
2. The board of directors shall set a corporate culture and the values by which executives throughout a group shall behave.
3. Members of the board of directors shall act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the listed entity and the shareholders.
4. The board of directors shall encourage continuing directors training to ensure that the members of board of directors are kept up to date.

5. Where decisions of the board of directors may affect different shareholder groups differently, the board of directors shall treat all shareholders fairly.
6. The board of directors shall maintain high ethical standards and shall take into account the interests of stakeholders.
7. The board of directors shall exercise objective independent judgement on corporate affairs.
8. The board of directors shall consider assigning a sufficient number of non-executive members of the board of directors capable of exercising independent judgement to tasks where there is a potential for conflict of interest.
9. The board of directors shall ensure that, while rightly encouraging positive thinking, these do not result in over-optimism that either leads to significant risks not being recognised or exposes the listed entity to excessive risk.
10. The board of directors shall have ability to step back to assist executive management by challenging the assumptions underlying: strategy, strategic initiatives (such as acquisitions), risk appetite, exposures and the key areas of the listed entity's focus.
11. When committees of the board of directors are established, their mandate, composition and working procedures shall be well defined and disclosed by the board of directors.
12. Members of the board of directors shall be able to commit themselves effectively to their responsibilities.
13. In order to fulfil their responsibilities, members of the board of directors shall have access to accurate, relevant and timely information.
14. The board of directors and senior management shall facilitate the independent directors to perform their role effectively as a member of the board of directors and also a member of a committee of board of directors.

IV. **Having explained the principles, Chapter IV lists the obligations.** Some important provisions are as follows :

1. Reg 17(1) refer to composition of the Board
2. Reg 17(2) refer to minimum number of meetings of the board
3. Reg 17(3) refer to review of law compliance reports
4. Reg 17(4) is relevant for this paper which read as under :

**The board of directors of the listed entity shall satisfy itself that plans are in place for orderly succession for appointment to the board of directors and senior management**

5. Reg 17(5) refer to Code of Conduct
6. Reg 17(6) refer to remuneration to non-executive directors
7. Reg 17(7) refer to minimum information to be placed before Board as specified in Part A of Schedule II
8. Reg 17(8) refer to CEO CFO compliance certificate to Board as specified to Part B of Schedule II
9. Reg 17(9) refer to Risk Assessment , minimising and monitoring procedures
10. Reg 17(10) refer to performance evaluation of Independent Directors by the Board.
11. Reg 18 refer to constitution and functioning of Audit Committee and minimum information to be reviewed by Audit Committee as stated in Part C of Schedule II
12. Reg 19 refer to constitution and functioning of Nomination and Remuneration Committee and its role as stated in Part D of Schedule II.
13. Reg 20 refer to constitution and functioning of Stakeholders Relationship Committee and its role as stated in Part D of Schedule II.
14. Reg 21 refer to Risk Management committee for top 100 listed companies.
15. Reg 22 refer to Vigil Mechanism
16. Reg 23 relate to Related Party Transactions and how to deal with them.

17. Reg 24 relate to Corporate Governance requirements with respect to subsidiary of the listed company.
18. Reg 25 refer to Obligations with respect to Independent Directors
19. Reg 26 refer to obligations with respect to employees, including senior management, key managerial persons, directors and promoters.
20. Reg 27 refer to other Corporate Governance Requirements. Discretionary requirements are stated in Part E of Schedule II.

Corporate Governance regulations in India is therefore covered under 2 statutes. First in terms of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015 covered under listing agreement entered by listed companies with Stock Exchanges and regulated by SEBI and also through provisions in the Companies Act, 2013.

In the year 2003 Narayana Murthy committee in its report to SEBI had recommended regulation for CEO succession policy initially recommendatory and made mandatory after 4-5 years.

While the listing agreement in terms of erstwhile clause 49(II) (D)(6) has made it mandatory in 2014 to disclose existence of a succession policy of the company in its Annual Report, the Companies Act is silent on this issue of Corporate Governance.

