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The off-target debate

Any corporate governance debate should focus on managers exploiting shareholders, as also majority shareholders exploiting minority ones

Only a fool would admit that Satyam failed to comply with each item on the checklist for corporate governance nirvana: majority independent board, big four auditor, US listing, GAAP accounting, separation of CEO and chairman, high-profile CSR foundation and much more. So what happened?

If governance is defined broadly as the allocation and monitoring of decision rights, the Satyam episode highlights two important aspects of how corporate governance is implemented:

- The Indian governance debate has focussed solely on the exploitation of minority shareholders by majority shareholders, whereas Satyam and most other relevant episodes concern management exploiting all shareholders;
- The spirit of governance is more important than the letter of governance.

Let's address the second point first because it is simpler. There need not be much correlation between how often an individual goes to a temple or a church and his level of spirituality; the rituals of religion are different from the spirit of religion. Similarly, the true end objective of corporate governance is the fair treatment of all stakeholders. This debate gets particularly complex in family businesses, where the checklist of governance is not regularly fulfilled but where shareholder value is still created. It is hard to measure 'spirit' but there is no benefit in measuring some other standard that does not get us where we want to go.

The crux of the corporate governance debate in India should focus on the relative role of managers and shareholders rather than the traditional Western approach of positioning governance as an issue of balancing majority and minority rights. It may be time for the West to review their thought process in this regard; some people estimate that the financial services industry may have lost more money in the last

two years than the entire profits made by the industry since the Medicis invented banking 400 years ago. This was not some stubborn majority taking advantage of shareholders with no voice; this was management skewing compensation in their favour and then gambling for redemption.

This debate is particularly important in the Indian context because most traditional 'promoters' or industrial houses have controlled companies while having small equity holdings. India's corporate legal system has several idiosyncratic features (management can invest up to 60 per cent of the net worth of a company without seeking shareholder approval) which have resulted in a spate of unrelated diversifications. The mindset displayed by the Rajus (and echoed by many traditional Indian families) is that we control only, let's say, 8 per cent of the company but own 100 per cent of the cash.

This is unacceptable and the new disclosure rules around pledged shares and the Pyramid Saimira charge sheet represent huge progress on this front. The typical Indian promoter is not a majority shareholder but a manager with some shareholding. Therefore, if we can think of a structure, which prevents management from stealing, we would have addressed the bulk of the Indian corporate governance 'problem'.

However, truly moving the needle of corporate governance necessitates many things: intelligent board members, additional disclosures, genuine shareholder power, more transparency and much more. The Indian corporate and regulatory ecosystem has displayed immense maturity in its handling of the Satyam episode; the process of holding and auctioning the company demonstrates an institutional maturity and depth that has surprised many Indians.

The lack of a knee-jerk Sarbanes Oxley equivalent may represent an inability of the Indian democracy to pass laws quickly or it could reflect a willingness to reflect on lessons and act deliberately. This is welcome, but the successful closing of the Satyam episode must not become an alibi for genuine reform to a legislative, regulatory and enforcement structure written for a very different country with a unique capital market structure and investor profile.

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