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Study of Bifurcation in Chairman and CEO Designation – A Recommendation of Kotak Committee

Vijaykumar Madhukar Wankhede*
Assistant Professor, Department of Management, Godavari Foundation's Godavari College of Engineering, Jalgaon, India

***Abstract*: Structure of boards of directors has taken prominent position in recent times. It is propagated to separate position of Chief Executive Officer and Chairman. Boards of Directors are envisaged in managerial roles. Effectiveness diluted due to dual role exercised by same executive. Family run businesses manifest inclination to bifurcate roles to certain extent. However, entrepreneurship entails capabilities beyond professional sphere.**

***Keywords*: Business Strategy, Corporate governance, Independence, Promoters.**

1. Introduction

To ensure enhanced corporate governance practices, market regulator Securities and Exchange Board of India (SEBI) has mandated a transparent separation within the roles of chairperson and director. The additional provisions also say that the chairperson should be a non-executive director and not related to the managing director or the CEO.

The new provision will come to force on April 1, 2020, and is predicted on the recommendations made by the Kotak Committee.

In most Indian promoter-led companies, the posts of chairman and director are interlinked. Promoters say the committee didn't recommend that the 2 posts shouldn't be related and hope the order gets deferred by 2-3 years.

The rule, which applies to top-500 Indian companies by market capitalization, mandates that the posts do not overlay and are delineated from one another. Nseinfobase.com (run by Prime Database) numbers show that currently, of the highest 500 companies. In 52 companies, the chairperson and managing director/CEO are related.

Venu Srinivasan, chairman of TVS Motor, says the benchmarking isn't correct. "The rule is not fair. Family-owned businesses cannot always be targeted. We should either follow the provisions of the corporate Law Board or the SEBI ruling. SEBI cannot issue its own guidelines. Globally, promoters have little or no stake within the company," he says.

Corporate top bosses feel that despite the hands-on actions taken by promoters, the SEBI notification may be a let-down.

In many promoter-led companies, families have reduced their individual stakes and moved the shareholdings to trusts, thereby encouraging more entities to be a part of the company's shareholding structure. Godrej Industries is a recent example. The Godrej family has transferred part of its ownership in the company to trusts; a move which is likely to simplify succession planning

A top Mumbai-based industrialist says businesses are run on guts, instinct, and entrepreneurship. "Some of the best businesses build in the country have been promoter-led. Too much process-thinking and bureaucracy ruin it. But yes, ethics too must be part of the culture while doing business," he says.

The Confederation of Indian Industry (CII) has also written to the Centre highlighting the very fact that the businesses Act 2013 had left it to the shareholders to make a decision on this issue and it shouldn't be within the sort of a diktat.

Confederation of Indian Industries president Vikram Kirloskar says the board of a company is best placed to determine the need for a separate or combined chairman and managing director/CEO role keeping in mind the character of the corporate, its business segments, competition profile, and other related matters. "It is vital that Indian entrepreneurs aren't placed at an obstacle position by imposing such requirements," he says.

RPG group chairman Harsh Goenka says the suggestion that chairman and director shouldn't be related may be a bad idea. "I don't see merit in it. It's the prerogative of the board to make a decision on the chairman and director. In fact, promoters are more invested, search for long-term growth, and work towards the great of the corporate," he says.

A. Debate over balance of power

Experts feel the first reason behind the SEBI directive might be to urge more professionals into the company framework instead of let families run the whole show. It will also encourage a way of professionalism within the working of a corporation.

Today, many family-run businesses face succession and ownership challenges. At a worldwide level, most European countries and therefore the US don't encourage this type of a separation of roles. In the UK, the market provides a thumbs-

*Corresponding author: wankhede22@gmail.com

down to the present practice.

"Why shouldn't Mukesh Ambani be CMD of Reliance? He is an excellent director and has managed to steer the board and make great value," says Goenka. "But I think separation of CMD roles is a good idea," he adds.

However, Securities and Exchange Board of India (SEBI) chairman Ajay Tyagi says the regulations were advised in May 2018 to be made pertinent from April 2020 and adequate time has been given to implement the same. "Extending the deadline will only mean that corporates don't want to do it,"

The idea was to form people understand and plan for it. If the role of the chairman which of management are separated, there are often a balance in power, responsibilities, and decision-making. Of the top 500 companies, I believe two-thirds are already meeting the prerequisite," he said.

Srinivasan of TVS says regulations should be stringent, but easy to follow. "To benchmark, why do we need to look at declining economies? Instead, relate it to developing or emerging markets," he says.