Initially the listing agreement proposed to declare the Succession Policy but it was not mandated by SEBI considering the confidentiality in the matter and adverse public comments. All that was mandated in LODR regulations was that the Board should satisfy itself that plans are in place for orderly succession for appointments to the Board and to Senior Management.



Bombay Stock Exchange announced in February 2016 that they are in collaboration with International Finance Corporation (IFC), Washington, a member of the World Bank group for developing a “CG Scorecard” for Indian Corporates. 30% weightage has been to responsibilities of the board with 19 questions and maximum 38 marks is expected to cover succession planning policy.

### **Chapter 3 – Methodology**

The primary objective of the study is to identify the ingredients of successful succession planning in select companies in Pune region. The investigators adopted **exploratory research method** for the investigation with emphasis on primary data collected using questionnaire and interviews. 10 pointers were circulated before visiting the company representatives. As the study related to the subject of Corporate Governance, it was felt that the Company Secretary shall be ideal person to discuss and reveal the practices followed than the HR department. This is because of his close proximity to Board proceedings and being compliance officer for Corporate Governance and listing requirements.

6 Companies were short listed and then visit was undertaken to their office.

Detailed discussion with the persons concerned were taken up and practices followed and reasons therefore were noted, analysed and captured to conclude on the issues raised in the objective of the study.

1<sup>st</sup> was an unlisted large joint venture between a EURO company and its Indian Partners in the area of Infrastructure development.

2<sup>nd</sup> was a listed company in the service industry relating to business of Software development and/or Information Technology. Market cap of the company is over Rs.40000 crores.

3<sup>rd</sup> was also a listed company engaged in manufacturing activity of high quality engineering products / machinery for over 90 years. Market cap of the company is over Rs.1200 crores.

4<sup>th</sup> was also a listed company engaged in manufacture of 2 & 3 wheelers and existing over 90 years. Market cap of the company is over Rs.80000 crores.

5<sup>th</sup> was a listed company in engineering industry established in 1979 who have faced several succession problems and the latest being in family due to sudden death of the promoter.

6<sup>th</sup> was also a mid-cap listed company in consumer products manufacturing in full control by the start-up promoters.

### ***Sample Size and Distribution***

The investigators set a sample size of 6 companies which satisfied the requirements for the study. Among the 6 companies, 4 were companies whose shares are listed in Indian Stock Exchanges. 4 of the 6 were Large Cap companies. All had PE investments. All companies were pertaining to manufacturing sector while 2 companies were representing real estate sector. IT and Services industries were also included as a category but the investigators did not find companies fitting the research criteria for the aforementioned sectors. The investigators have not mentioned the names of the companies confirming to the confidentiality request made by the target companies.

### ***Parameters for Evaluation***

The researchers identified the following parameters for analysis

I. Promoter succession plan – To understand to what extent the ownership vs control issues are addressed.

II. CEO Succession plan – To understand whether mere just fill up the gap or even addressing the changes in business cycle and changing growth strategies are addressed.

III. Key Management Personnel

IV. From Within or outsider

V. Time gap

VI. Familiarisation programme, and training

VII. External agency support

VIII. Assessments and data base

IX. Past experiences and risks

X. Role of Nomination and Remuneration committee

1<sup>st</sup> Unlisted entity was clear about the importance of succession planning for board members and KMP's. Transparency and disclosures were minimal and the JV partners reserved the right to nominate / replace as and when need arose. There were very few changes in the past 3 years on Board member succession.

As regards KMP's there has been attrition and in all cases which occurred there has been smooth transition and in no way it has affected the operations or growth path of the company.

2<sup>nd</sup> listed company in the software business informed us of the following:

Have 10 directors

Have declared 4 KMP for compliances under SEBI (LODR) Regulations, 2015. No changes have happened to KMP's in the recent past of over 5 years.

While preferred succession are from within the board is open to induction from outside with persons having more management capabilities and taking the company to the next level.

