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Reflection on governance issues in IL&FS and L&T

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Over the past few months, a spate of events occurred in the space of corporate governance presenting challenges in improving corporate governance and ethical standards being practised by companies. Those are worrying, but no solution is in sight.

As per media reports, the government-appointed board has charged 14 former directors of group firm IL&FS Financial Services Ltd (IFIN) with facilitating money laundering, sanctioning loans in violation of rules and causing "huge financial stress and losses" to the company. Those serious allegations are based on the special audit report submitted by Grant Thornton. It reported numerous financial irregularities in deals with

financial implications of over Rs 13,000 crore. The company has issued notices, dated February 27, asking former directors as to why departmental and legal actions should not be taken against them for their "misconduct, dereliction of duties, gross negligence and acts of conspiracy and getting unlawful gains for oneself and others". Independent directors in the board that had been superseded by the government after a series of defaults by the company, included individuals of high repute like R C Bhargava, chairman of Maruti, Michael Pinto, a former secretary for Shipping, and Sunil B Mathur, former LIC chairman. It is likely that independent directors failed to apply due diligence, possibly because of lack of their understanding of the complex business model of the company. If independent directors fail to demonstrate that they had applied due diligence, they will be held liable for the omissions and commissions of the company. They may face imprisonment.

Interestingly, the board that replaced the disgraced board of IL&FS is acting swiftly, decisively and effectively. In the case of Satyam also, the board that replaced the disgraced board did a wonderful job in bringing back the company from the crisis and protecting its value. In both cases, the newly appointed boards are/were effective because their performance is/was measurable and is/was in public view. Unfortunately, when the going is good or until the crisis does not surface, the independent director's performance is not visible to stakeholders. Therefore, independent directors, in general, lack motivation. A solution to motivational issues is yet to be found out. Therefore, the use of the stick is the only solution. It will be interesting to observe how the IL&FS story unfolds -- whether the company will proceed to take legal actions against the members of the superseded board and if it proceeds, what view the court will take on the alleged

failure of independent directors to apply due diligence in decision making.

The story of bribing government officials by L&T on behalf of Cognizant is also interesting. In the second week of February 2019, Cognizant had agreed to pay \$25 million to settle charges that it violated the Foreign Corrupt Practices Act (FCPA). The US Securities and Exchange Commission (SEC) alleged that Cognizant authorised the construction firm to make bribes to government officials in India. It has come out that the said construction firm is L&T. L&T has decided to take the services of external experts to ascertain whether its employees were involved in bribing the government officials. Quite likely, evidence will not be available, as companies have learned the art of concealing such payments skilfully. If evidence is available, the employees will be made scapegoats to clean the image of the company.

Ethical standard and values of institutions cannot be better than the ethical standard and values of the members of the system within which they operate. Corruption and crime are not important issues in parliamentary elections. Voters elect corrupt and criminals to represent them. In a system (society) where corruption is a non-issue, investors are also not bothered about ethical standard of the company, if by aligning with the external environment, the company earns a profit for them and manages the risk by skilfully doctoring the books and documents to avoid detection. It may be argued that mighty players like L&T should take the lead to eradicate corruption, but that is a difficult proposition in a fragmented industry like construction, where a large number of players of different sizes operates. The risk of spearheading the fight against corruption is to lose in the competition. As long as the eradication of corruption remains rhetoric for the government and political parties, both the government officials and companies will continue to adopt corrupt practices and investors will not bother too much about the same.

Big names in the board do not provide comfort to stakeholders, as the practice of 'lending names' with token participation continues. A corruption-free India is yet a mirage, but we need to work towards it.

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