B. The way forward

Amit Tandon, founding father of corporate-governance and proxy-advisory firm IiAS, says there's no evidence that companies, where the role of the chairman is separated from that of the CEO, do better. But the rationale to separate the 2 posts is that the roles of the chairman and CEO are different. "The chairman sets the schema for the committee meeting, questions the robustness of the business tactic and its conventions. The CEO sets the strategy and implements it.

Separating the roles requires months of planning. Plan A is to ask for SEBI's decision to be kept in abeyance. Should the regulator not comply with postpone the choice, businesses got to have an idea B, says Tandon.

"The roles of chairman and managing director should be not related as, historically, the promoter families have behaved as 100 per cent owners of cash flows, though they owned only part-shareholding in the listed company. That's where problems with related-party transactions are available. SEBI is ensuring that the minority shareholders' interests are taken care of," says Shriram Subramanian, founding father of InGovern Research, a proxy-advisory firm.

Public confidence in professionals is lesser than the family members in most promoter led companies. The role of the family and the head of family is very important, which is borne out by the fact that majority of family businesses have been producing higher growth than their non-family peers. In addition, the younger generation is educated from a very early age to take on the reins of the company in due course of time.

For listed companies, SEBI can mandate additional regulations, which may not be a part of the Companies Act," says Pranav Haldea, managing director of Prime Database.

According to him, the real test shall be in its execution and whether it is followed only in letter or in spirit.

2. Literature Review

SEBI had recently amended Regulation 17 of the SEBI LODR Regulations 2015 by inserting a new clause (1B). The clause requires that top 500 listed companies in terms of market capitalization should have a Chairperson who (i) is a non-executive director; and (ii) is not related to the Managing Director or CEO. This was SEBI's version of the popular western corporate governance good practice of separating the Chairman and CEO's post. This is to be implemented by the company's latest by 31st March 2020.

This amendment has its genesis in Western shareholding and board structures where public shareholding is usually held quite widely. Thus, danger that one person may have disproportionately high concentrated powers in his hands is real. This gets even more worrisome if the Chairman and CEO is the same. Hence, the accepted norm of good corporate governance is that the post of Chairman and CEO should be separate. This was also largely the basis on which the Kotak Committee on corporate governance recommended a similar requirement in India.

However, the Indian context is different. Companies are largely promoter group driven, typically by a founder and then his family. They usually have large controlling shareholding and dominance on the Board too. The Chairman's post has largely administrative powers, more functions and duties than any substantial power. But it does have cosmetic value – corporate and business both.

The Indian context requires regulatory focus on countering the concentration of powers in the Promoter Group and not on post of Chairman or even CEO. Separating the post of Chairman and CEO does not serve any real purpose or change any reality but does harm a company's corporate and business image. Effectively, in most cases, companies will have to find a non-promoter Chairperson.

3. Research Methodology

A. Problem Statement

SEBI formed a committee on corporate governance in June 2017 under the Chairmanship of Mr. Uday Kotak with a view to enhancing the standards of corporate governance of listed entities in India. The committee consisted of officials from the government, industry, professional bodies, stock exchanges, academicians, lawyers, proxy advisors, etc. The committee was requested to submit its report within four months. The terms of reference of the committee were to make recommendations to SEBI on the many issue including ensuring independence in spirit of Independent Directors and their active participation in functioning of the company as well as improving effectiveness of Board Evaluation practices.

B. Research Question

The Kotak Committee submitted its report to the Securities and Exchange Board of India (SEBI) on *October 05, 2017* wherein the Committee provided *80 recommendations* to improve the Corporate Governance Standards. Some of the proposals faced oppositions from industry and other regulators. The Securities and Exchange Board of India (SEBI) had to take all stakeholders on board to ensure implementation of the measures suggested the Committee. As a result, the market regulator couldn't implement all the 80 recommendations and has accepted *40* recommendations without any modifications; 15 with modifications; 18 were rejected and eight have been referred to other agencies.

Few of the recommendations of Kotak Committee which were accepted by the Securities and Exchange Board of India (SEBI) with/ without modifications such as on Composition and Role of the Board.

Author intends to study the compliance on The listed entities with more than 40% of public shareholding shall separate the roles of Chairperson and Managing director (MD) or Chief Executive Officer (CEO) which shall be applicable to *top 500 listed entities* by *April 01, 2020.*

C. Research Objective

The objective of this research was to know the compliance with respect to Uday Kotak Committee recommendation on separating the role of Chairperson and Managing director (MD) or Chief Executive Officer (CEO) in sample listed companies.