While existing board members , who are broad based and KMP's who are competent exist, regular review by Nomination and remuneration committee of the succession policy and capability assessment of persons concerned is being addressed as an ongoing policy to avoid disruption in succession.

3<sup>rd</sup> listed company also faced succession problems 2 decades back and its effect and therefore are conscious of the same and all steps are taken to prevent such occurrences.

No major transition problem has occurred in the recent past on succession to board members.

Nomination and remuneration committee of the board is conscious of its responsibility on succession and so far addressed the issues smoothly.

As regards KMP succession, it has been noted that attrition was minimal. Wherever occurred has been a smooth transition. Though in one case it resulted with replacement from outside and not within, during the transition the second line in command was competent to hold on till replacement happened. Thus it never affected a smooth transition.

4<sup>th</sup> was also a listed company. Discussion with them revealed some vital issues on the subject which are worth considering in this study:

- CEO succession was from the family controlling the business
- The board is very broad based with very experienced and responsible members whose guidance and support have taken the company to overcome various challenges affecting the industry
- Minimal attrition in KMP is the highlight.
- Sufficient second line strength will never make replacements as and when it will occur disrupting the functioning of the company.
- Smooth transition occurred in KMP changes in the past
- Board member changes were also minimal and were smooth transitions
- For both new board members and KMP's it was felt no training system exists as the selection itself were of very well experienced and competent persons, who hardly require any training. Necessary familiarisation programmes are organised for their benefits
- Successor in both board members and KMP's more than functional capabilities exposure to new challenges in the industry and experience in, restructuring issues, M&A's strategic management aspects are given more importance.
- Gap between the vacancy and induction of new incumbent was minimal

- Nomination and remuneration committee headed by experienced Independent Director with full support of the board members and long experienced Chairman, maintain, review and update a broad-based list of suitable incumbents for consideration at appropriate time and need.
- Ownership vs control aspect of promoters have also been addressed for the next generation successor smoothly without affecting the family control.
- Entire functional authority is not limited to the owner/family controlled person but a whole-time director has also been inducted to share the implementation aspects of board decisions.

## **Chapter 4 – Observations**

- A clear succession policy is in place in all companies depending on their size and activity levels.
- As stipulated in the listing agreement the board only states in the Annual Report existence of the policy and do not disclose beyond for confidential reasons.
- Companies were more comfortable on succession from within except in specialised areas of function.
- Shying away from outsider induction is both due to fear of losing control and sometimes also due to fear of losing values.
- Outside succession is preferred only to take advantages of their exposure to leadership qualities, latest governance challenges and special skills like risk management, for both board members and also KMP's.
- Most of the companies were conscious of the seriousness of the succession planning process and did not consider it as a mere fill in the gap compliance.

- Nomination and remuneration committee review need for changes in succession policy and also maintain a broad database and update it with assistance from board members
- Past successions experiences and the succession policy facilitated smooth transition.
- Past generation change and its effect on succession and its impact, how affected and difficulties faced, were in sharp memory for being not repeated.
- Lack of taking calculated risks and not owning accountability found in present generation managers, who wish to share successes only is the primary reason for not offering CEO succession from outside.
- Reasonable, adequate and not disproportionate compensation compared to skills is a factor reckoned for selection.
- Focusing on future needs not past accomplishments in today's changed business landscape look for leaders with different skills.
- Leadership matters but performance is what counts.
- More than the individual, succession leads to business succession.
- Annual review of succession for all critical position was being felt as necessary. Though done regularly is being improved upon.
- Succession planning is felt as a deliberate and systemic effort to ensure leadership continuity in key positions and retain and develop intellectual and knowledge capital for the future which will ensure sustainability and effective performance of the organisation.

### **Researchers Observations on their Comments –**

#### **I. Promoter / Directors succession plan:**

**Expected:** Statement of existence of succession policy as mandated will be mentioned. There will less transparency on periodicity of assessment though the issue is discussed in Nomination and remuneration committee meetings and also of the meetings of the board. As regards Independent Directors regular review in accordance with law and selection process is by the board in close consultation with the promoters.

