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Corporate governance failure at Ranbaxy?

It is unlikely that independent directors on Ranbaxy Board had no exposure to corporate governance models

Asish K Bhattacharyya June 09, 2013 Last Updated at 21:30 IST

Ranbaxy's criminal guilty plea and $500 million in fines and penalties has brought back the spotlight on corporate governance. The criminal case focused on sales in the US market. However, if media reports are to be believed, Ranbaxy committed systemic fraud in its worldwide regulatory filings. The US case dates back to the year 2004. This is the initial year when the Corporate Governance Code, which was issued by Sebi in the year 2000, was made mandatory. Therefore, it is quite likely that many independent directors had no clear idea about their responsibilities and accountability. But that cannot be said about independent directors on the Ranbaxy Board.

In the year 2004, Ranbaxy Board had Tejendra Khanna, Gurucharan Das, P S Joshi, Vivek Bharat Ram, Nimesh Kampani, Vivek Mehra, Surendra-Daulet Singh and J W Balani as independent directors. All of them are enlightened leaders in their own field. Sebi Code was drawn from Anglo-Saxon corporate governance model. It is unlikely that those who were on the Ranbaxy Board had no exposure to corporate governance models.

Ranbaxy's shareholding data as on March 31, 2004, shows that promoters' shareholding was 32.04 per cent, while foreign shareholding and Indian institutions' shareholding were 32.98 per cent (including FII's shareholding of 22.68 per cent) and 15.16 per cent respectively. One would expect corporate governance of highest order with the illustrious Board and significant foreign and institutional shareholding, however, the reality was different. Ranbaxy systematically perpetrated fraud on shareholders by exposing their investment to huge reputation and compliance risks by fuzzing data submitted to regulators. By selling adulterated drugs, it perpetrated fraud on consumers, hospitals, value chain partners and common Indians who took pride that Ranbaxy had emerged as the first Indian multinational in the pharmaceutical sector. The corporate governance failures manifested in the Board's failure to check fraud, absence of adequate risk management system, and unethical culture. Should we hold independent directors accountable for the same?

There is a similarity in the fraud at Satyam and the same at Ranbaxy. In both cases, the top management overrode the internal control system. On January 2, 2013, southern district of New York judge Barbara Jones gave a landmark judgment. The judge did not see a case of the former independent directors of Satyam acting recklessly.

The claim was not sustainable because "intricate and well-concealed fraud perpetrated by a very small group of insiders and only reinforce the inference that the [independent directors] were themselves victims of the fraud." It may be argued that the Ranbaxy fraud was perpetrated with the support of employees at different levels and not by a small group at the top level. But the fact remains that it was well concealed. Therefore, it would be harsh on independent directors if they were held accountable for the fraud.

Clause 149 (11) of the Companies Bill, 2012, provides that an independent director shall be liable "only in respect of such 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". We have to wait for Court rulings to understand Court's interpretation of 'diligence' in the context of independent directors.

The dictionary meaning of the word diligent is 'Having or showing care and conscientiousness in one's work or duties'. Did independent directors fail to act diligently? Did independent directors fail to catch signals from the exit of Devinder Singh Brar (then CEO), Rashmi Barbhaiya (then president, R&D), Rajinder Kumar (successor to Rashmi) and Dinesh Thakur (whistle blower in this case and subordinate to Kumar), who were celebrated leaders of the company, in quick succession. Their exit signaled that something was wrong.

Assume that independent directors had taken notice of that and arranged exit-interview and interacted with the employees at random to know the cause of their exit. I guess that process would have been futile, as none would have blown the whistle in the absence of protection to whistle-blowers. Thakur had blown the whistle in USA and not in India.

It may be inappropriate to conclude that independent directors did not act diligently. It has been reported in media (BS story on June 5, 2013) that Tejendra Khanna and P S Joshi were present in the science committee meeting held on December 21, 2004, in which detailed presentation was made on wide spread lapses and fudging of data. If it is true, they cannot claim innocence.

Independent director's responsibility is limited to ensuring that he/she understands the business model, best corporate governances practices (e.g. board process, risk management system, internal audit and statutory audit, whistle-blower policy, and transparency within and outside the Board) are in place and operating effectively, analysing information available through the Board processes or otherwise and acting proactively based on that analysis for the benefit of the company as a whole. If independent directors are held responsible for frauds perpetrated by or with the support of the top management, which has the ability to override internal controls, it will be difficult to induce professionals to join Boards of companies as independent directors.

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