D. Hypothesis

For this research after the deep study of literature following hypothesis has been proposed.

H1 Chairperson and Managing Director are separate as per SEBI constituted Committee recommendation on National Stock Listed companies.

E. Population & Sample

Researcher conducted research using secondary data from various published sources. 15 listed companies chosen randomly.

F. Time Dimension

In this research, researcher collected and studied data till 31 Mar 2019.

4. Data Tabulation and Analysis

The sample collected data is tabulated

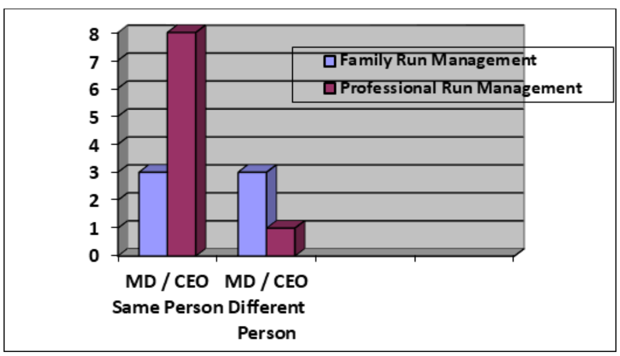

Fig. 1. Composition of MD /CEO as Single Entity

Interpretation: 20 % of family run management have MD/CEO same Person whereas at professional run management it stands 53%. Total of 73% hold dual position whereas only 27% are separate.

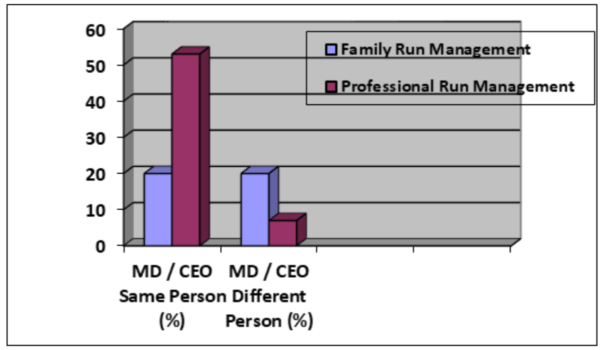

Fig. 2. Compositions of MD /CEO as single entity in percentage

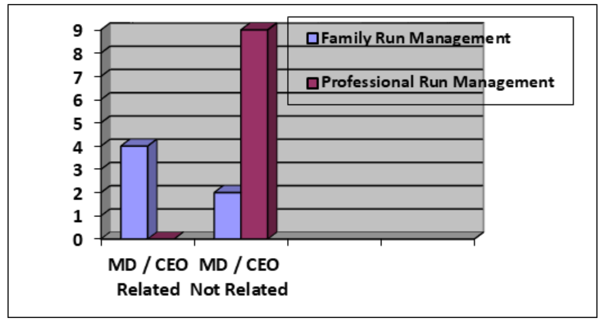

Fig. 3. Compositions of MD /CEO in family member capacity

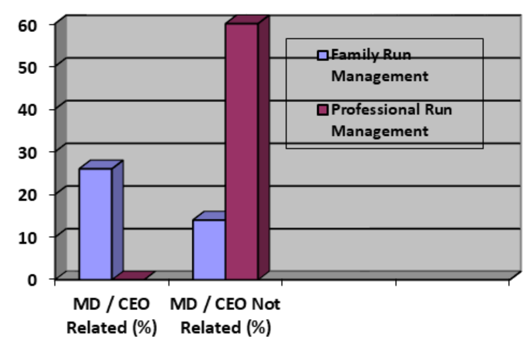

Fig. 4. Compositions of MD /CEO in family member capacity as percentagewise

Interpretation: 14% of family run management have MD/CEO not related whereas at professional run management it stands 100%.

5. Chi-Square Test

A Chi-square test of independence showed that there was no significant association between MD/CEO is same person or different, X2 (2, N=15) = 2.7, p=.95

6. Conclusion

This study found that majority of directors is executive directors. Managing directors and Chief Executive Officers are related in family run businesses.

It is recommended that independence in spirit of Independent Directors and their active participation in functioning of the company enforced through creating really independent entities. Effectiveness of Board Evaluation practices shall be enhanced through transparency and disclosures. It will improve effectiveness of Board of Directors and professionalism on the part of Chief Executive Officer. Business strategy will be sole criteria to run company. It shall bolster business and entrepreneurship ecosystem in the country.

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