**Actual:** As expected it was noted that all 6 companies surveyed accepted existence of succession policy which also cover promoter succession also. Only existence of policy and not the policy is disclosed. 4 out of the 6 companies stated that at least once a year discussion of promoter succession is taken up. However 2 of the 6 companies never made any commitment on regularity of the review.

**Deviation:** No material deviation than expected.

## **II. CEO Succession Plan:**

**Expected:** Where the CEO is not promoter or their relative adequate review and succession plan shall exist for smooth transition of succession. In other cases issues covered in 12.1 above shall apply.

**Actual:** In 3 of the company's adequate succession plan to meet contingencies exist where CEO's were not promoters or not relative of the promoters. In the other 3 companies where promoter or their relative is CEO no clear policy or periodicity of review by Nomination and remuneration committee exists.

**Deviation:** No material deviation.

## **III. Key Management Personnel:**

**Expected:** As compared to promoter/CEO succession there will be more transparency in the plan of succession. Regular review of process take place in the meetings of Nomination and remuneration committee and Board meetings.

**Actual:** All the companies were conscious of the disruptions in the respective functions headed by relevant positions which could affect business continuity and growth. Hence there is regular review of succession issues of KMP's in the meetings of the Nomination and remuneration committee and of the board which have helped in smooth transitions.

**Deviation:** No material deviation was noted.

## **IV. From Within or Outsider:**

**Expected:** Though companies are engaged in training programmes of the KMP's mostly succession from outside than by promotion from inside is adhered to.

**Actual:** 3 of the companies had met succession issues from within in certain cases but in all other cases and for other 3 companies as regards KMP's outside succession were preferred to avail advantage of new skills for better growth of the business but all were conscious of the importance of retaining values and importance of that factor in selection of candidates.

**Deviation:** No material deviation noted

## **V. Time Gap:**

**Expected:** Not more than 6 months have elapsed from vacancy and succession of promoters/ directors and also Key management personnel

**Actual:** In all the 6 companies surveyed the 6 month time gap was adhered to.

**Deviation:** No deviation exist.

## **VI. Familiarization Program and Training:**

**Expected:** Companies will have a familiarisation programme for new incumbents (Directors / KMP's) on succession. They also could be arranging leadership training programmes.

**Actual:** All companies have familiarisation programmes for new persons on succession. Except for gaining knowledge of their functions no leadership training programmes are arranged. In 2 large cap companies, it was felt that as regards Independent Directors, they are of such experience and dynamism with which only they have been selected and obviously does not qualify for any training.

**Deviation:** Exist but not material as it is found that is the standard practice.

## **VII. External Agency Support:**

**Expected:** External agency support is not taken for Directors succession except may be for by way of due diligence. For KMP external support of specialised agencies are taken to avail best choices.



**Actual:** It was noted that expert external agencies have been utilised only for limited purpose of due diligence cases and that too not in all cases in the companies surveyed. However as regards KMP's where inside replacements were not met outside support was sought to make better choices.

**Deviation:** No material deviation was noticed.

### **VIII. Assessments and Database:**

**Expected:** Assessments as required in terms of the listing agreement for all directors is maintained. Database for KMP's are maintained and periodically reviewed by Nomination and remuneration committee.

**Actual:** All companies comply with the legal requirement of periodical evaluation of all directors and KMP's. Nomination and remuneration committee also maintain sufficient database for replacements of KMP's and also rely on database of outside agencies.

**Deviation:** No material deviation was noted.

### **IX. Past Experiences and Risk:**

**Expected:** The companies would have faced succession issues which affected smooth transition and would be remembered to improve succession policy to overcome risks which cannot be planned.

**Actual:** All the companies were conscious of the past difficulties faced by them and also by others in the corporate world and confirmed that it made them review the succession policy. Risks being risks which cannot be avoided but can only be better controlled and managed to avoid serious disruption in the growth of the business. 2 companies faced promoter succession 2 other faced CEO succession issues but none faced Independent director or KMP succession issues.

**Deviation:** No material deviation occurred.

### **X. Role of Nomination and Remuneration Committee:**

**Expected:** The role of Nomination and remuneration committee of the board with Independent Directors are active and engage in the succession planning and related issues.

**Actual:** 5 of the 6 companies have very active nomination and remuneration committee who cover succession issues of KMP's including non-promoter CEO's and Independent Directors but though the succession policy is in existence the question of promoter succession is least discussed and transparent an issue. However they make regular disclosures to the stock exchanges of the resignations and changes to be transparent and avoid stakeholders' queries

**Deviation:** No material deviation was noted.

Our observations tabulated in matrices- Succession Planning On a scale of 1 to 5 scale based on the regulations the observations of each company on all the 10 pointers were recorded to arrive at a weighted average:

SI No	Pointers	Company 1	Company 2	Company 3	Company 4	Company 5	Company 6	Average
1	Promoter/Director	4	5	4	5	4	4	87%
2	CEO	4	5	4	5	4	3	83%
3	KMPs	4	5	4	5	5	3	87%
4	Within/Outsider	4	5	3	5	4	3	80%
5	Time Gap	5	5	5	5	5	5	100%
6	Familiarization/Training	4	5	3	5	4	3	80%
7	External Support	3	4	4	4	4	3	73%
8	Assessments Database	3	5	4	5	5	3	83%
9	Past Experiences/ Risk	3	5	4	5	5	4	87%
10	Nomination/ Remuneration Committee	3	5	5	5	5	4	90%

- The companies have seriously considered “succession policy” as a factor of governance and not a mere compliance requirement.
- The serious impacts of disruption in business is known and recognised by the corporate.
- Frequent attrition attitudes and seeking disproportionate compensation vis-a-vis the skills have been an impediment in selection of candidates from outside.
- Though not mandated some companies are transparent and make regular disclosures on resignations and reappointments than others.
- All the companies have a Nomination and Remuneration committee who regularly review concerned issues
- More than the person, focus of the companies were on capability of the person to achieve goals as the criteria for successful succession planning.
- More than the issue of from within or from outside the companies are conscious of shared values as the criteria when selecting persons and avoid those whose values are conflicting.
- A proactive succession policy and transparency has also helped build confidence of other stakeholders and in particular trust of other employees.
- The companies are conscious of the fact that succession planning is irrespective of the aging factor and is prepared to face the challenges any time.
- Most of the companies were confident of their addressing the issue of succession as there were minimum queries on the issue from other stakeholders.

**The best scenario felt was:**

- Have a detailed succession policy
- Periodically review the succession policy
- Succession policy should reckon disruptions if any which may arise due to estate and wealth succession issues which will affect business successors.
- Review performance of persons in critical areas to consider succession
- Build good database and /or take support from specialised agencies

- Review actual performance of persons even after orderly succession
- Transparency and periodical communication by way of disclosures to minimise stakeholders' queries.
- Succession in board appointments are generally close secrets and confidentiality maintained.
- However in selection of Independent Directors besides compliance factors like acceptability by other stakeholders like lenders, PE investors is kept in mind.
- CEO and KMP like functional heads succession is often discussed in the board meetings as they are very critical and may affect growth path and may result in disruptions due to sudden exit.
- Though second line persons or sometimes persons above the persons exiting is asked to shoulder the responsibility, it often is limited to a short period until suitable incumbent is recruited.
- Reason being, knowledge level and number of years of experience alone were not considered the criteria for promotion to fill senior posts falling vacant. Leadership qualities and acceptability by internal customers come in the way.
- Attitude towards ability to take decisions, owning up to failures, and not looking for support from top, is a leadership quality many managers fail to imbibe during their course of experience as managers.
- Small and mid-level companies struggle to maintain market share by internal improvement and sometimes by acquiring technology. They keep away from attempting to grow by acquisitions for the reason of their acceptance of not being able to handle different cultures which could detrimentally affect integration of the organisations for combined growth and take benefit of synergies.

Inability to fill vacancies from outside is equally challenging due to dearth of getting suitable candidates due to various factors like location of the unit, not high growth business even if profitable, disproportionate compensation commensurate to the job responsibilities etc.

## **XII–Importance of the laws of succession in succession planning:**

In the course of discussions with the representative of companies visited it was also brought to the notice that despite the planning process, the laws of succession has a dominant role to play in the planning process.

Successor of controlling shares has a role in succession of control on management. If the controlling shares are held by a person or family, the successor to the controlling shares by default become the successor of the control over the board. Hence how succession of controlling interest result is necessary to be understood before an effective planning can take place.

The laws in India is clear. If the person having control on the shares dies intestate i.e., without creating a will, the laws of inheritance will come to play by default. If however a will is created, the person/ persons named in the will be the person entitled to the property which include controlling shares of the person making the will, in the eventuality of happening of death of creator of the will. If however the person dies without making a will i.e., a case of intestate, the laws of inheritance will automatically come to play and the persons entitled to the shares to the property and / or shares of the company as per the law will be so entitled. Details of the laws in force in India are explained hereunder.

While Corporate Governance practices call for competence as the criteria for succession, the laws of succession has no such criteria. Criteria in a will is the wish of the person making the will and the criteria in the case of applicability of law the descendants, as per the law. Hence the remuneration committee considering the succession planning process of the promoter directors in particular (not necessarily in the case of professional CEO succession without ownership control) have to reckon the legal provisions which will come to play in the eventuality of succession of ownership and the consequent succession of control on the Board.

Brief laws as applicable in India on the issue of succession are as follows:

1. For the Hindus Jains Sikhs and Buddhists provisions of Hindu Succession Act, 1956 will apply.
2. For Muslims, The Muslim Personal Law (Shariat) Application Act 1937 will apply.
3. For all other faiths Indian Succession Act, 1925 will apply. Special provisions for Parsis are contained in Section 50 to 56 of this Act and for Christians and Jews are contained in Sec.31 to 49 of the Act.
4. However in the case of Inter faith marriages, provisions of Special Marriage Act, 1954 will apply.

It should be noted that the aforesaid laws will apply only in the cases of a person dies intestate or without making a will. Merely making a will naming an executor and not detailing the distribution of property also invite application of the laws for succession.

While all the laws are Union Laws applicable to the whole of India, certain states have made amendments to the law as may be applicable to their States. Tamil Nadu, Maharashtra, Andhra Pradesh and Kerala have amended the laws including rights of women coparceners.

## Chapter 5 – Recommendations

These recommendations are based on observations during the assessment of six companies on succession planning in their respective companies. The following are the recommendations for improving the existing succession planning process –

1. The present regulation of merely stating that there exists a policy without giving any further details requires modification by way of more disclosures at least of the review steps and periodicity taken by the nomination and remuneration committee.
2. Auditor’s observations on the adequacy of the succession planning policy.

Suggested changes in the regulations to bring out changes in reporting on succession planning are as follows:

**1. SEBI LODR Regulations, 2015 be amended to cover a clause on the following lines:**

“The Board of the company shall record its satisfaction on the review made on the adequacy by the Nomination and remuneration committee review on CEO and Board members succession planning.”

**2. Auditors certificate to members on Corporate Governance in the Annual Report to include a clause on following lines:**

“In our opinion and to the best of the information and explanations given to us the board of the company have recorded its satisfaction on the review made on the adequacy by the Nomination and remuneration committee review on CEO and Board members succession planning.”



## **Annexure I - Organizations Associated with Succession Planning**

1. Succession or failure – GE Capital
2. Succession management in IBM
3. BSE Corporate Governance Scorecard

\*\*\*\*\*